Northern Trust | Follow the Dot "Plot"

[MUSIC PLAYING]

Last week, the Federal Open Market Committee met for the second time this year, and reiterated a dovish message, with Chairman Jerome Powell continuing to articulate a cautious approach. Although trying to sound reasonably upbeat, he pointed to a weaker growth outlook in slower positive momentum with regards to inflation expectations.

The clear emphasis-- to be patient-- underscores a Fed willing to wait and see how the economy evolves. The highly anticipated summary of economic projections, often called the dot plots, surprised investors. The median dot plot suggests most committee members expect only one more hike within the next two years.

Interestingly, the projections showed no more hikes in 2019, leaving the single forecasted increase to next year. This is a significant departure from the last set of economic projections in December that forecasted two more increases in 2019. Furthermore, the median forecasted long-term neutral rate of 2.75% appears just slightly above the current federal funds range.

In regards to its balance sheet, the Fed said it would slow the pace of monthly balance sheet runoff, from $30 billion to $15 billion a month, starting in May-- with the aim of concluding tapering in September. This wasn't a surprise, but some other details on the Fed's balance sheet were notable. Specifically, the Fed plans to reinvest principal payments from its mortgage securities to purchase treasuries that roughly match the average maturity of all outstanding treasuries.

This is interesting, because the average maturity of treasuries in the broad market is 69 months, well below the 100 month average for treasuries on the Fed's balance sheet. We think this means that the Fed will be more biased towards purchasing securities in the front end of the treasury curve. Higher demand for shorter maturity treasuries could drive those yields even lower.

As a result, money market investors will be watching these developments closely. While the entire yield curve rallied after the Fed's dovish announcement, the larger than expected shift in the dot plots had a noteworthy effect on the short-term fixed income markets. The treasury bell curve quickly flattened, and investors observed further inversion in the front end of the yield curve, going out to five year maturities. For liquidity investors, we think these developments provide attractive opportunities in cash because of the higher yields on the front end.

[MUSIC PLAYING]