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MONTHLY COMMENTARY

February Rates Update

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In many ways, February closed in the exact same way it opened, with market participants continuing to look for a definitive and long term investable signal among all the policy related bluster from both the White House and the FOMC. In the past month, if you asked any Federal Reserve Branch President, they would have enthusiastically told you that the March FOMC meeting is live for a rate hike. However, that is not necessarily the message Fed Chair and policy decider Janet Yellen has conveyed to the market in recent weeks. Similarly, President Trump has trumpeted the rollout of a new and improved tax plan, a big increase infrastructure spending and an improved American healthcare solution but has yet to provide the market with anything definitive. This lack of tangible action did not dampen the spirits of investors though, as the 30y Treasury yield rallied 10bps over the course of the month and the S&P 500 rallied nearly 3.5%.

The FOMC kicked off the February macroeconomic calendar with the heavily anticipated release of their post February meeting statement. Despite expectations of guidance towards the timing of the next hike, the tone was ambiguous at best as the 499 word statement was the least verbose since 2012. While somewhat abbreviated, the statement did note the FOMC believes that inflation "will rise to 2%" over the medium term, and that business and consumer sentiment had improved, while the labor market continued to strengthen. The inflation outlook was the only material change. In December it read "inflation is expected to rise to 2%." The Fed also dropped the reference to "transitory effects of past declines in energy and import prices" as it relates to medium term inflation expectations. This was the first time the statement did not reference energy price declines since mid-2014. On the whole, the statement did not read like it was written by policy makers who intended to tighten policy post-haste and instead reflected the wait and see approach that has characterized their approach to this unorthodox tightening "cycle."

Although the February policy statement did not point to imminent policy action from the FOMC that did not stop multiple FOMC members from affirming that a tightening at the March FOMC meeting was still under consideration. Indeed, in multiple appearances over the course of the month four FOMC voters (Bill Dudley, Jerome Powell, Patrick Harker, and Robert Kaplan) and four non-voters (Dennis Lockhart, John Williams, Loretta Mester, and Jeffrey Lacker) all confirmed that they viewed a March tightening as a distinct possibility. Noticeably absent from this list is Fed Chairman Janet Yellen who did deliver comments of her own in February at her

semi-annual testimony to Congress mid-month. The Chair's testimony was fairly upbeat stating that the Fed will adjust the rate path as the economy evolves, and will evaluate progress at "upcoming meetings." She added that further policy adjustment will "likely be needed if the economy remains on track." She also warned that it would be "unwise" to wait too long to tighten. While delivering an upbeat economic assessment on the margin, the Chair avoided any outright time-based guidance, unlike several of her colleagues.

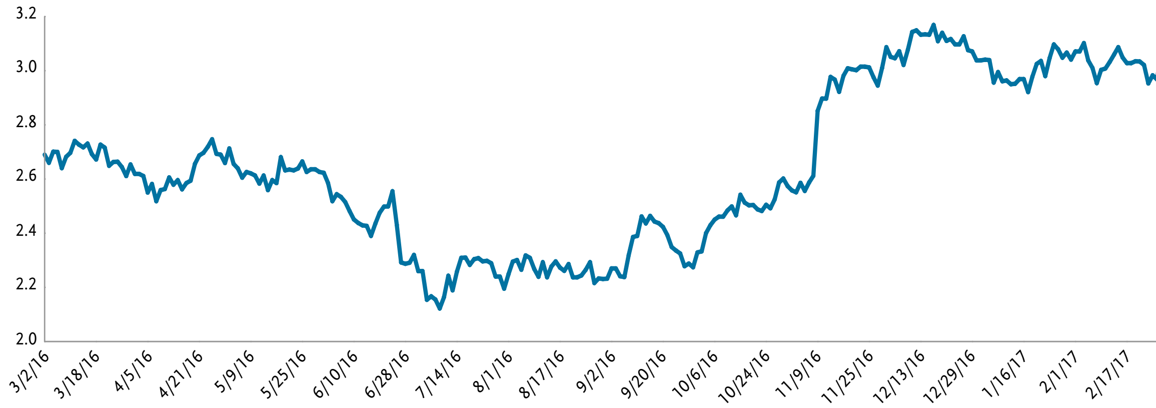
While Chair Yellen was planning her next monetary policy move, her new counterpart in fiscal policy, Treasury Secretary Steve Mnuchin was confirmed to the position by Congress mid-month. Mnuchin was the former chief information officer for Goldman Sachs and has spent time managing several hedge funds. Additionally, he was part of the purchase of ill-fated mortgage lender IndyMac which later became One West Bank. Mnuchin comes into the role at a critical time as he will almost immediately need to persuade Congress to increase the nation's debt limit. If he can't, the Treasury would have to start using a series of extraordinary measures to extend the deadline for several weeks to avoid a U.S. default on its debt. Following his mid-March budget deadline, he will have to meet an April 15th deadline to inform Congress if the Treasury Department will label China a currency manipulator, a favorite talking point of President Trump. Finally, Mnuchin will be tasked with examining the Treasury's current debt issuance program, and making a judgment on whether or not he believes it is prudent for the US to issue longer dated debt than 30ys, the longest maturity issued to this point. In recent weeks, the potential for a 40y or 50y Treasury bond has been rumored as a possibility but it remains to be seen if the Treasury will ultimately decide to go down that path.

As the markets digested the interplay between monetary and fiscal policy under the new administration, the frequently referenced Trump reflation trade began to stall somewhat over the course of the month. Indeed, US equities did slowly grind higher, but moves higher in both US Treasury yields and the US dollar started to stagnate and reverse somewhat as the market's faith in the new administration started to waiver. This would all change on the eve of the final day of the month when President Trump delivered what was judged to be his best public address since the night he won the election. In an address CNN reported 78% of viewers saw favorably, President Trump struck a more conciliatory tone, urging Americans to abandon conflict and help him rebuild the country. While still somewhat light on specifics, President Trump reiterated his intention to find a replacement for Obamacare, overhaul taxes, invest $1 trillion in US infrastructure and increase the nation's defense spending. Risk assets responded to this more presidential version of Trump in kind, as the S&P 500 continued its ascent while Treasury yields and the dollar surged higher. It remains to be seen if President Trump's speech was catalyst enough sustain a further rally in risk assets but March will certain begin with risk assets on solid footing.

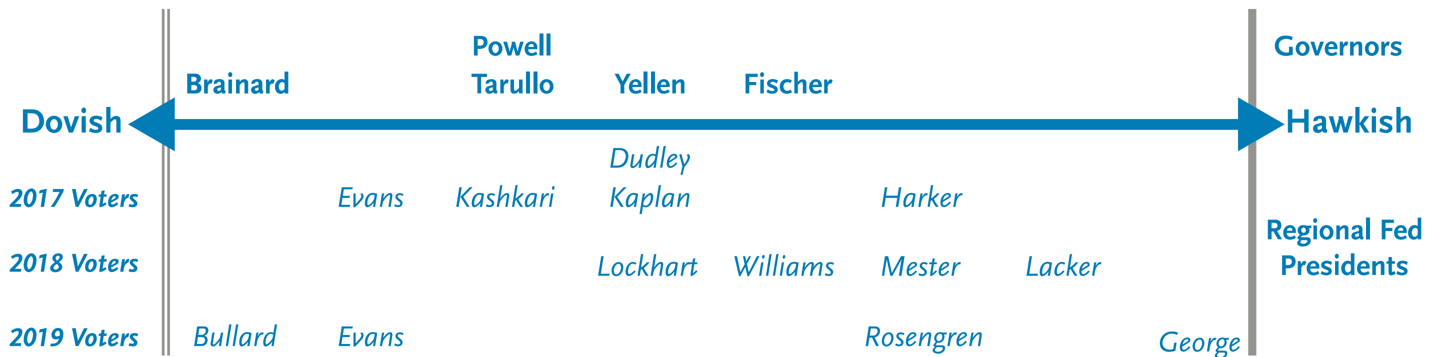
With the FOMC doing its best to encourage the market to consider pricing in a March tightening and with President Trump promising meaningful change, March will be a crucial inflection point for global macro in 2017. Whether or not the FOMC and the new administration can deliver on their promises will go a long way in shaping the trajectory of the rest of the year as meaningful investment, business spending and household budgetary decisions will be driven by the outcome of the upcoming fiscal and monetary policy decisions. Given recent developments, the prospects of a March tightening as well as eventual pro-growth fiscal action appear as if they are distinct possibilities. However, now that markets globally are expecting both the American central bank and administration to deliver, the downside risks may be magnified upon failure of either policy making body to deliver.

	1/31/2017	2/28/2017	52 Week High	52 Week Low
2y Treasury Yields	1.20	1.26	1.30	0.50
5y Treasury Yields	1.91	1.93	2.12	0.89
10y Treasury Yields	2.45	2.39	2.64	1.32
30y Treasury Yields	3.06	3.00	3.21	2.09
Yield Curve Steepness 2s to 30s	185.29	173.03	205.73	139.67
Barclays Aggregate Index	1980.25	1993.56		

Source: Bloomberg Barclays Live



Source: Barclays Live



Source: B0fA Merrill Lynch Global Research
Note: NY Fed President (Dudley) is always a voter.

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