WEEK IN REVIEW | REINHART FIXED INCOME BY MADISON INVESTMENTS

May 6, 2022

THE FED

The Federal Reserve increased its benchmark interest rate by half a percentage point to a range of 0.75% to 1.0%. Additionally, the Fed announced the plan for reducing the size of its balance sheet. Starting June 1, the Fed will reduce its holdings of Treasuries by $30 billion per month and of mortgage-backed securities by $17.5 billion per month. Starting September 1, the amount of balance sheet reduction will double to $60 billion and $35 billion. Fed Chairman Jerome Powell indicated that future increases of 50 basis points "should be on the table at the next couple of meetings," but that a move of "75 basis points is not something the committee is actively considering."

Our Take: The Fed is in the early stages of its tightening cycle. Current market expectations are for increases of 50 basis points at the next two meetings followed by 25 basis point hikes at the final two meetings of 2022. The Fed's terminal rate, the point at which they stop raising rates, is currently unknown. This is causing very volatile markets.

EMPLOYMENT

Nonfarm payrolls increased by 428,000 jobs in April. The unemployment rate was unchanged at 3.6%. Labor force participation unexpectedly fell from 62.4% to 62.2%. Average hourly earnings rose 0.3% for the month and are up 5.5% year-over-year.

Our Take: The biggest surprise in the employment report was the drop in labor force participation. Higher quit rates, retirements, and individuals leaving jobs to care for family means the U.S. continues to experience a tight labor market. Continued tight labor markets could lead to faster wage growth which in turn could affect inflation. The two likely paths to loosen labor markets, and thus reduce inflation pressure, are increased participation or an economic slowdown.

MUNICIPALS

California lawmakers have estimated that the state's budget surplus could reach $68 billion. Senate Democrats released the recent estimate, which is significantly higher than the $29 billion surplus estimate from January. Governor Gavin Newsom is due to release his latest budget revision by May 15.

Our Take: Amid the pandemic recovery, California has experienced higher-than-expected revenue collections, which has led to the projected surplus. Lawmakers must now determine how to allocate the excess funds. Many lawmakers have compiled spending wish lists, which include additional spending on education, taxpayer rebates, and adding to the reserve funds.

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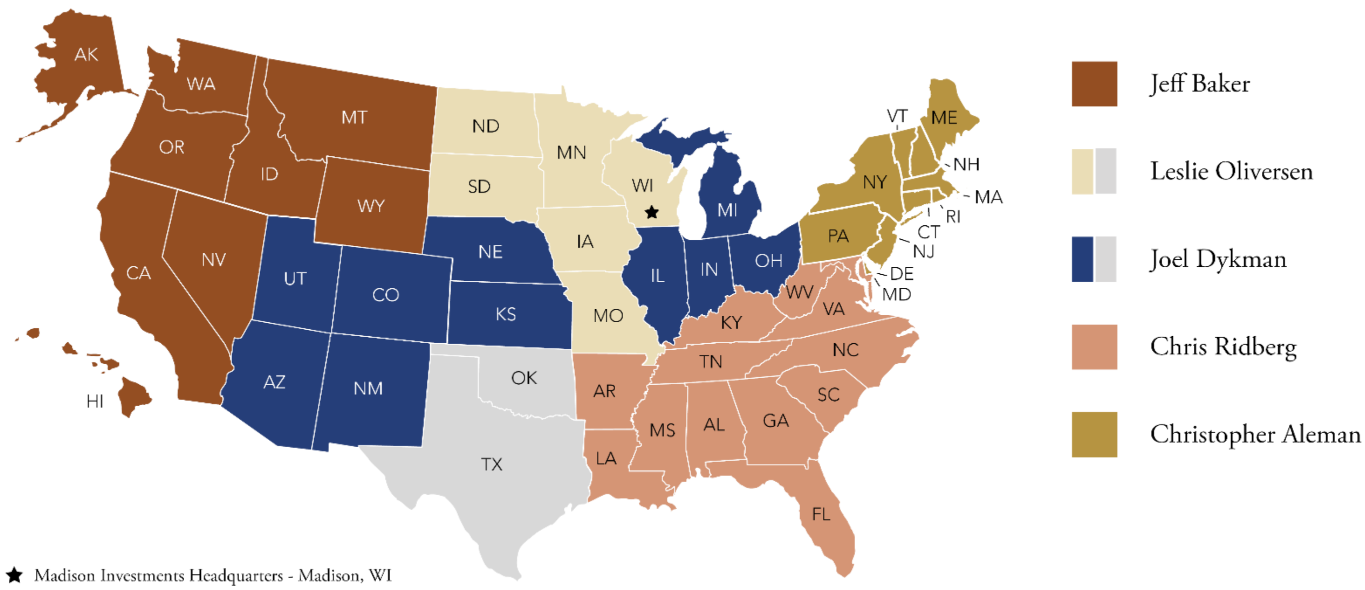

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