Citizens™

GLOBAL MARKETS – FED POLICY AND INTEREST RATE OUTLOOK

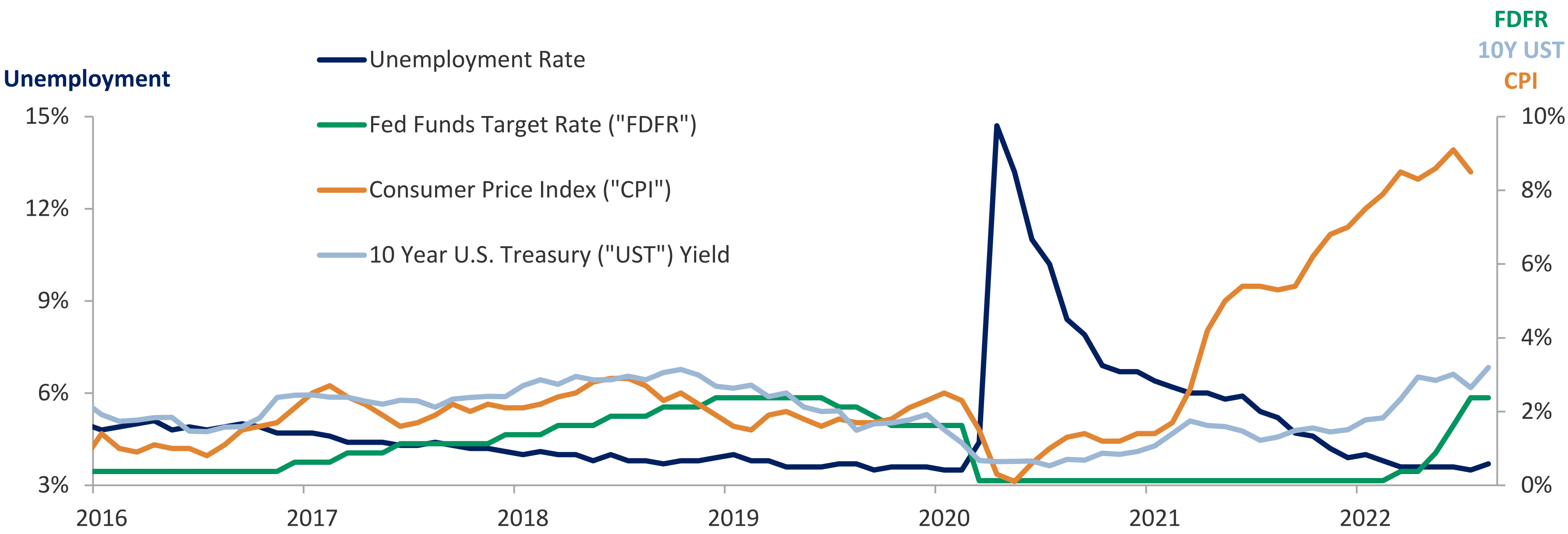
Prepared for NESGFOA Conference

September 14th, 2022

Market Pre- vs. Post-Pandemic

Economy leading up to the inception of Covid and the aftermath

ECONOMIC BACKDROP



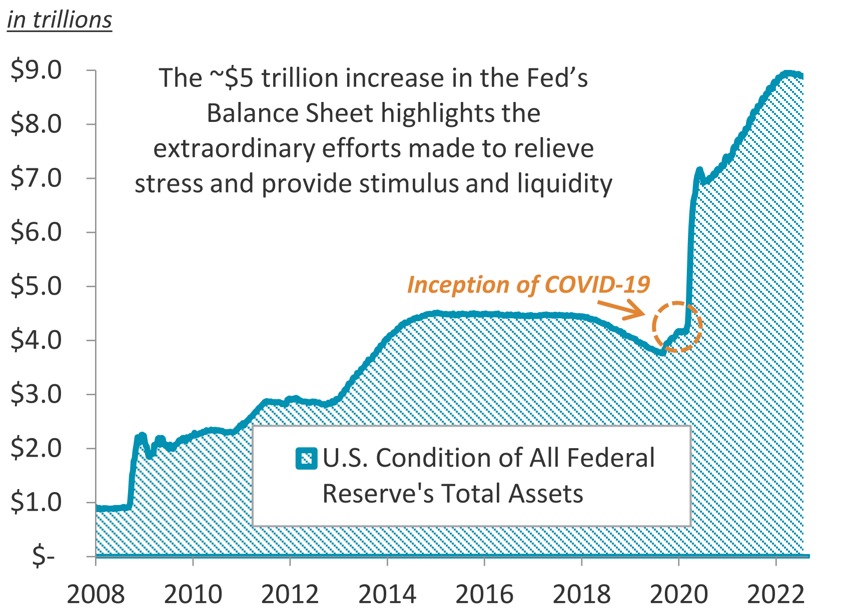
Source: Bloomberg

- Leading into the 2020 Covid-19 crisis, key economic metrics were trading in normalized ranges, with the Unemployment Rate at an all-time low and inflation remaining contained at ~2%
- Covid resulted in the Unemployment Rate spiking to 15% very quickly, however action from Global Central Banks and Governments stabilized the situation fairly quickly
- Implementation of record stimulus resulted in the Unemployment Rate falling back near all-time lows by mid-2022 put upward pressure on wages, however, has left the economy with other issues….

Record Fed Action & Fiscal Stimulus

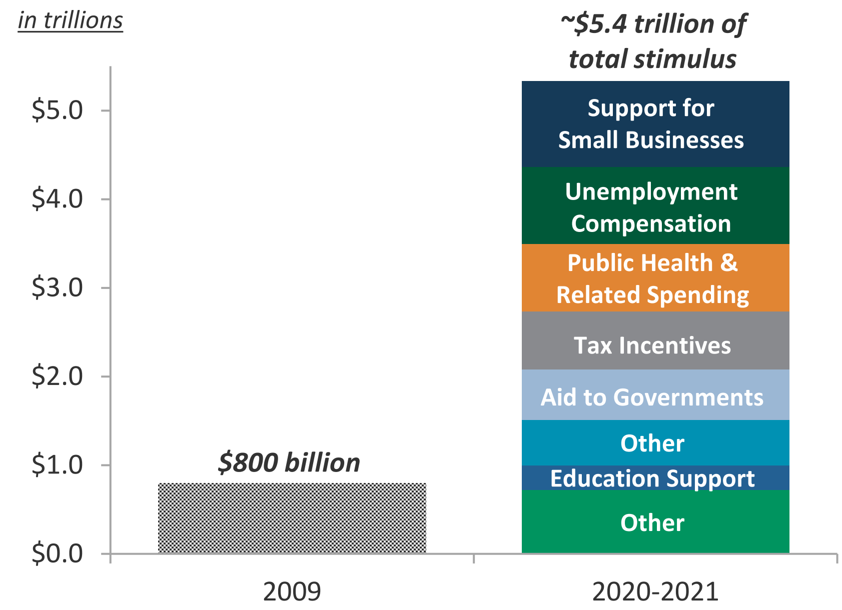
Federal Reserve balance sheet & congressional accommodation

FEDERAL RESERVE BALANCE SHEET



Source: Bloomberg

HISTORIC FISCAL STIMULUS



Source: Peter G. Peterson Foundation

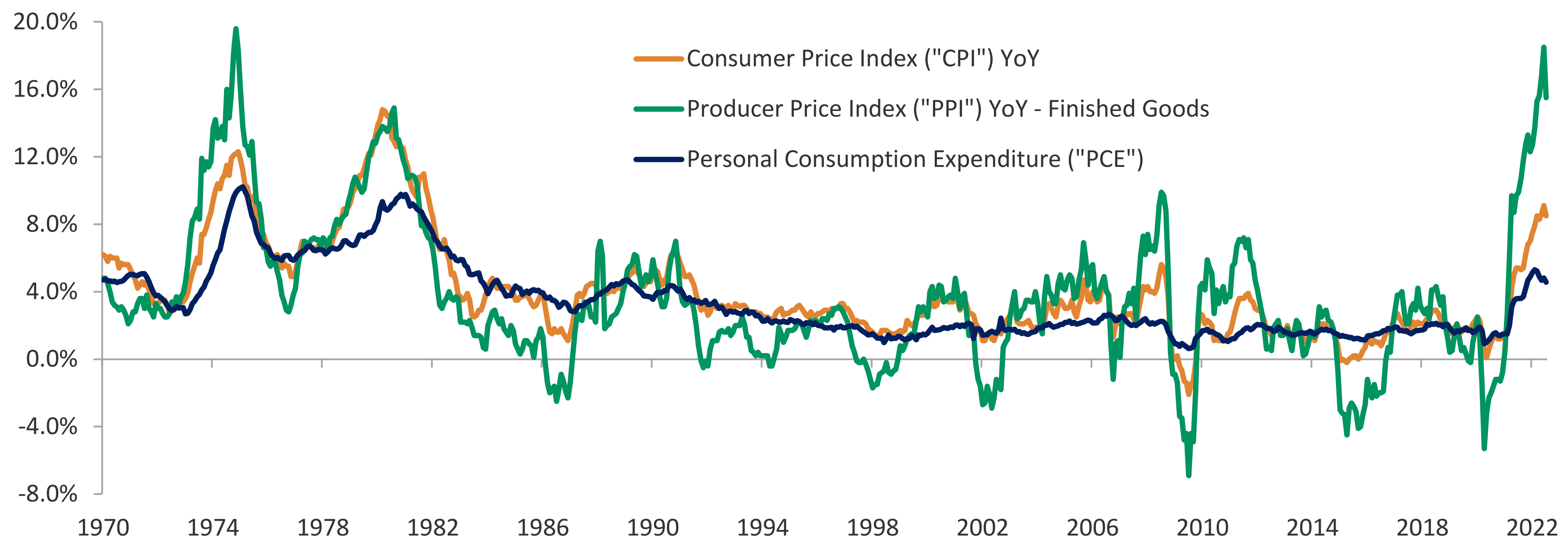
- By increasing the supply of money, the Federal Reserve has effectively provided downward pressure to interest rates
- Just as asset purchases lowered interest rates, the reversal of asset purchases could provide upward pressure to term rates even in the absence of Fed hikes

- Significant cash savings and pent-up demand during the pandemic bolstered the economy once mass vaccination was reached
  - Fiscal stimulus includes the $2 trillion March 2020 Cares Act and the $1.9 trillion March 2021 American Rescue Plan

Inflation

Prices at multi-decade highs

INFLATIONARY INDICATORS



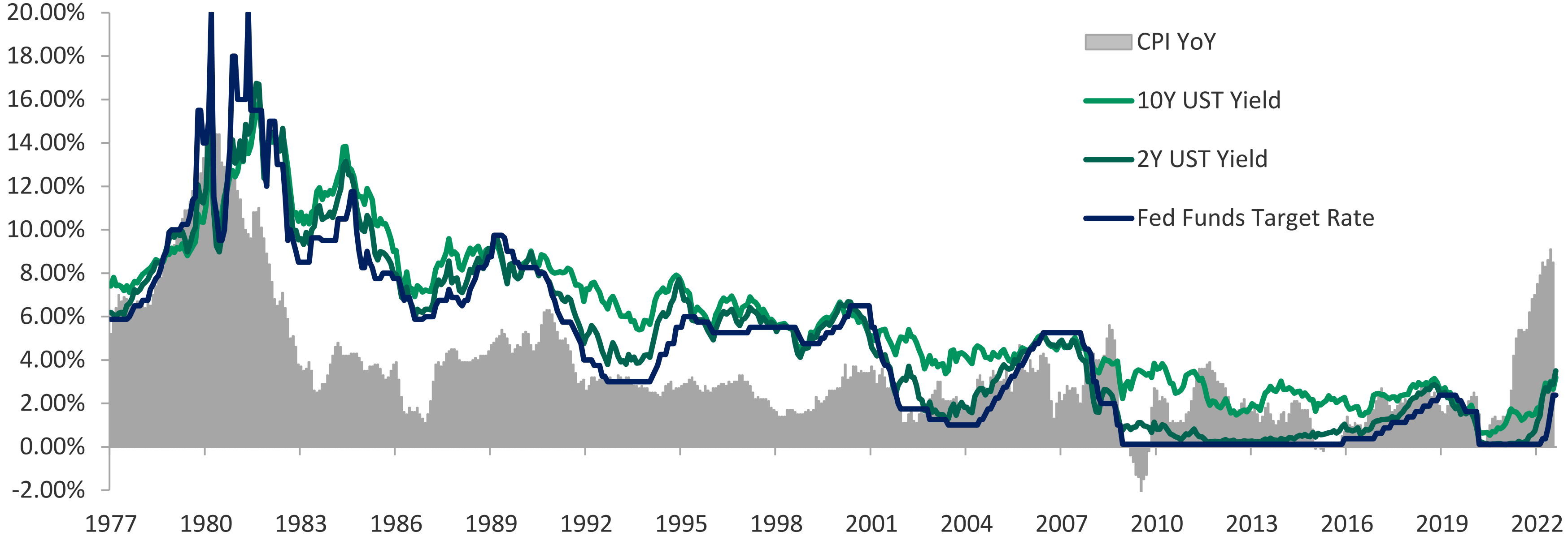
Source: Bloomberg

- While various inflation metrics have remained mostly tame for the past few decades, current price pressures stemming from the Covid crisis have not been seen since the early 1980s
- Historically, the Fed and other Central Banks tighten monetary policy in order to stifle inflation. Primarily, the Fed's tools to tighten policy are:
  - Increase short-term borrowing rates (such as the Fed Funds Rate), and…
  - Decrease the size of the Central Bank balance sheet ("Quantitative Tightening")

Yields vs. Inflation vs. Fed Policy

Rates have historically set above inflation to constrain prices

INFLATION CURRENTLY ABOVE RATES



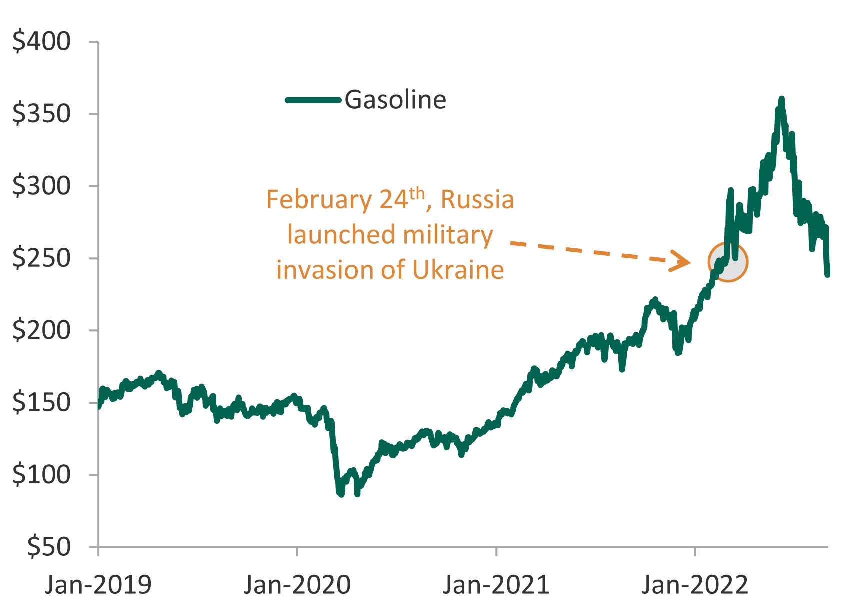
Source: Bloomberg

- On past occasions where inflation had risen above palatable levels, Central Banks have tightened monetary policy by increasing their respective short-term borrowing rate (such as the Fed Funds Target Rate in the U.S.)
  - During record inflation in the early 1980s, the Fed pushed short rates as high as 20% to combat record-high inflation (Volcker era)
  - Today we have an economy with primary inflation metrics (such as CPI) well-off 40 year averages, however, interest rates (Fed Funds Target Rate, Treasury yields, etc.) remain well below historical averages

Commodity Prices

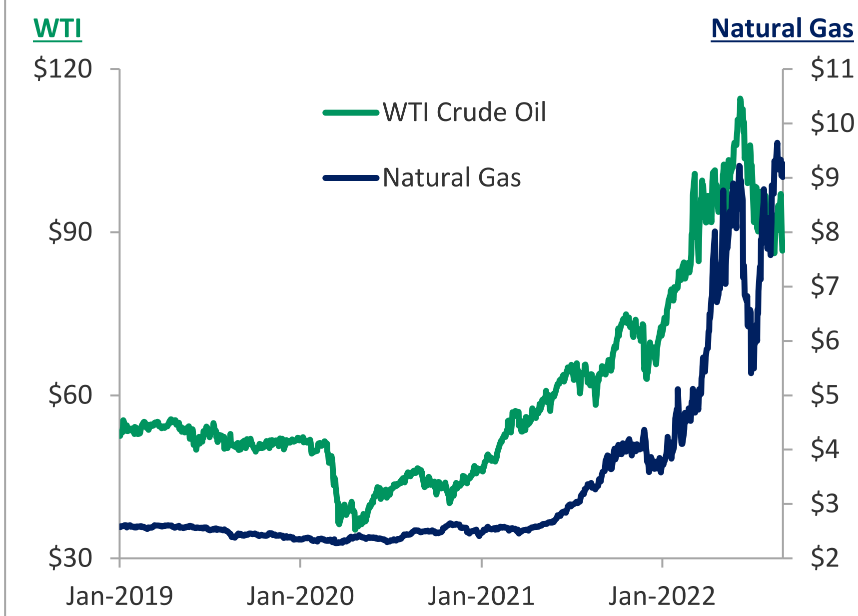
Increased costs carving into household balance sheets

GAS PRICES



Source: Bloomberg

ENERGY PRICES



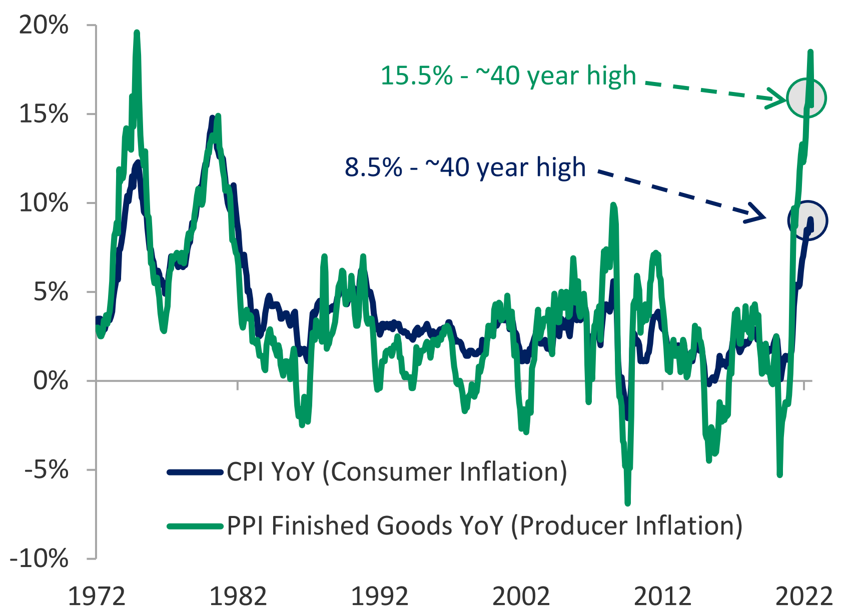
Source: Bloomberg

- Energy costs have increased dramatically since spring of 2020; partly as a result of an initial supply chain disruptions coupled with drilling restrictions implemented by the Biden administration, however, the Ukraine – Russia war has further exacerbated the situation
- Higher energy costs have helped fuel inflationary pressures

Inflation & Employment

Price pressures & a strong domestic labor market

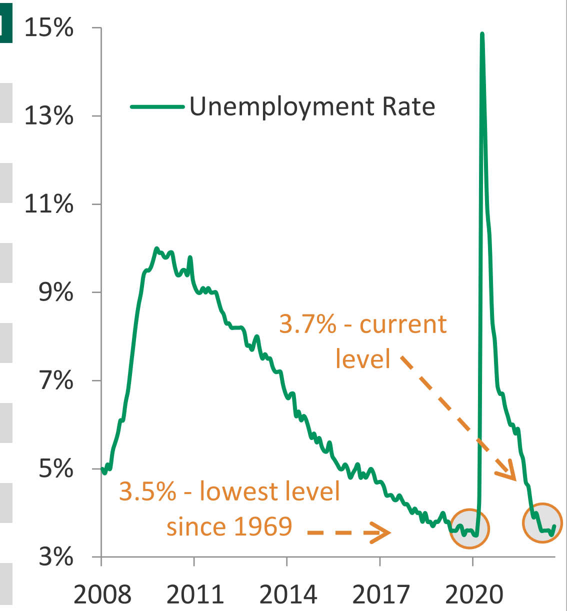
INFLATION AT RECORD HIGHS



Source: Bloomberg

STRONG LABOR MARKET RECOVERY

Year	Jobs Created
2008	-3,553k
2009	-5,051k
2010	1,034k
2011	2,074k
2012	2,176k
2013	2,301k
2014	3,004k
2015	2,720k
2016	2,318k
2017	2,114k
2018	2,292k
2019	1,968k
2020	-9,292k
2021	***6,743k***
2022 YTD	***3,504k***



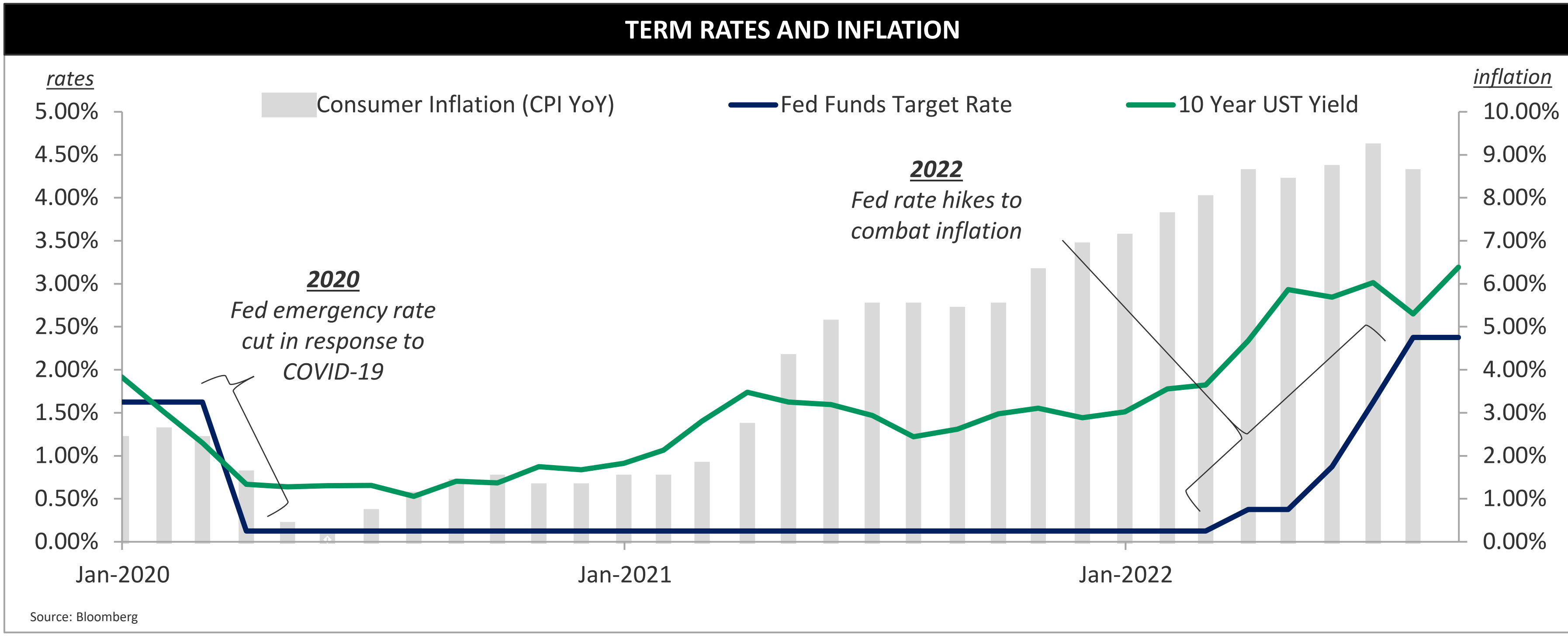
Source: Bloomberg

- The Fed's "transitory" inflation stance (now abandoned) was based upon the premise that once producer side inflation abated, consumer side inflation would follow
- With wage growth sustaining spending habits, consumer prices are unlikely to wane
- With elevated inflation expected to be sustained as producers comfortably pass higher costs onto consumers, the Fed is expected to continue raising interest rates

- Labor growth had made a full recovery of the jobs lost at the onset of the pandemic while the unemployment rate is just above its ~50 year low reached last month

Post-Pandemic Term Rates as Inflation Rises

Market pricing for Fed rate hikes as inflation accelerates

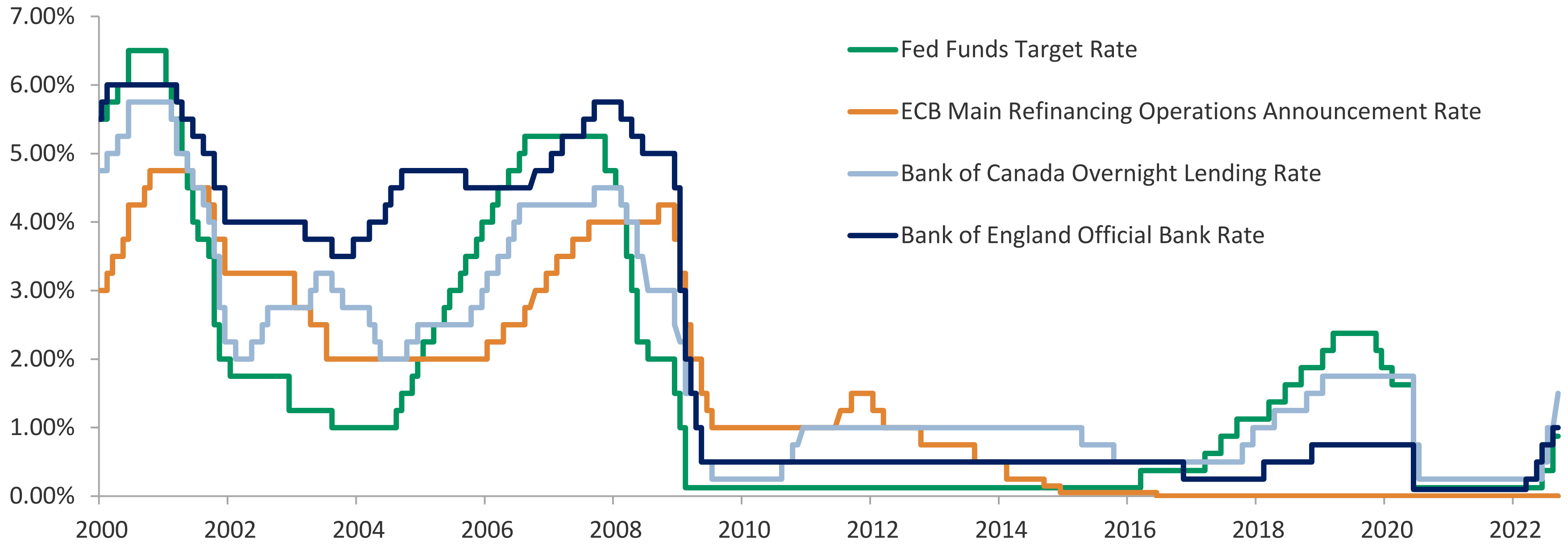


- With price pressures eating into American paychecks, the Federal Reserve has tightened monetary policy by:
  - Increasing short-term borrowing rates by 2.25% (YTD), with another 1.50% of increases priced into the market
  - Shrinking the FOMC balance sheet by $47.5 billion per month since June, and is increasing the pace to $95.0 billion this month
- The continuation of Fed action is expected at upcoming FOMC meetings, with term rates rising in anticipation

Global Central Bank Rate Policy

Currently a historically low rate environment

CENTRAL BANK POLICY RATES



Source: Bloomberg

- Global Central Banks have begun tighten monetary policy to combat prices, with the ECB being the last to raise rates due to the risk of fragmentation of the Eurozone, though a rate increase is expected at the ECB's upcoming meeting
- Despite historic Central Bank policy adjustments and the corresponding increase in yields, the current rate environment is still comparatively low

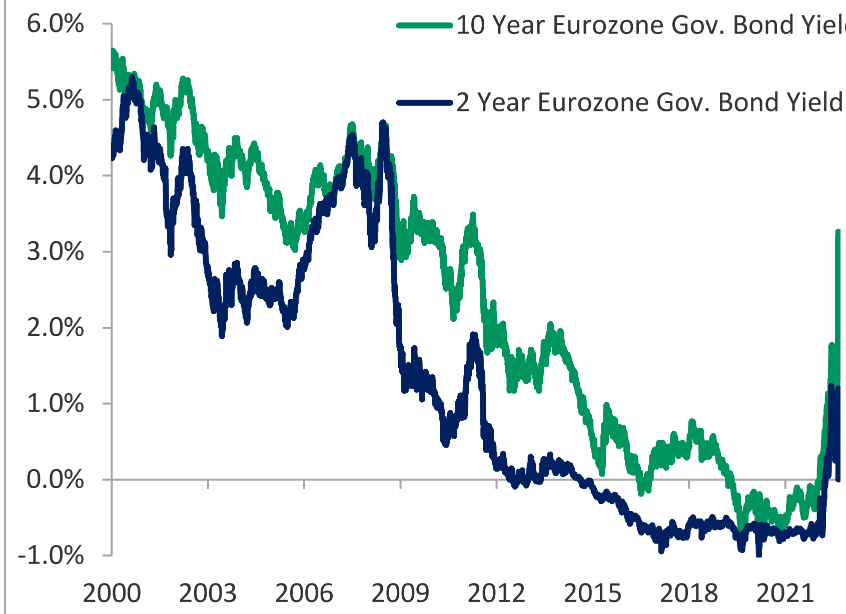
Government Bonds Yields

Global rates on the rise

U.S. GOVERNMENT BOND YEILDS

Source: Bloomberg

EUROZONE GOVERNMENT BOND YEILDS

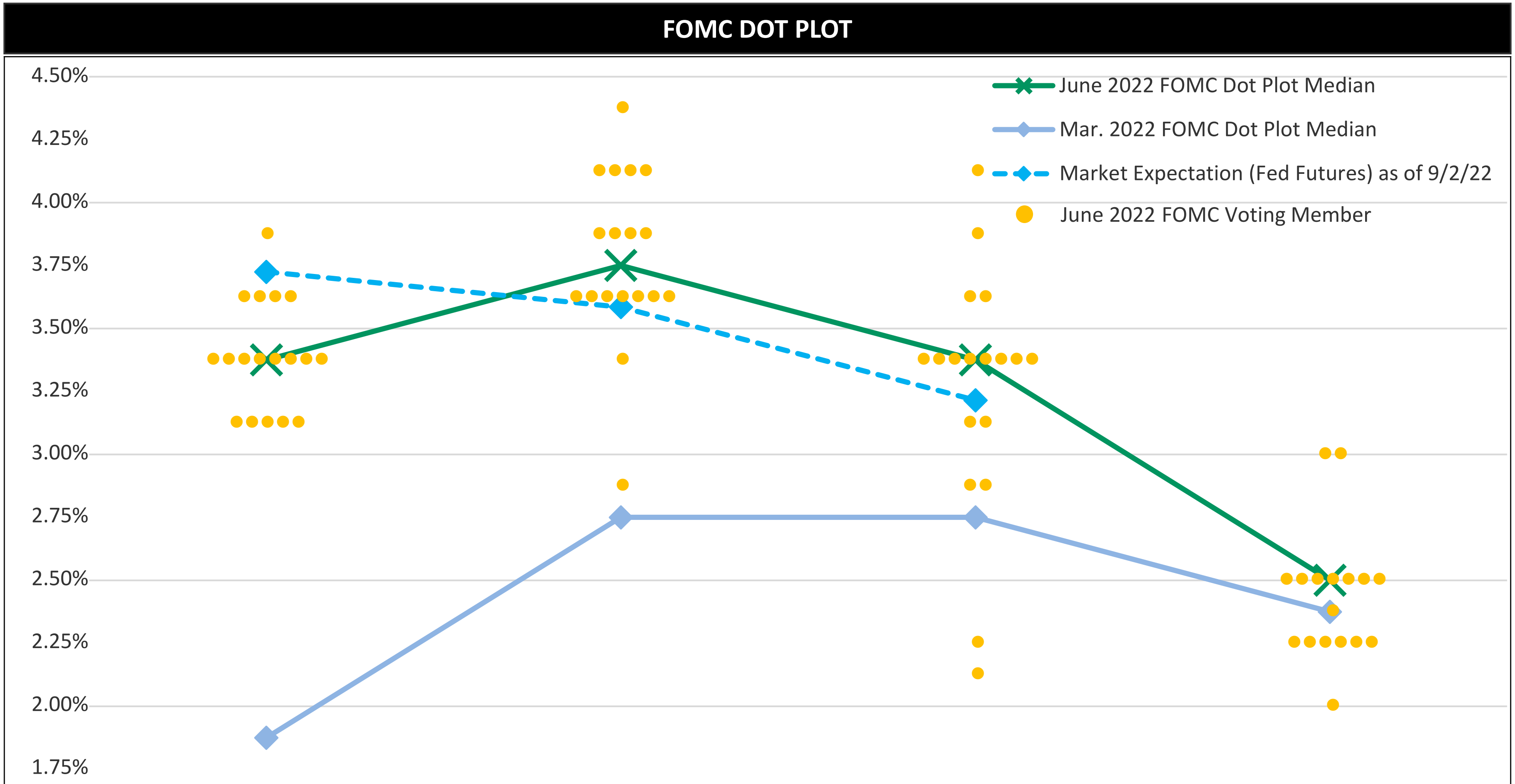


Source: Bloomberg

- With Central Banks tightening short-term rates, longer yields have been on the rise as well, with 2 and 10 year government yields back to pre-pandemic levels.

June 2022 FOMC Dot Plot

The Fed's tool to communicate its forecasted rate policy



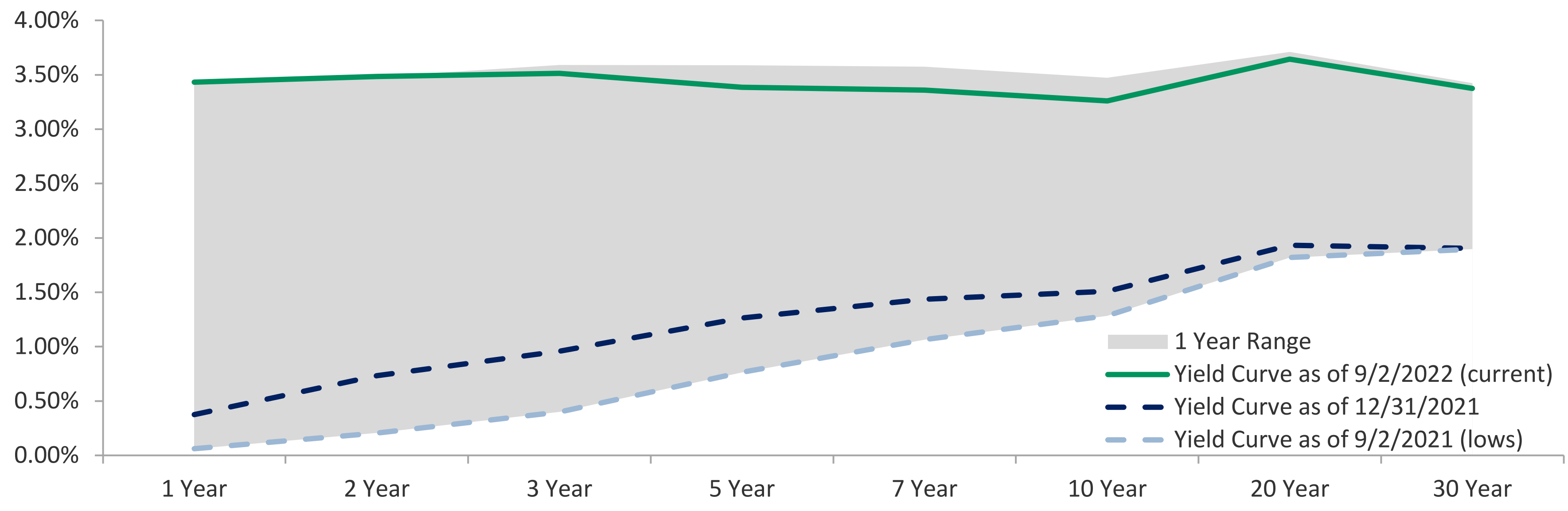
Source: Bloomberg

- Chair Powell stated "clearly, today's 75 basis-point increase is an unusually large one and I do not expect moves of this size to be common" following the largest rate hike since 1994
- The latest "Dot Plot," the Fed's tool to communicate projected policy action, reveals a median expectation of 6.5 future hikes this year (162.5 bps)
  - Furthermore, an additional 62.5 bps of tightening is expected by the end of 2023, implying a median rate of 3.75%
- **The increase in rate policy expectations shows that the FOMC has demonstrated flexibility with its monetary policy stance**

Volatility in Yields

Post-pandemic volatility in the rate market

YIELD FLUCTUATIONS



Source: Bloomberg

- Notable market fluctuations have seemingly become normal moves, with data releases and Fedspeak adding volatility to an already-sensitive rate environment
- Since the Fed's Jackson Hole Economic Symposium in late August of '21, 1o year yields jumped ~200 basis points while 2 year yields increased ~300 basis points
  - The move was a function of the market pricing in Fed tightening after inflation failed to dissipate

Fedspeak

Committee members pushing back on rate cuts priced in

- [Minneapolis Fed President Neel Kashkari]
  - Regarding rate cuts priced in, the FOMC's perennial dove stated **"I don't know what the bond market is looking at in reaching that conclusion" and that the he is "surprised by markets' interpretation" of expected Fed action.**
  - "We're going to continue to do what we need to do until we are convinced that inflation is well on its way back down to 2 percent – and we are a long way away from that."
  - "Whether we are technically in a recession right now or not, doesn't change my analysis. **I'm focused on inflation.**"
- [Chicago Fed President Charles Evans]
  - Highlighting the asymmetric risk of rates rising further rather than falling, Evans stated that, if inflation doesn't abate, **the Fed "might have to rethink the path a little bit higher."**
  - "Interest rates are higher, but they're not necessarily tight."
- [San Francisco Fed President Mary Daly]
  - **The Federal Reserve is "nowhere near" done raising rates** to combat inflation.
- [Cleveland Fed President Loretta Mester]
  - **"We have more work to do because we have not seen that turn in inflation**... it's got to be a sustained, several months of evidence that inflation has first peaked – we haven't even seen that yet – and that [inflation is] moving down."

FOMC DASHBOARD

Fed Official	Hawks vs. Doves	Voting Year		
	most hawkish	2022	2023	2024
St. Louis President Bullard		✓	×	×
Governor Waller		✓	✓	✓
Cleveland President Mester		✓	×	✓
Philadelphia President Harker		×	✓	×
Richmond President Barkin		×	×	✓
Governor Bowman		✓	✓	✓
Fed Chair Powell		✓	✓	✓
New York President Williams		✓	✓	✓
Atlanta President Bostic		×	×	✓
Kansas City President George		✓	×	×
Dallas President Black*		×	✓	×
Governor Barr		✓	✓	✓
Boston President Collins		✓	×	×
Governor Jefferson		✓	✓	✓
Governor Cook		✓	✓	✓
Fed Vice President Brainard		✓	✓	✓
San Francisco President Daly		×	×	✓
Chicago President Evans		×	✓	×
Minneapolis President Kashkari		×	✓	×
	most dovish			

- Bold names designate 2022 Voting members

** Meredith Black to be replaced by Lorie Logan in August*

Questions?

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