August 27, 2020

U.S. Federal Reserve announces updated policy framework, solidifying expectations for ongoing supportive actions

Summary:

- The U.S. Federal Reserve (Fed) announced a highly anticipated update to its monetary policy approach.
- Rather than **target** a 2 percent inflation rate, the Fed will now seek to **average** 2 percent inflation. This will allow inflation to remain above its 2 percent target at some point to make up for past shortfalls and likely extend the time before the Fed will begin raising interest rate targets.
- The Fed also broadened its definition of maximum employment to incorporate a review of labor market conditions across the economy, which also supports expectations for an extended period of low rates even when the job market appears fully healed.
- Today's announcement is consistent with our "glass half-full" view on the path forward.

Federal Reserve (Fed) Chairman Jerome Powell announced an updated monetary policy framework this morning at the annual Fed conference in Jackson Hole, Wyoming. The changes provide flexibility for inflation to remain above-target for some time and the job market to strengthen considerably before the Fed tightens policy via increasing interest rates or removing other supportive policies such as asset purchases. Markets anticipated the substance of today's announcement, but weren't expecting a change until the next Fed meeting in mid-September. This solidifies our view that the Fed will maintain powerful and supportive policy for the foreseeable future and into an economic recovery.

The Fed has historically operated under a mandate of achieving price stability (measured by inflation), maximum employment and moderate long-term interest rates. In the past, if inflation was low but rose to the target level, the Fed would raise interest rates to prevent inflation from moving above target. Today's announcement acknowledges the difficulty in generating adequate inflation (and the significant risks of deflation) and promotes a concept called inflation averaging. Inflation averaging embraces the idea that after long periods where inflation readings have been below target, the Fed should allow inflation to rise and remain above target for some time to make up for past shortfalls. This indicates the Fed will likely keep rates low, even when inflation rises beyond the Fed's reaffirmed 2 percent longer-term target. This policy clarification likely extends the Fed's ongoing economic and market liquidity support. Similarly, today's changes acknowledge the Fed could allow unemployment to fall to very low levels before worrying about inflation implications, reflecting a recent weakening in the relationship between the job market and inflation.

We have long stated the Fed will maintain forceful accommodative policy for an extended period, and today's announcement supports our view. The Fed's target interest rate is likely to remain near zero for years, and its bond buying programs will likely continue to keep borrowing costs low. In upcoming meetings, the Fed maintains additional flexibility in the form of enhanced forward guidance, or indications of the extent and time frame around

policy decisions. This may come in the form of committing to accommodative policy until reaching certain economic data benchmarks, for a certain amount of time, or a combination of both. These announcements would provide further clarity to markets around timing of supportive Fed policies.

We continue to emphasize a glass half-full outlook as we evaluate market conditions and the investment landscape. While respecting the two-sided nature of market uncertainty, in our view the Fed's ongoing policy support and optimism for an eventual virus vaccine and therapeutic slightly outweigh election uncertainty and virus resurgence risks during the back-to-school season. As always, we value your trust and are here to help in any way we can. Please do not hesitate to let us know if we can help address your unique financial situation or be of assistance.