Market Alert

All Eyes on the Dots: What to Expect from the Fed

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The U.S. Federal Reserve Board's final interest rate announcement of 2016 will also be one of the most scrutinized by investors, especially in light of the surprise U.S. election result. Although the market fully expects Fed Chair Janet Yellen to announce a 25-basis-point increase in the Fed Funds rate to a target range of 50 to 75 basis points (bps), it is the release of the Fed's updated projections for long-term economic growth and interest rates (the "dot plot") that has potential to move the markets.

Here are key factors to consider ahead of the Fed's statement and Chair Yellen's news conference on December 14:

Issue	Key Points to Watch in the Fed Statement and Press Conference
Rate Announcement	• The Fed will likely increase the Fed Funds rate by 25 bps to a target range of 50 to 75 bps in line wi market expectations. • Based on Fed Funds futures, markets expect a 94% chance of a rate hike by 25 bps and a 6% cha a hike by 50 bps.
Basis for a Rate Hike	• The Fed is drawing close to achieving its dual objectives of full employment and 2% inflation. • With the U.S. unemployment rate dropping to 4.6%, its lowest since August 2007, both Fed doves hawks can find support for a hike at the December meeting. • The decline in the unemployment rate to 4.6% has already put it below most Fed policymakers' es of non-inflationary full employment. • The Fed's preferred measure of inflation has also increased to 1.7% compared to 1.4% last year.
The Fed's Economic Forecasts and the 'Trump Factor'	• Since the U.S. election, markets have focused on the growth and inflation impact of President-ele Donald Trump's proposed policies, driving the 10-year Treasury rate higher by about 60 bps and expected inflation to about 2%, compared to 1.4% earlier this year. • Fed policymakers may take a more cautious view about expected growth and inflation, preferring and see the actual policy package passed by Congress before revising their outlook. • Fed policymakers may also be concerned that the rise in longer term interest rates and continued dollar strengthening will slow economic growth well before a fiscal stimulus can be implemented.
The Fed's Dot Plot	• At the Fed's September meeting, the median Fed policymaker expected two rate hikes in 2017 an hikes in both 2018 and 2019. • Based on current swap pricing, markets also expect two rate hikes next year but fewer rate hikes afterwards. • In past quarterly updates, the Fed slowed its expected pace of rate hikes and its forecast of the lo term Fed Funds rate. • Given the uncertain size and design of the fiscal policy package, the Fed may not significantly dow its forecast at its December meeting.
Dovish and Hawkish Factors	• The Fed will need to balance dovish and hawkish factors in setting its expected pace of future rate • A focus on the recent bond market selloff, strengthening U.S. dollar and sluggish labour force participation with disappointing growth in average hourly earnings would be dovish signals for sto bonds but not the U.S. dollar. • In contrast, hawkish signals from the Fed would focus on factors that counterbalance tighter finan conditions, such as higher share prices, lower volatility, a steeper yield curve and reduced credit s • Hawkish Fed policymakers may also wish to signal concerns about the inflation impact of a fiscal s while the economy operates near full employment.
Mackenzie's Asset Allocation Team Views	• We remain tactically underweight bonds relative to stocks, mainly because bond valuations appea stretched than stocks. Stocks also benefit from stronger market sentiment. • We also remain tactically underweight U.S. stocks relative to Canadian stocks, mainly because of valuation. Our indicators of market sentiment also point to a more bullish outlook for Canadian sto • We remain underweight the Canadian dollar given the stronger U.S. growth outlook and increasin divergent central bank policies.

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