INVESTMENT UPDATE
NEWSLETTER

ALLEN TRUST
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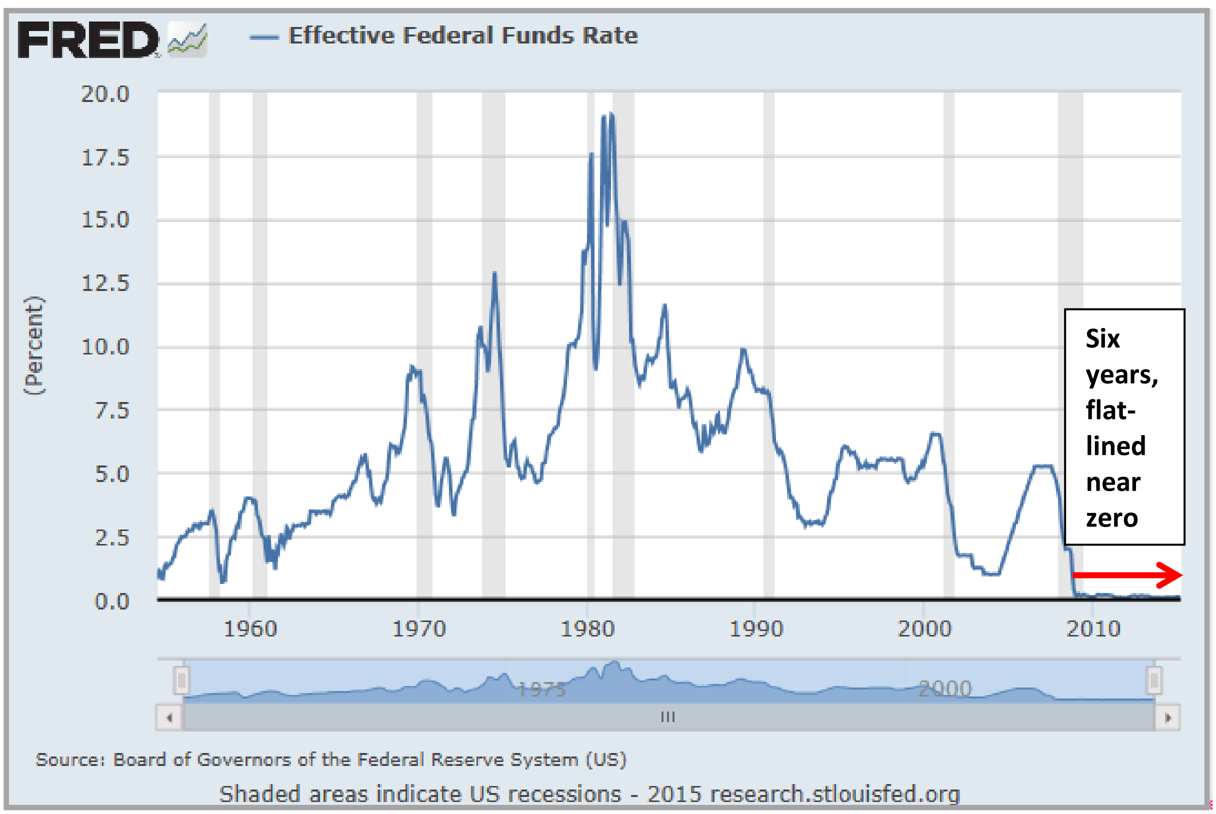
Why 25? Exiting ZIRP may call for 10bp rate hikes

There are few things most everyone in the markets seems to agree on. One is that the US Federal Reserve's exit from zero interest rate policy (ZIRP) will be a tricky business, and we concur. Another is that the Fed will exit by raising rates in 0.25% (25bp) increments. Here, we demur. It has been nearly nine years since the Fed last raised its target range for the Fed Funds Rate; this is the interest rate banks charge each other on overnight loans and it sets the starting point for the entire term structure of interest rates. Moreover, staying flat-lined near *zero* for more than half a decade suggests that from a monetary accommodation standpoint at least, the Fed has been keeping the financial system on life support, no matter the health of the patient (Wall Street at least has been looking quite rosy for years). Foreign policy and market rates at or below zero suggest the US is an outlier only in that its term structure is entirely positive, as contrasted with Germany, Switzerland and other countries where yields have gone negative. While that global rate set may be absurd, it is a reality nonetheless.



Unhooking from life support needn't entail throwing cups of ice water in the patient's face. Perhaps thimbles will do. Choosing a 10bp exit pace could redirect rates toward normalcy – no small thing, symbolically – without kicking the legs out from under the economy or the markets. Indeed, prior to the 1990s, 12.5bp policy moves were not uncommon. So why assume 25bp is now the minimum increment, as everyone seems to be doing? When zero looks like the ceiling for so many countries, the Fed needn't rush when it's been our floor.

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