

RAYMOND JAMES

WHY THE FED IS STILL STEPPING IN THE MARKETS

GIOA Pre-Conference Workshop

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See Slide 25 for Important Disclaimers & Disclosures*

FIXED INCOME RESEARCH

QUESTIONS TO START

- Which round of QE are we on now?
 - QE4
 - QE5
 - I don't care, I stopped counting.

QUESTIONS TO START

- When will the Federal Reserve Raise Rates?
 - 2021
 - 2022
 - 2023
 - Never again

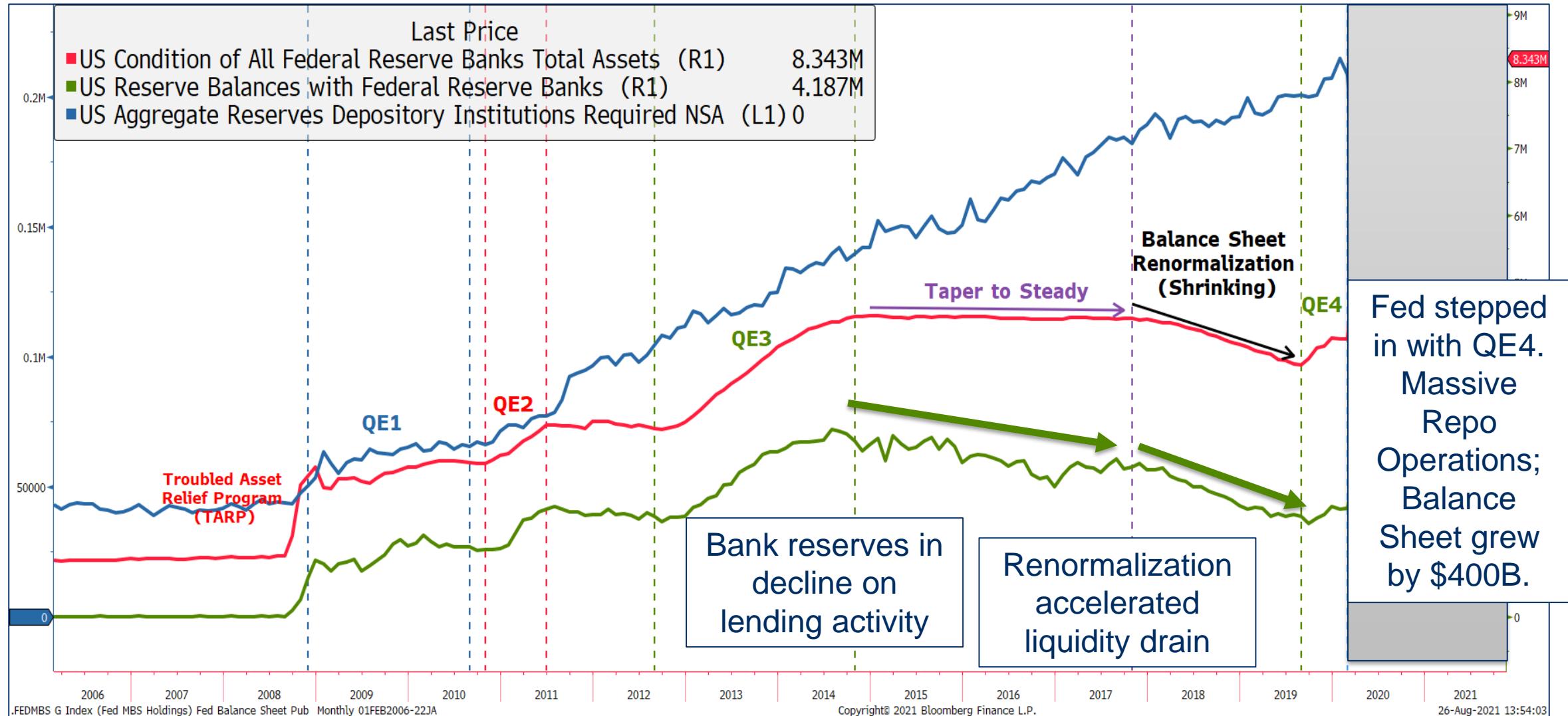
QUESTIONS TO START

- Do you believe inflation is
 - Temporary?
 - Transitory?
 - Here to stay?
 - Going to take off like a rocket?

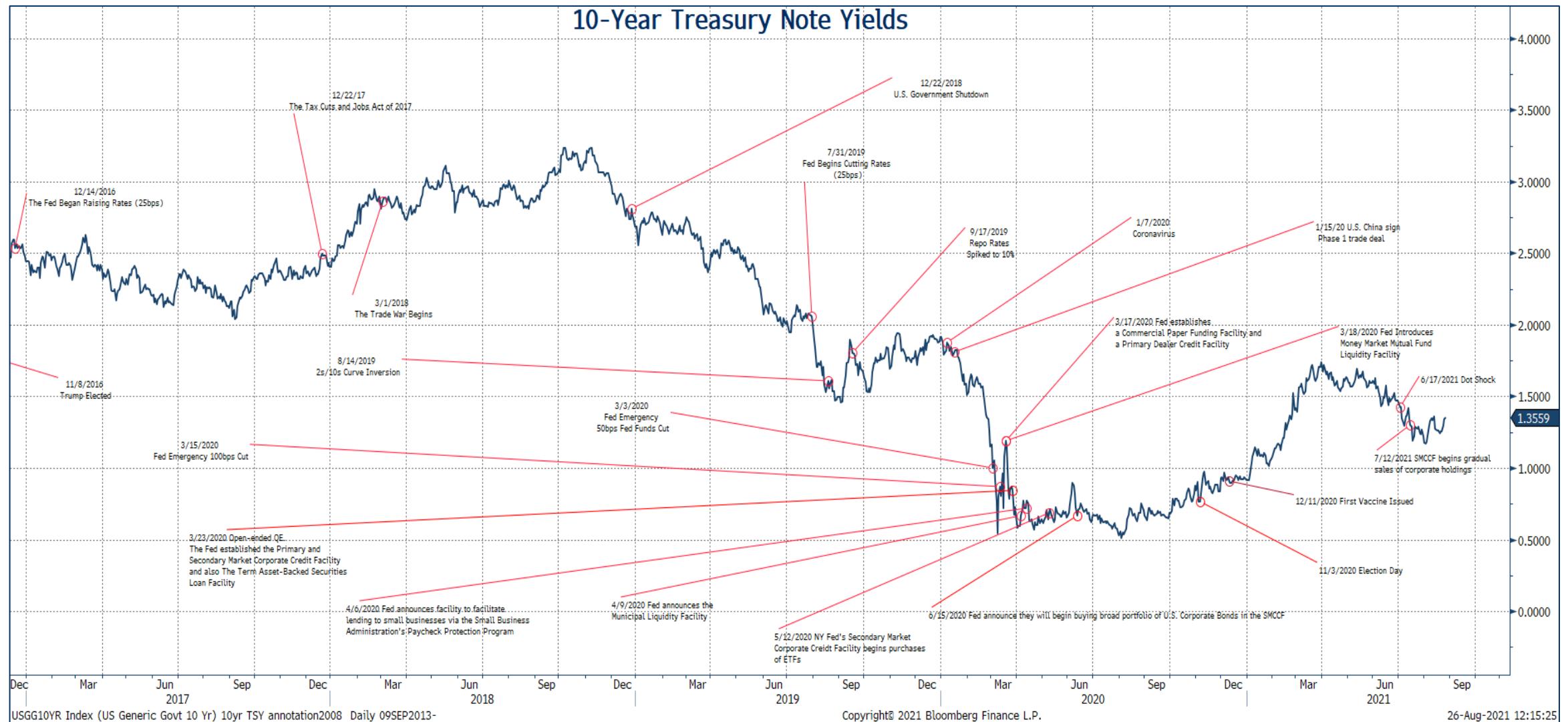
THIS WAS THEN



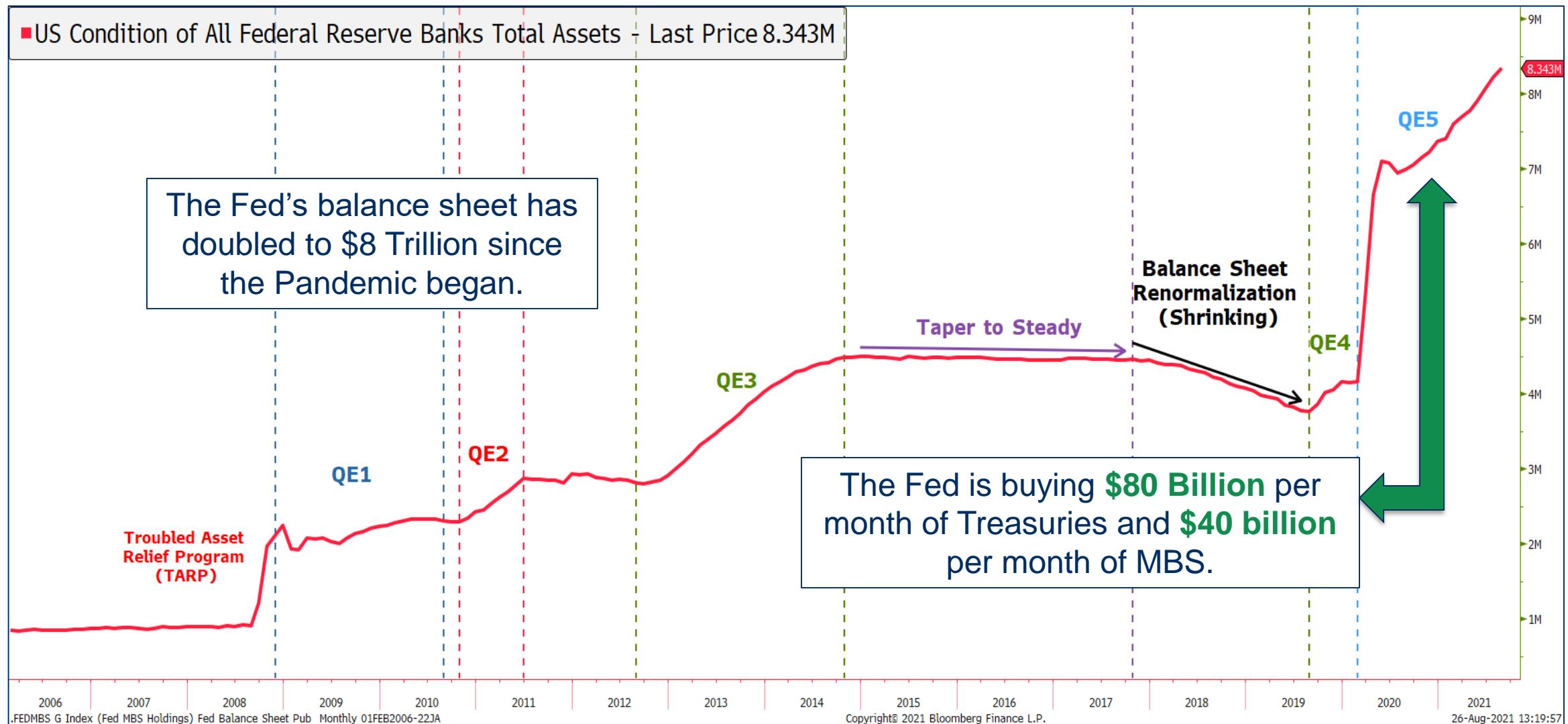
LIQUIDITY PRESSURED FROM ECONOMIC GROWTH AND RESERVE REQUIREMENTS



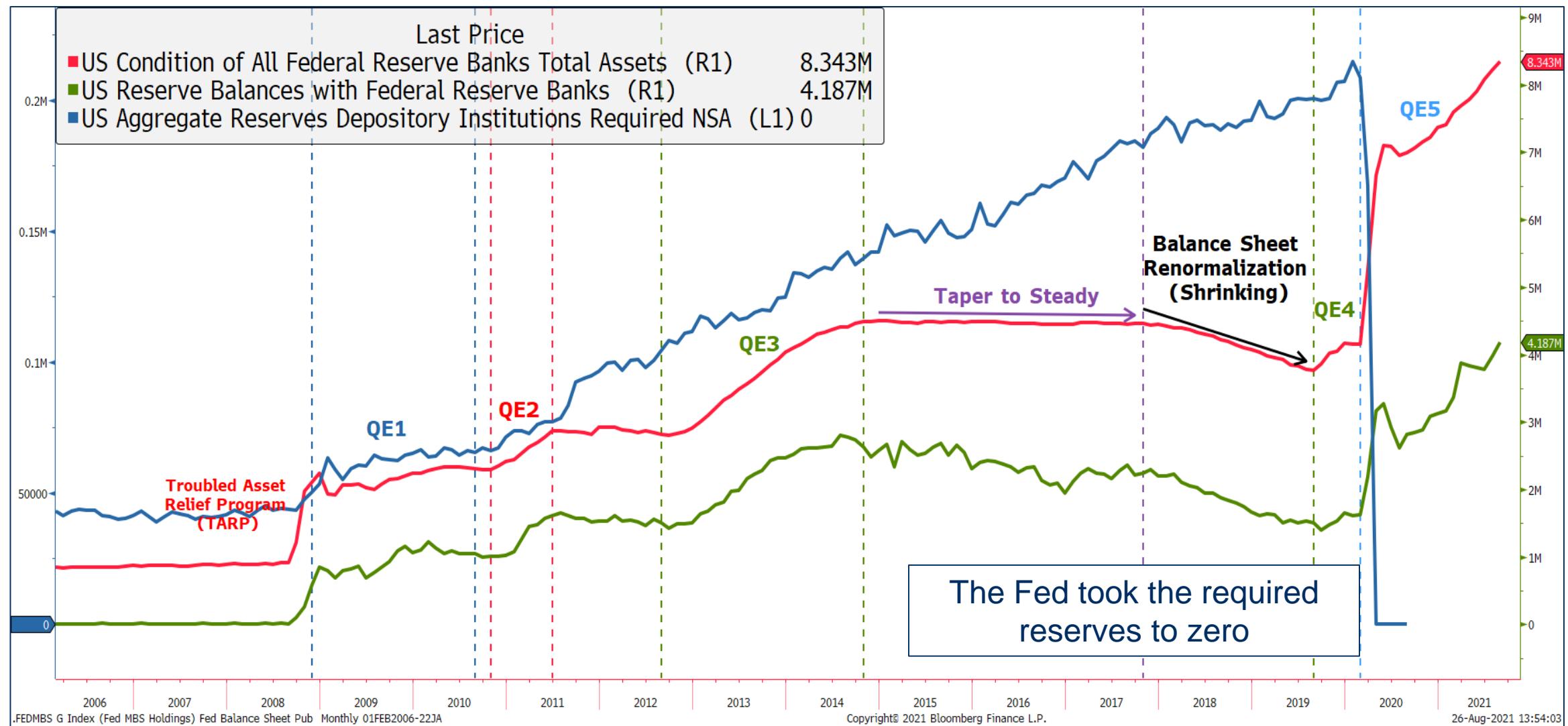
THIS IS NOW



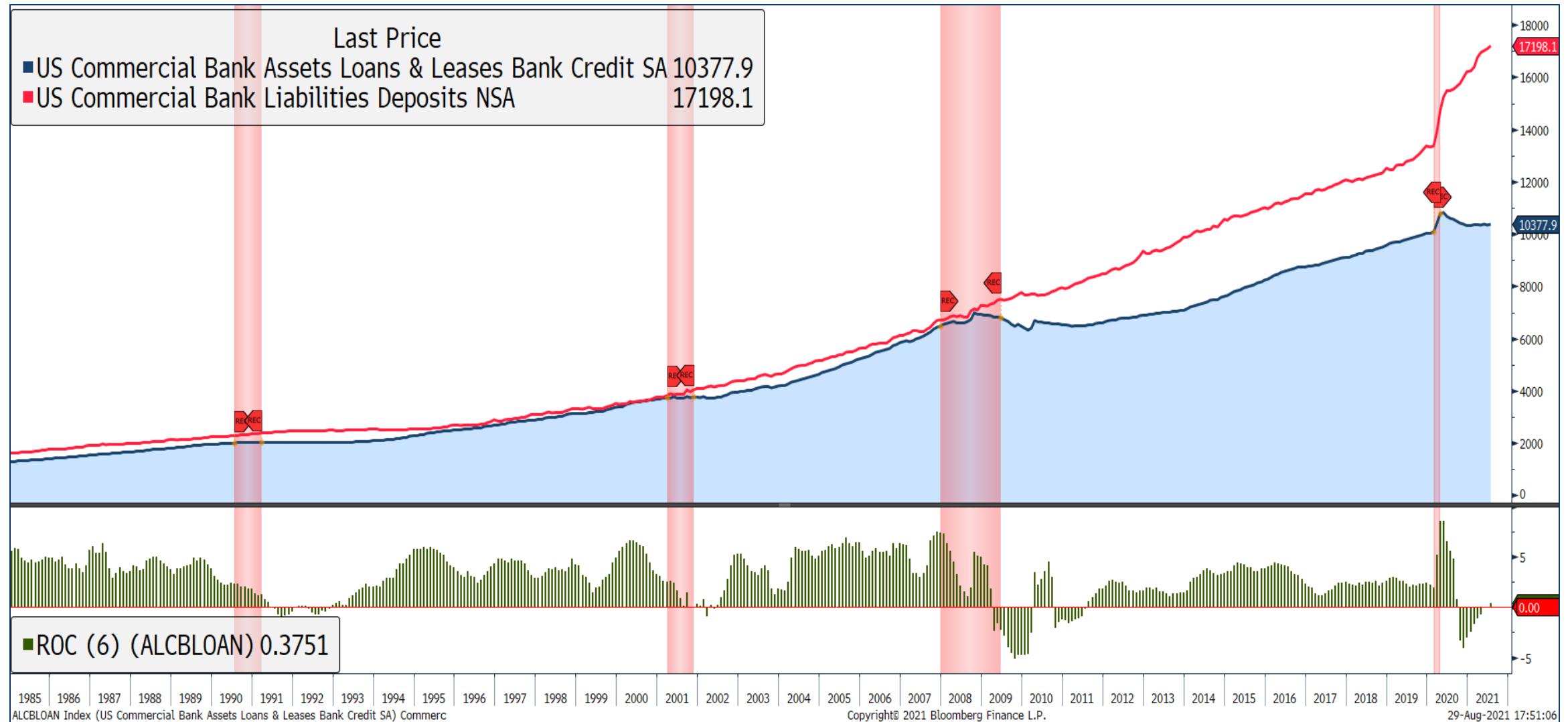
GROWTH IN THE FED BALANCE SHEET



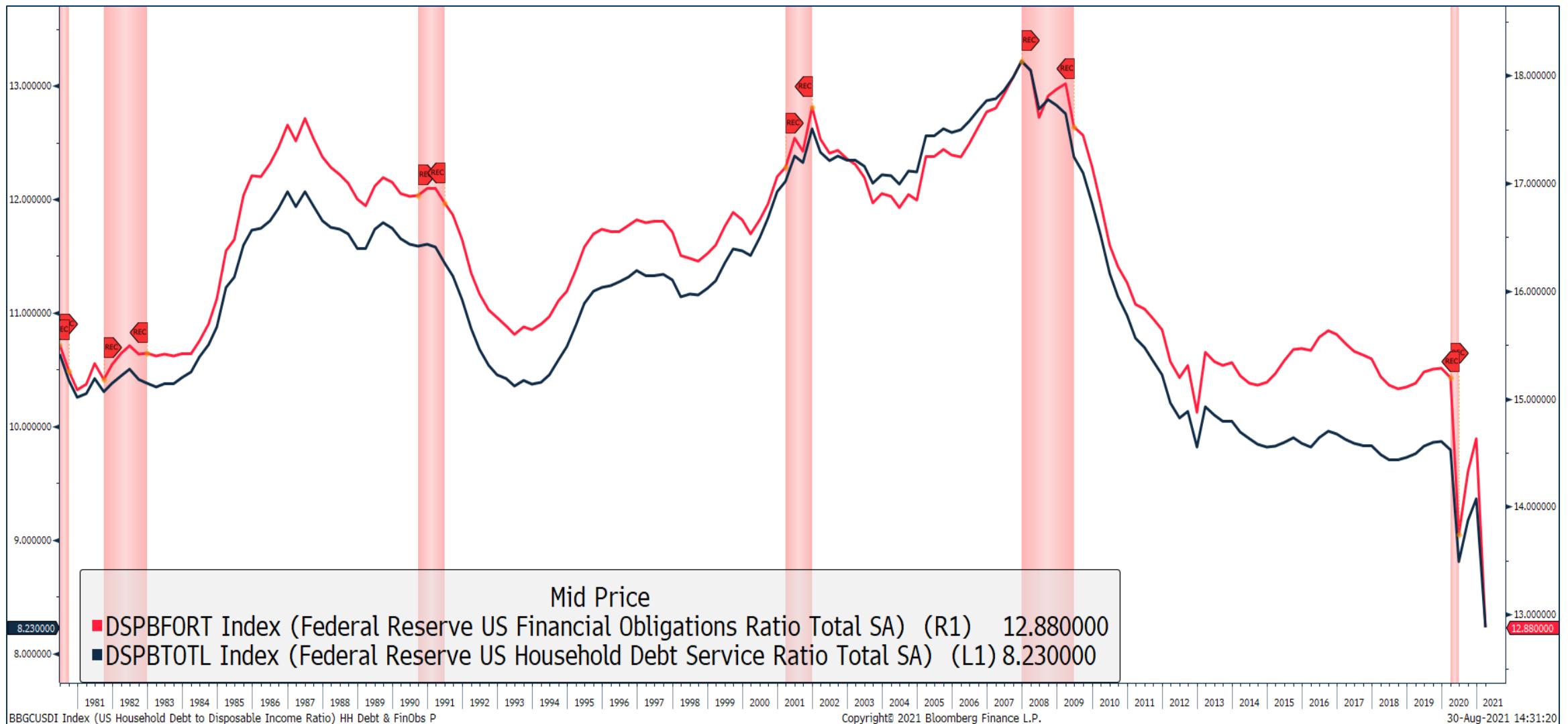
SOMETHING LOOKS DIFFERENT THIS TIME



BANK LOAN ACTIVITY IS STAGNANT



THE CONSUMER BALANCE SHEET IS STRONG



CORPORATE BALANCE SHEETS ARE CASH-LADEN

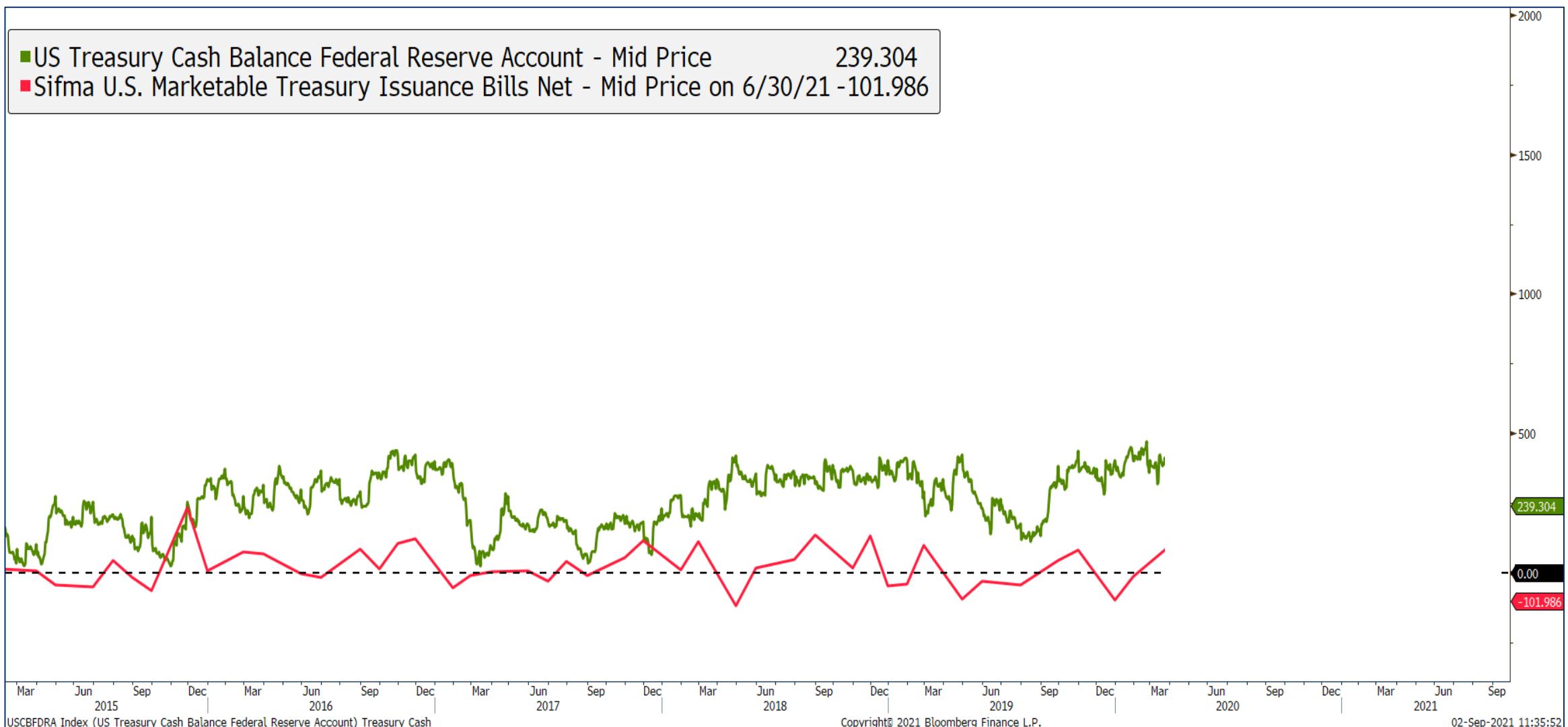
Cash on the balance sheets of S&P 500 companies has swelled to a record \$1.9 trillion, compared to \$1.5 trillion before the pandemic crisis in early 2020.

- Reuters - 7/21/21

Cash and short-term investments on corporate balance sheets globally are at an all-time high of \$6.84 trillion, according to data from S&P Global, extrapolated from second-quarter earnings reports. That is 45% higher than the average in the five years preceding the pandemic and a 2.6% increase from the previous quarter.

- The Wall Street Journal - 8/16/21

TREASURY CASH ACCOUNT AND BILL ISSUANCE



TOO MUCH MONEY CHASING TOO FEW BONDS

- The Federal Government and the Federal Reserve injected massive amounts of cash into the system to combat the financial effects of the pandemic.
- The Fed is buying \$120 Billion per month of securities.
- The Treasury is spending down its Cash Account and not issuing T-Bills (allowing them to mature without rolling them over).
- Banks are absorbing cash and not making loans.
 - Consumers and companies are flush with cash – little need for borrowing.

THE CASH WAVE

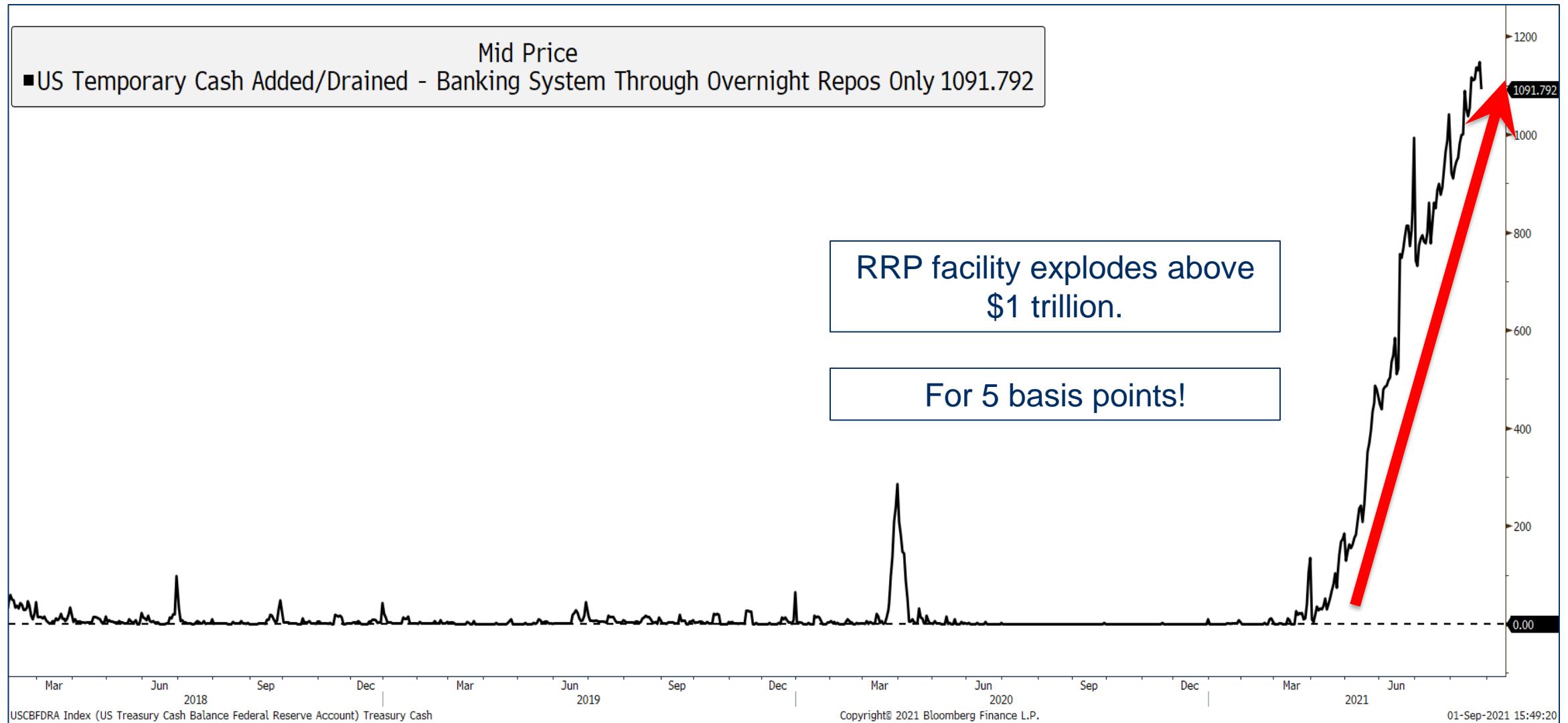


FED STARTS TO MOP UP THE EXCESS LIQUIDITY

On June 16, the Federal Reserve adjusted their two “administered” rates.

- Interest on Excess Reserves (IOER): The interest rate it pays banks on reserves. Up 5bps to 15bps (0.15%).
- Reverse Repo Agreement Facility (RRP): Used to set a floor on interest rates. Up 5bps to 5bps (0.05%).

THE RRP FACILITY BECOMES THE PLACE TO PARK MONEY



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Simply put, the Reverse Repo Facility (RRP) is a tool where the Federal Reserve borrows money from banks, money market funds, etc. **It is primarily a tool the Federal Reserve uses to drain excess money from the banking system.**

Eligibility:

- A state or federally chartered bank or savings association (or a state or federally licensed branch or agency of a foreign bank) with total assets equal to or greater than \$30 billion, or reserve balances equal to or greater than \$10 billion on the last quarter for which relevant reports are available; or
- A government-sponsored enterprise; or
- An SEC-registered 2a-7 fund that has, measured at each month-end for the most recent six consecutive months, either net assets of no less than \$2 billion or an average outstanding amount of RRP transactions of no less than \$500 million.

ENTER THE TAPER

"We have said that we would continue our asset purchases at the current pace until we see substantial further progress toward our maximum employment and price stability goals, measured since last December, when we first articulated this guidance. ***My view is that the 'substantial further progress' test has been met for inflation. There has also been clear progress toward maximum employment.*** At the FOMC's recent July meeting, I was of the view, as were most participants, that if the economy evolved broadly as anticipated, it could be ***appropriate to start reducing the pace of asset purchases this year.*** The intervening month has brought more progress in the form of a strong employment report for July, but also the further spread of the Delta variant. We will be carefully assessing incoming data and the evolving risks. Even after our asset purchases end, our elevated holdings of longer-term securities will continue to support accommodative financial conditions.

The timing and pace of the coming reduction in asset purchases will not be intended to carry a direct signal regarding the timing of interest rate liftoff, for which we have articulated a different and substantially more stringent test. We have said that we will continue to hold the target range for the federal funds rate at its current level until the economy reaches conditions consistent with maximum employment, and inflation has reached 2 percent and is on track to moderately exceed 2 percent for some time. We have much ground to cover to reach maximum employment, and time will tell whether we have reached 2 percent inflation on a sustainable basis."

Fed Chair Jerome Powell, Jackson Hole Speech, 8/27/21

BACK TO THE FUTURE – MORE CASH TO MOP UP

For historical context, the previous taper to tightening cycle lasted from December 2013-December 2018.

- Reduced bond purchases to \$75 billion from \$85 billion in January 2014.
- Purchases slowed by \$10 billion per month until concluding purchases in October 2014.
- First rate hike in December 2015.
- Continued to reinvest principal payments from agency debt and agency MBS and rolling over treasuries at auction “until normalization of Fed Funds rate was well under way.”
- June 2017 stated “The committee currently expects to begin balance sheet normalization this year.”
- July 2017 stated “The committee expects to begin implementing its balance sheet normalization plan relatively soon.”
- September 2017 announced bond buying would end in October, allowing the balance sheet to shrink (aka normalize).

MARKET'S VIEW OF FUTURE FED MOVES

Region: United States »

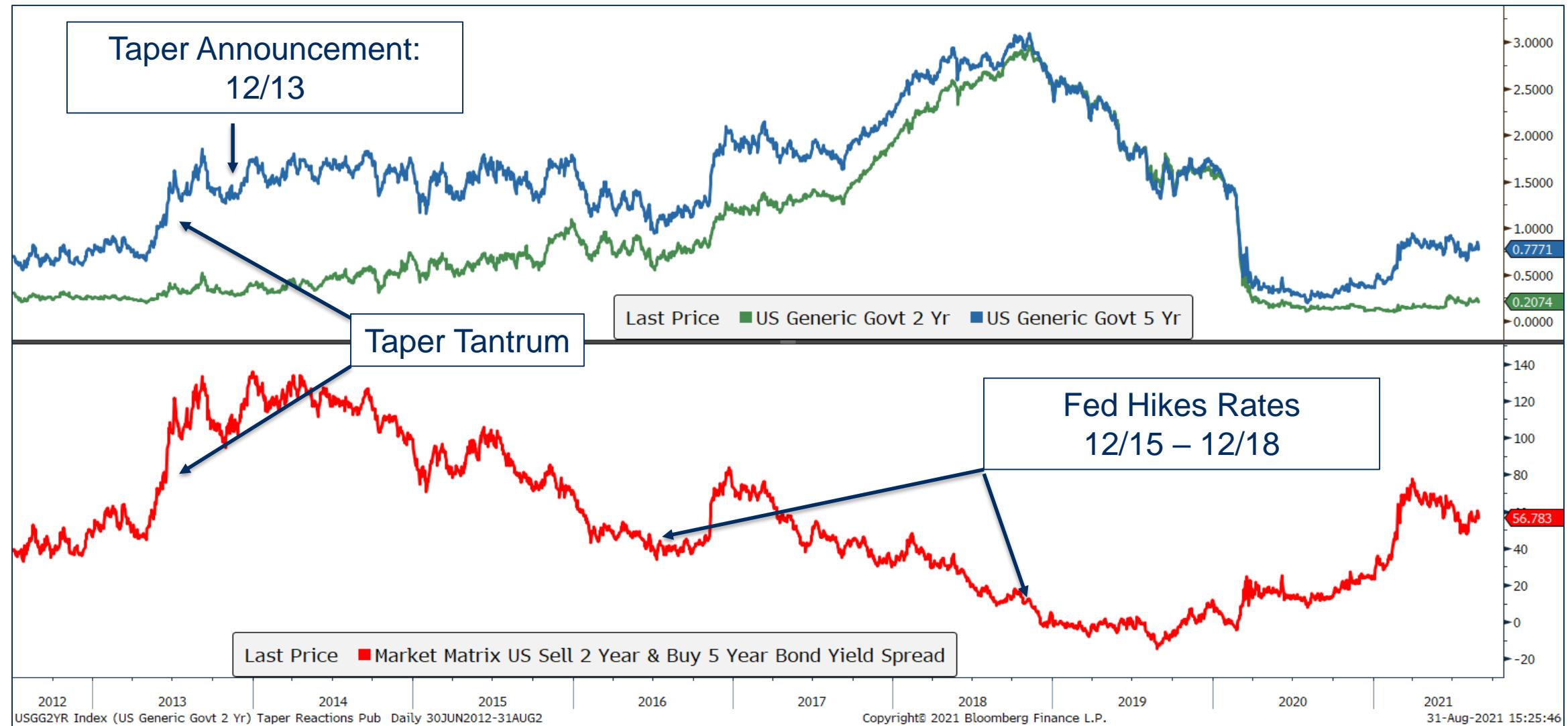
Target Rate 0.25
Effective Rate 0.08

Instrument: Fed Funds Futures »

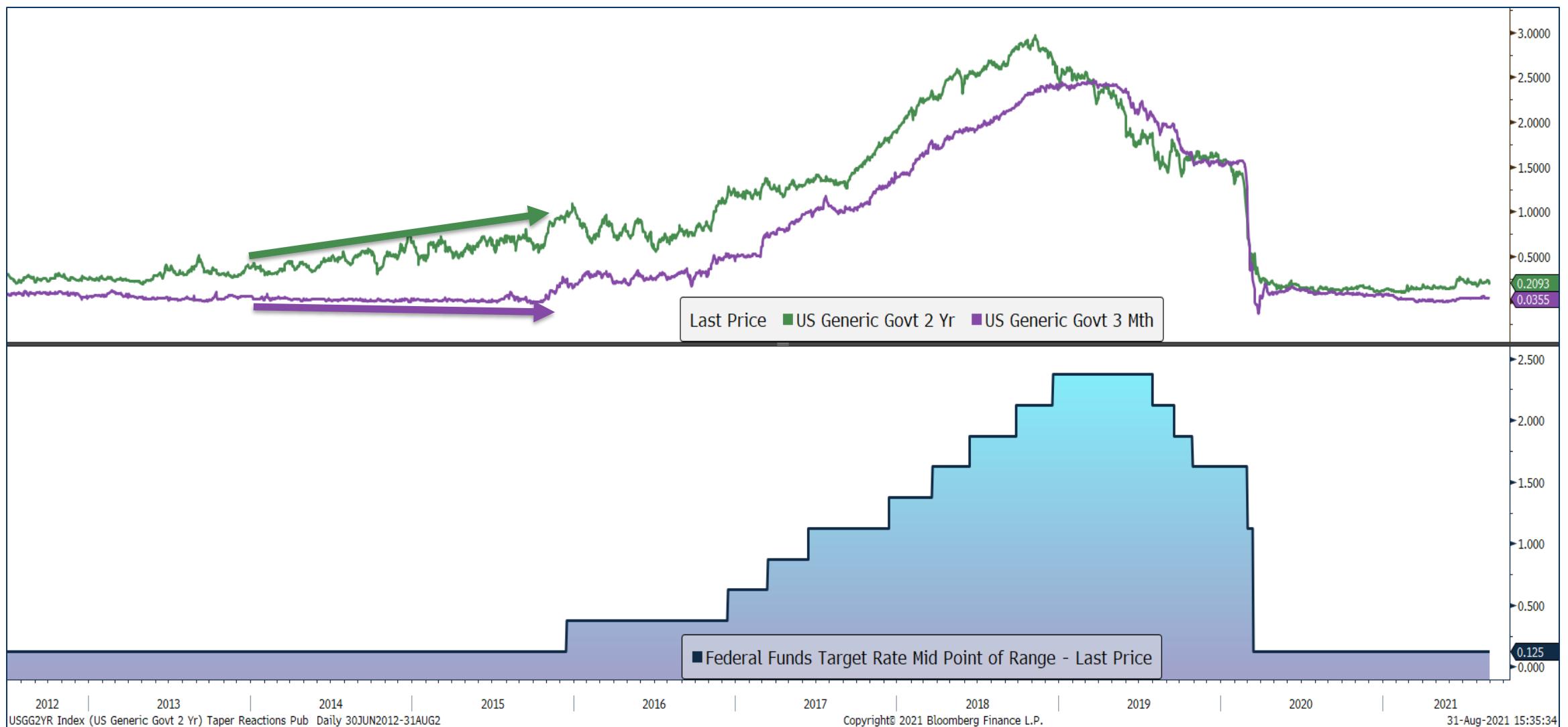
Pricing Date 08/30/2021
Cur. Imp. O/N Rate 0.091

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
09/22/2021	-0.121	-12.1%	-0.030	0.061	0.250
11/03/2021	-0.055	+6.6%	-0.014	0.077	0.250
12/15/2021	-0.045	+1.0%	-0.011	0.080	0.250
01/26/2022	-0.035	+1.0%	-0.009	0.082	0.250
03/16/2022	-0.035	+0.0%	-0.009	0.082	0.250
05/04/2022	-0.035	+0.0%	-0.009	0.082	0.250
06/15/2022	+0.041	+7.6%	+0.010	0.101	0.250
07/27/2022	+0.105	+6.4%	+0.026	0.118	0.250
09/21/2022	+0.305	+20.0%	+0.076	0.168	0.250
11/02/2022	+0.414	+10.9%	+0.103	0.195	0.250
12/14/2022	+0.725	+31.1%	+0.181	0.273	0.250
02/01/2023	+0.849	+12.4%	+0.212	0.304	0.250

YIELD AND CURVE MOVEMENT – PREVIOUS TAPER TO TIGHTENING CYCLE

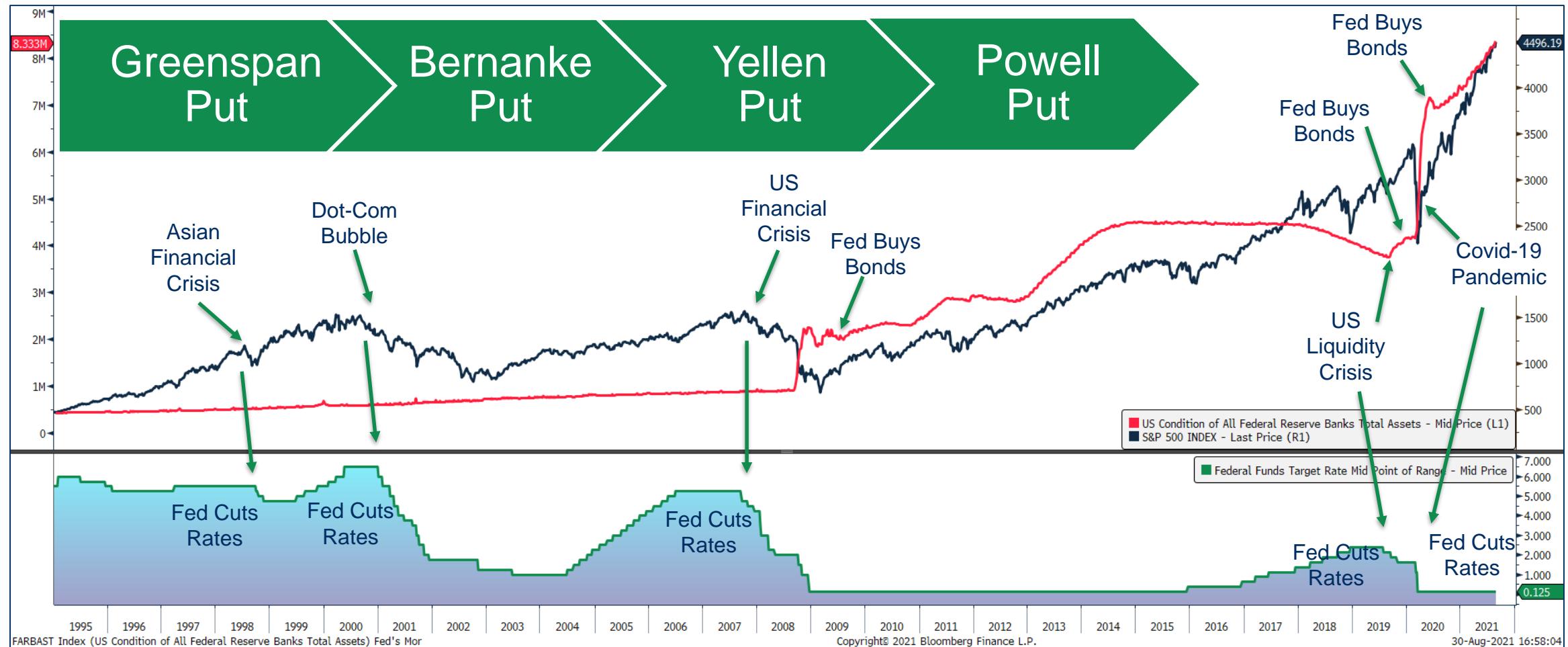


TWO-YEAR YIELD AS A FED BAROMETER



MORAL HAZARD? WHAT MORAL HAZARD?

Moral hazard is a situation in which one party gets involved in a risky event knowing that it is protected against the risk because another party will incur the cost.



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