INCOME RESEARCH + MANAGEMENT

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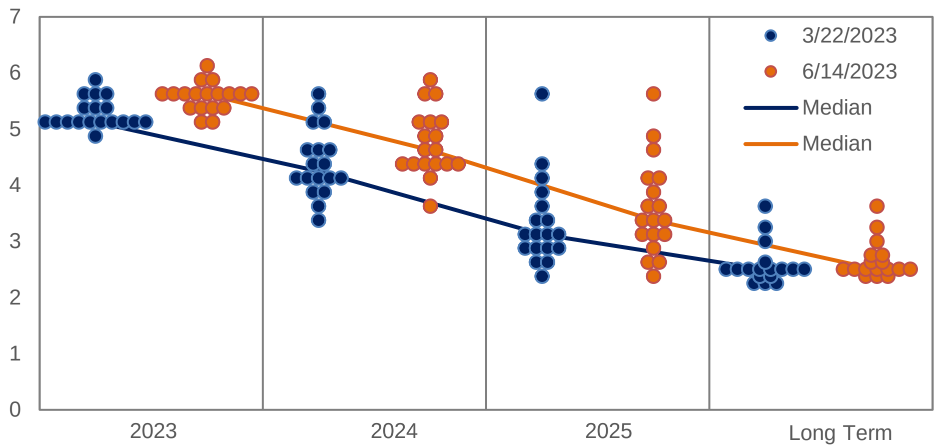
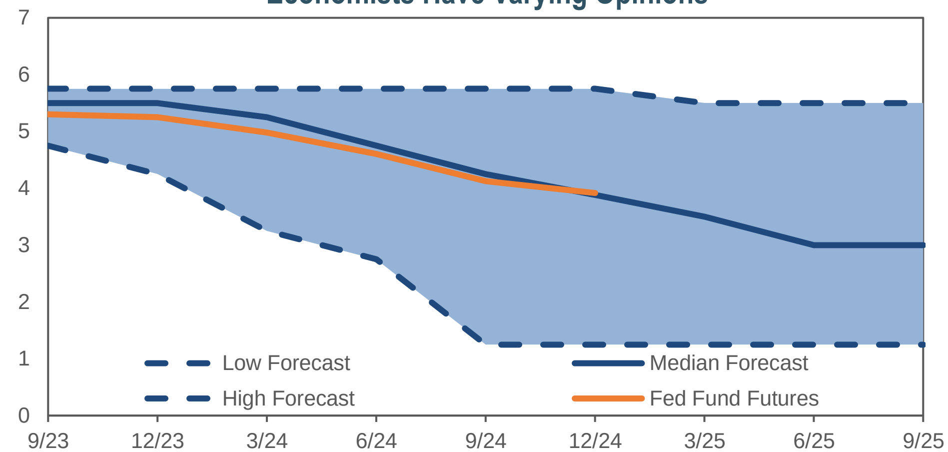
Dispersion Grows Across Market Participants on the Future Path of Rates

FOMC Members Still Divided



Economists Have Varying Opinions



- While presenting the Federal Reserve's (Fed) semiannual economic update, Fed Chair Jerome Powell reiterated the Fed was not done hiking interest rates, even though hikes were paused at the June meeting. This was in line with the updated FOMC dot plot, a survey of Fed officials, that had a median terminal fed funds rate of 5.625%, up from 5.125% in the March survey, and suggesting two more hikes by year-end. However, there is still a wide dispersion across market participants, and even amongst Fed officials, on the future path of rates.
  - **Federal Reserve.** The median dot plot projection was far from unanimous with two members calling for a pause, one for 100bps of additional hikes, and some in between. Atlanta Fed's Bostic even published an essay last week to voice his desire to keep rates steady.
  - **Investors.** While the market-implied probabilities acknowledge the likelihood of another rate hike in 2023, the market is currently discounting the chances of two more rate hikes and still believes a rate cut is possible before 2024.
  - **Economists.** According to data compiled by Bloomberg, Economists' forecasts for the year-end fed funds rate range from 4.25% to 5.75%, with a median of 5.50%. This suggests anywhere from 100bps of cuts to 50bps of hikes, but more likely than not, one additional hike.
- Ultimately, we believe data will dictate the Fed's path from here. But unfortunately, that does not make the future route any more exact. While inflationary pressures continue to dissipate, albeit slowly, core inflation has remained stubbornly elevated. The labor market has also shown its strength with jobless claims remaining on trend and wages growing. The risk of overtightening the economy is real, but the Fed appears determined to reach a soft landing. Some investors believe it will be increasingly difficult for the Fed to achieve its objective with unforeseen cracks forming across the banking sector and commercial real estate.
- Given the wide dispersion of expectations, elevated volatility could be here to stay and performance dispersion across fixed income managers may increase. While some may make bets on the future path of rates, at IR+M, we prefer to avoid making such predictions and instead, stick to what we feel we do best – diligently scour the fixed income market for attractively priced securities, regardless of where rates go from here.