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Investment Institute

Weekly perspective on current market sentiment | **August 25, 2021**

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Last week's S&P 500 Index: -0.6%

Tapering

Key takeaways

- We believe the Federal Reserve (Fed) will announce that it will begin removing some of the emergency monetary policies put in place during the pandemic.
- It is likely the Fed will announce that it will begin the bond tapering process at the September monetary policy meeting.

Recently, Wells Fargo Investment Institute released our top 10 risks to fade, follow closely, or fear. Among the risks that clients ask most about is the process of the Federal Reserve beginning to remove some of the emergency monetary policies that were put in place to help the economy weather the rough pandemic seas of 2020. The Fed is currently purchasing a total of $120 billion of Treasury securities and mortgage-backed securities (MBS) in the open market each and every month. The idea is to keep interest rates low and liquidity high. These purchases have been one of the factors keeping the yield on the 10-year Treasury note below 1.5%. The process of reducing the amount of bonds purchased each month by our central bank has come to be known as "tapering."

But, in our opinion, the magnitude of the emergency that led to these Fed actions has been meaningfully reduced. Yes, the delta variant has seen a surge in the U.S. and globally over the last two or three months, but our analysis suggests any lockdown measures likely will be milder than those disrupting economic activity in 2020 and earlier this year. Elevated vaccination rates, particularly in developed countries, should limit the number of severe cases and hospitalizations. Just over 60% of the U.S. population has now been fully vaccinated according to the Centers for Disease Control (CDC), and that number is expected to climb further in coming months, especially in the wake of the Food and Drug Administration's (FDA) approval of the Pfizer vaccine for nonemergency use this week. The Fed is certainly considering the spread of the virus when making monetary decisions, but we believe the economy is on track to deliver strong growth this year and next.

Recent economic data shows the labor market continues to improve, and the recent ISM Purchasing Managers survey notched a record high for the services segment of the U.S. economy. In addition, multiple Fed governors have taken a more hawkish tone in recent media interviews. This combination confirms what the market has expected: An announcement that the tapering process is set to begin will likely come in the near future, possibly as early as the September Federal Open Market Committee (FOMC) meeting of policymakers.

The risk and uncertainty for the financial markets lie in the potential timeline for eventual hikes in the federal funds target rate. The Fed has indicated that the majority of voting Fed members believe rate hikes will not start until 2023, but many market participants think rate hikes could come sooner. At this point, we do not think the Fed will hike rates in 2022.

There is always some risk to the financial markets when the Fed moves from easy-money policies to something less loose. We believe tapering will be a slow process and rate hikes will be quite gradual when they do occur.

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Definitions

An index is unmanaged and not available for direct investment.

Institute for Supply Management (ISM) Manufacturing Index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders and supplier deliveries.

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