Caron's Corner Transcript – 5.1.2023

The Fed Did it "Their Way"

- Today's title is clearly a play on Frank Sinatra's famous song "My Way."
- The connection is that the Fed believes what they did was right, albeit not perfect, and they have few regrets abut their actions.
- This means they may do more if necessary and this is important, as they are not looking back in error.
- If inflation proves to be unanchored - my biggest fear - the Fed will not hesitate to hike more, regardless of what they say at the post May 3 meeting presser.
- So, what comes next? We discuss in today's audiocast.

Jim Caron: Hello, this is Jim Caron, Co-CIO of the Global Balanced and Risk Control strategies. This is a big week with the Fed and payrolls, but let's focus on the Fed. The Fed is coming to the end of their rate hiking cycle we believe and what we can say is that the Fed did it their way.

And now the end is here, the fed faces that final curtain, for their rate hiking cycle.

They stated their case, for which they are certain, after traveling each and every highway.

Hiking 500 basis points was what they needed to do and they did it their way.

Regrets? Well, we're sure that they had a few, like the whole part with transitory inflation.

But then again, too few to mention the Fed saw through without exemption, planned each charted course along the way and they hiked more, much, much more than most expected. They did it their way.

Yes. There were times when we thought the Fed bit off more than they could chew. But through it all, they had no doubt, they faced all the criticism, they ate it up and spit it out, stood tall and did it their way.

But what is the Fed's mandate but to fight inflation, not to say what they truly feel and not the words and actions of someone who kneels to political pressures. Let the record show they took all the blows and did it their way.

Clearly the verbiage is a play on Frank Sinatra's classic song "My Way." The relevance is that like the song, the Fed believes that what they did was right, albeit not perfect, and they have few regrets. This means they may hike more if necessary. It is important that they are not looking back in error if inflation proves to be unanchored, which is my biggest fear. I've talked about that before, that the Fed will not hesitate to hike more. So no matter what they say at the post-meeting press conference on May 3rd, keep this in mind. It should be factored into one's risk calculus.

What's next? Well, if history is any guide, a recession comes next, but the question remains how hard, how soft or at all? These are all still open questions, and if history is any guide, only long duration high quality bonds is where you ought to be historically. But bond yields have already moved down sharply and if the hard landing scenario is not delivered, then larger duration bonds may add risk to portfolios, not reduce it. This is what may be different today. Again, if history is any guide, the yield curve should steepen. But the 2-year/10-year curve is already priced to steepen by 80 basis points over the next year, meaning it needs to steepen more than that in order to profit, as nearly 100 basis points of rate cuts are already priced in over the next 12 to 14 months. So the common trades that have worked after hiking cycles seem to already be well priced. The key point here is that there's no easy trade available today. We still think the risks are more balanced than the more ideologically bearish consensus. But as per usual, our motto is that it's better to be balanced and defensive and apply risk controls to portfolios.

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