WELLS FARGO
Investment Institute

TIMELY GUIDANCE
Institute Alert

Timely guidance that may affect your investment strategy **June 17, 2022**

Global Investment Strategy Team

- ☐ Guidance changes
- ☑ **Forecast change**
- ☐ Allocation changes

Updating interest rate targets

Guidance changes

- No changes.

Forecast changes

- Global fixed income: We are raising our target federal funds rate and U.S. Treasury 10- and 30-year yield targets.

Allocation changes

- No changes.

Fed is committed to tackling inflation, even if it brings a hard landing for the economy

The new summary of economic projections and the midpoint target level for the federal funds rate published at the Federal Open Market Committee (FOMC) June 15 meeting highlighted that the Federal Reserve (Fed) is determined to tackle inflation, even at the expense of creating a hard landing, or even a recession for the economy. We believe inflation will remain elevated through the remainder of the year and into 2023, pushing the Fed to further step up its aggressive tightening policies.

The FOMC increased policy rates by 75 basis points (bps; a basis point is 1/100 of a percentage point) at the June meeting, the biggest single increase since calendar year 1994. The new FOMC dot plot of policy-maker expectations now prices a terminal rate of 3.8%, which implies an additional 200 bps in interest rate increases by year-end 2023. It is our belief that the Fed ultimately will increase rates further, even beyond its projection.

The ultimate path of Fed decisions is data dependent. However, if inflation remains elevated as we expect, an aggressive path of rate increases will be necessary if the Fed is going to restore its market credibility and exert control over inflation. Our new base case path for interest rate increases is for the FOMC to raise interest rates by an additional 75 bps in July and September, and by 25 bps in November and December.

Therefore, we are increasing our year-end 2022 federal funds target rate by 100 basis points from our current forecast. Our new year-end 2022 federal funds target rate range is 3.50% – 3.75%. We also expect two additional 25-bps interest rate hikes early next year, increasing our year-end 2023 federal funds target rate to 4.00% – 4.25%.

Table 1. WFII 2022 and 2023 year-end interest rate targets

Fixed income	New 2023 year-end target	Previous 2023 year-end target	New 2022 year-end target	Previous 2022 year-end target
10-year U.S. Treasury yield	2.75%-3.25%	2.50%-3.00%	3.25%-3.75%	3.00%-3.50%
30-year U.S. Treasury yield	2.75%-3.25%	2.50%-3.00%	3.25%-3.75%	3.00%-3.50%
Fed funds rate	4.00%-4.25%	3.25%-3.50%	3.50%-3.75%	2.50%-2.75%

Source: Wells Fargo Investment Institute, June 17, 2022.
Targets are based on certain assumptions and on views of market and economic conditions, which are subject to change.

Higher yields across the yield curve, even as we expect an economic slowdown

We believe U.S Treasury yields will continue to climb as the threat from inflation remains elevated. In our opinion, however, the most damaging fixed-income price movements in intermediate- and longer-term bonds are likely in the rearview mirror. We expect the yield curve to shift higher only gradually toward our targets by year-end. Consequently, we are adjusting our 2022 and 2023 10-year and 30-year U.S. Treasury yield target ranges higher by 25 basis points each.

Risks considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve.. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. Although **Treasuries** are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

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