11/3/21

Good Afternoon,

The Federal Reserve concluded its two-day meeting this afternoon and as expected, they have begun to taper their bond purchase program. The Fed has been buying $120 billion per month of Treasury and mortgage-backed securities since June 2020. This effort has the effect of spurring demand for bonds to keep their prices up and conversely, interest rates down. They will reduce that amount by $15 billion this month and again in December. This rate of taper would put them on a path of eliminating the program by next June. Investors have expected this move and are generally reacting positively in anticipation of a normalization of credit markets. The Fed left the Fed Funds rate unchanged.

Fed policy will continue to be a risk for markets as scrutiny over their contractionary policy elevates. With markets so accustomed to quantitative easing (bond purchases) and low rates, volatility is likely to rise as investors grow leery of a possible misstep in timing or magnitude. In addition, the recent agreement to delay the U.S. debt ceiling deadline may have calmed markets briefly, but the solution was temporary, and the new December 3 debt deadline is approaching quickly. (Did you hear the joke about the debt ceiling? Ah, it's over your head.)

The interest rate trajectory will have ramifications to the US budget, as well. Low interest rates have allowed the government to borrow more for less expense, but that can change. In fiscal year 2011, the government spent $227 billion for debt interest. During fiscal year 2021, the government spent $352 billion for debt interest. The average interest rate that the government pays on its interest-bearing debt as of 9/30/21 was 1.605%, down from 2.492% as of 9/30/19, allowing the US to borrow 55% more money today than it borrowed 2 years ago and still have the same out-of-pocket interest expense cost (source: Treasury Department). Rising rates will require more of the US budget to be directed to debt payments – and presumably less for other programs.

The World Series ended last night, and the Cincinnati Reds did not win. Again. Have a great week!

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As always, if you would like to discuss this or anything regarding current market conditions or your portfolio, feel free to contact me at any time.

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