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## Fed No Longer Controls Rates

By Brian Singer, CFA     Wed, Feb 1, 2017

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*'We believe the probability of the Fed raising rates three times in 2017 is less than what the market has begun to price in post the Donald Trump election,' writes the William Blair Funds portfolio manager.*

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I've written previously about how central bank policies across the globe are manipulating asset prices. To recap, the Bank of Japan (BOJ) is buying short- and long-term sovereigns, credit, and equity. They are literally buying every single asset class. The European Central Bank (ECB) is buying all of these asset classes except equity. The Fed is buying short- and long-term sovereigns, but not credit or equity.

These central bank activities are boosting asset prices, but that can't last forever. As a result, in the current environment, it's very difficult for the market to have a strong conviction on long-term fundamental value because investors don't know what asset prices really should be.

This creates more uncertainty and risk, so from a portfolio positioning perspective, this phenomenon, among other "Why" investment process considerations, has caused us to dampen some of our positions in markets and currencies around the world.

Over time, this environment will settle down. The Fed raised rates at the end of last year and has signaled that it anticipates three rate hikes in 2017. At the same time, it's hard to say that the Fed is actually in control of interest rates. Ultimately, they have ceded a lot of control to the market, and market participants are dictating monetary policy. Why do I say that?

For the last four or five decades, the Fed has always focused on not surprising the market. As they approach each of their meetings, they're looking, as everyone else is, at the probabilities that are priced into the short yield curve and LIBOR-OIS (Overnight Indexed Swap) spreads to determine whether or not the market is pricing assets based on the expectation that the Fed is going to raise rates. If this probability is below 50%, the Fed won't act, but if the probability is above 75%, the Fed will raise rates.

However, we believe the probability of the Fed raising rates three times in 2017 is less than

what the market has begun to price in post the Donald Trump election. So, we're a little bit less concerned by the potential for the Fed to raise rates multiple times over the coming year.

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