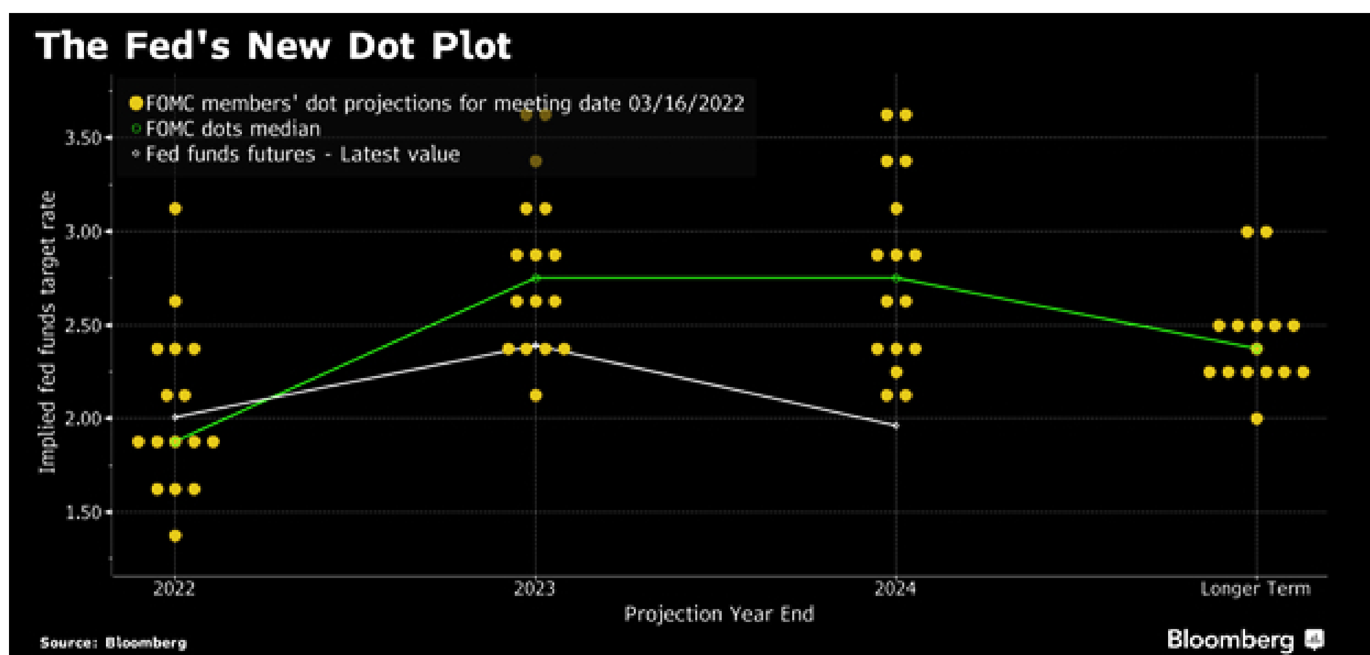
The Fed Lifts Rates, but Are They Behind the Curve?

As expected, at their March 15th and 16th meeting, The Federal Reserve (the "Fed") raised its Federal Funds rate for the first time since before the COVID-19 pandemic. This has been a long time coming. Consumer price inflation has been above 5% year-over-year since June 2021 and most recently was up almost 8% for the past year. When Chairman Powell finally acknowledged last September that supply chain disruptions and inflation were not transitory but here to stay, he and the Fed Board were "patient" about when to start raising rates.

Unfortunately, the war in Ukraine has not only led to significant hardship and deaths, but also to further supply chain disruptions and significant volatility in commodity prices. Both factors increased the pressure on the Fed to not only start to raise the Fed fund rates at this meeting but to raise it significantly more this year.

While Fed members were almost unanimous in supporting a 25 basis point hike at their March meeting there was very strong disagreement within the Fed about how much to raise the Fed Funds rate by year-end and in future years. The Bloomberg chart below shows each Fed Open Market Committee member's forecast of what the Fed Funds rate will be at year-end. The median Fed member's forecast is 1.75% for 2022, which is near market expectations. But seven Fed members supported more aggressive rate hikes, including two members who forecast that the Fed Funds rate will be above 2.5% by year-end. And most Fed members are forecasting additional rate hikes in 2023.



Source: Bloomberg, 3/16/22

A war in Europe, significant sanctions against Russia, and U.S. consumer price inflation that is almost 8%, have significantly punished both fixed income and equity investors so far this year. There have not been a lot of places to hide. And currently high levels of inflation, together with continuing global supply chain issues, may continue to put upward pressure on interest rates.

U.S. 10-year Treasury rates moved above 2% in February, fell back slightly by early March, but are now well above 2% at the highest level since 2019. But it's difficult to view the 10-year Treasury yield as being attractive. 10-year Treasury yields are lower than the market's expectation next year for the Fed Funds rate. As the chart below shows, investors are being paid very little to take the extra duration risk of owning 10-year Treasuries versus 2-year Treasuries.

Source: YCharts, 3/16/22

2022 has been tough for both equity and fixed-income investors. Forecasting long-term interest rates is tough. But with inflation high and short-term rates rising there may be pressure on long-term interest rates going forward.

Managers' approaches to difficult markets like this vary widely. Many active managers stay fully (or almost fully) invested, since that's what their investors expect. Other active managers will "step out" of markets, at least to some extent, to help reduce losses and keep some dry powder for the recovery. But bear markets often lead to fear. And without a disciplined approach active managers can hurt their performance if they capitulate near the bottom of the market or wait too long to re-invest.

At our firm, we take the emotion out of portfolio management by placing a trailing stop under each of our positions, tailored to the volatility of the asset class. Our process isn't perfect. No investment approach is. We believe that our tactical, rules-based approach keeps us focused on our goal of helping to mitigate severe downturns without letting our emotions get in the way. Our rules-based process also lets us know when and where we can reinvest the cash that we have been holding aside.

Historically after large drawdowns, many active managers will buy back pretty much what they sold, or something similar to it. But no two market cycles are the same. Our approach is different from many investors. In our diversified products what we sold isn't relevant when it comes time to move back into markets. I find it refreshing that we can look across a broad range of asset classes and individual investments to select those that are currently being rewarded by markets with strong risk-adjusted returns. In a past market cycle, as an example, we sold all of our High Yield Corporate Bonds. But when we later reinvested the proceeds of the Sells we didn't put the money back into High Yield Corporate Bonds. We stayed out of them because we saw stronger Buy Signals in Municipal Bonds. But in the next market cycle we reduced our exposure to Municipal Bonds to increase our exposure to Multisector Bonds and International Equities. This type of a tactical and flexible investment approach is one of the factors that not only differentiates us from many other managers, but also makes it an interesting and challenging place to be a portfolio manager.

Doug Loeffler, CFA, CAIA

Executive Vice President of Investment Management

Doug Loeffler is Executive Vice President of Investment Management at Sierra Mutual Funds & Ocean Park Asset Management. He provides research, analysis, and support for the investment activities of the organization and appears on behalf of the firm in the financial press.

Investments in Mutual Funds involve risk including the possible loss of principal. There is no assurance that the Fund's will achieve their investment objectives. Mutual fund investing involves risk, including the loss of principal and there can be no guarantee the strategies and processes discussed will be successful.

Investors should carefully consider the investment objectives, risks, charges, and expenses of the Sierra Mutual Funds. This and other important information about the Sierra Mutual Funds can be obtained in the prospectus, which can be obtained on our website www.sierramutualfunds.com or by calling 1-866-738-4363. The prospectus should be read carefully before investing. The Sierra Mutual Funds are distributed by Northern Lights Distributors, LLC, member FINRA/SIPC.

DISCLOSURES:

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy or sell securities, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her advisors. Economic conditions remain highly uncertain and there is no guarantee that the information presented in this commentary will come to fruition.
Neither Ocean Park Asset Management, Inc., nor Wright Fund Management, LLC are affiliated with Northern Lights Distributors LLC.

If you do not wish to receive communication via email reply back to this email with "Unsubscribe" as the subject line.

Sierra Mutual Funds & Ocean Park Asset Management, Inc.
3420 Ocean Park Boulevard, Suite 3060 | Santa Monica, CA 90405 | Sales: 844.727.1813

SIERRA MUTUAL FUNDS | OCEAN PARK ASSET MANAGEMENT

Entire publication ©2022 Sierra Mutual Funds & Ocean Park Asset Management.
All rights reserved.

1315-NLD-03172022
0517-OP00MCOM 03142022