ORCAM ALTERNATIVE PERSPECTIVES

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No Taper, No Tantrum….

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Big day today. Stocks, bonds and commodities all rallied on the news that the Fed would not be tapering any time soon. In fact, I think the press conference after the decision made it very clear that the Fed might not taper at all this year. This is a very important market moving event.

About a month ago when 10 year yields were hovering near 2.9% I said that I thought the bond markets had all been overreacting to the idea of tapering:

> "I think this recent move in bonds is largely driven by fears surrounding the Fed and the "tapering". For some reason, this is being viewed as a form of tightening. As if a reduction in bond purchases from $85B to $65 is all that meaningful to begin with. But more importantly, this is nothing like an actual tightening. By far, the more important move will be an actual rate increase. And I think the bond market is still getting this one wrong."

Long story short—The Bond Bull Market is Back.

Today's decision confirmed that view. In fact, I think the Fed has put an explicit ceiling on the long bond yield. Clearly, the move in interest rates in recent months has been exaggerated and spooked the Fed. They sounded a bit more concerned about the economy than they have in recent decisions. And the need for action was imminent in their minds.

The market reaction is more interesting than the change in tone though and I think the market is finally starting to get this right.

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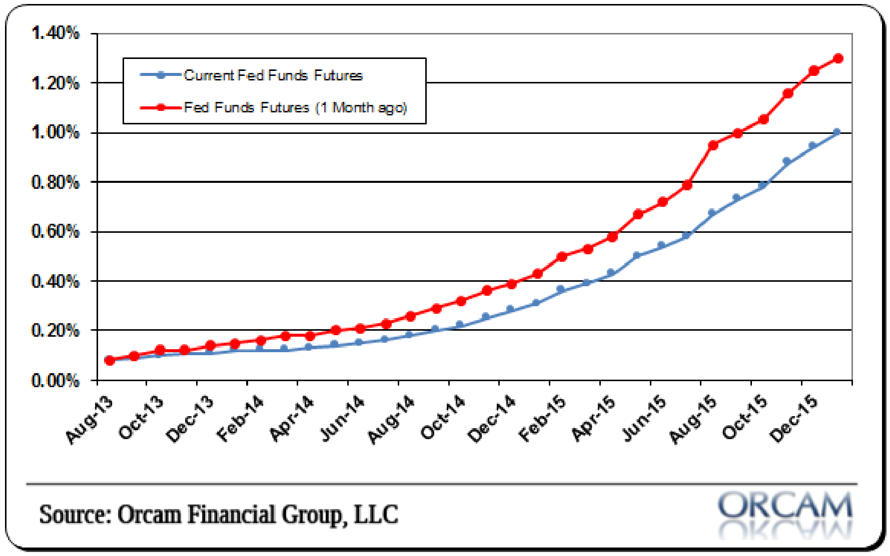

One of the main indications of bond market expectations that I've referred to in the past is the Fed Funds Futures curve. This gives us a very good idea of what bond traders expect relative to what the Fed is forecasting. And it's telling a pretty different story than it was a month ago.

Now, I thought two interesting things happened in today's decision. Not only did the Fed take the taper off the table, but the Fed was also adamant that their unemployment rate target was not a "due date", but a target date. The Fed has previously stated that they would be inclined to tighten policy when the unemployment rate hits 6.5%, but Dr. Bernanke made it very clear today that this is not a drop dead date, but merely a target at which they'll reassess the environment. Said differently, if the unemployment rate is likely to remain elevated well into 2014 (as I expect) then the Fed is unlikely to even begin considering a tightening phase until then. And even then they might not be inclined to act! Said even more succinctly, I think the Fed is on hold for longer than most others presume. And I think the Fed Funds Futures curve is starting to reflect that more accurately. The recent 30 bps decline in the long end of the curve is a clear sign that fixed income traders now expect the Fed to be easier for longer.

The big takeaway from today's meeting was simple in my opinion. The Fed is trying to put a ceiling on interest rates and I think it's highly probable that they'll get their way there. With the low rate of inflation, tapering now off the table and a market that has likely swung too far into the "taper tantrum" zone (ie, yields are too high now) we're likely to see a continued positive environment for bonds going forward from here.

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