WEEK IN REVIEW | REINHART FIXED INCOME BY MADISON INVESTMENTS

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THE FED

As expected, the Federal Reserve (the "Fed") decided to keep the target fed funds rate at 5.25%-5.50%. This is the fifth meeting in a row where the rate remained unchanged. Even the post-meeting statement was largely unchanged from the previous meeting, citing that economic activity has been "expanding at a solid pace," job gains "remained strong" and unemployment "remained low." In his post-meeting remarks, Chairman Powell noted that despite the strong inflation numbers so far this year, "the story is really, essentially, the same." There were some changes, however, in the latest Summary of Economic Projections. Expectations for both inflation and growth are slightly higher in the near term. Also, the dot plot showed several dots drifted higher than previous projections, suggesting a slightly slower path forward on rate normalization. While maintaining the previous outlook for three rate cuts in 2024, the Fed reduced its forecast in 2025 from four to three.

Our Take: Although the projected path of the fed funds rate over the next few years has shifted upward, the Fed remains optimistic about the direction of inflation, viewing the January and February inflation numbers as outliers. Overall, the Fed's message is unchanged. The Fed will be patient and wait for continued improvement in inflation before taking the first steps in cutting rates.

BANK OF JAPAN

The Bank of Japan (BOJ) moved its policy rate from -0.1% to 0%-0.1%, ending the last negative policy rate for a major central bank. The BOJ also ended its explicit yield curve control, which capped 10-year Japanese Government Bond (JGB) yields at 1%. The BOJ's communications did not signal any further tightening, which markets read as dovish, pushing the yen lower.

Our Take: The BOJ is finally moving away from its experiment in extreme monetary stimulus. Recent wage and price data indicate that the BOJ may be behind the curve in normalizing policy. The JGB yield curve is so distorted by BOJ policies that it is not a reliable signal of market expectations for the Japanese economy, but that should improve as the BOJ retreats from its Abenomics policies.

MUNICIPALS

Certain Build America Bond (BAB) issuers, whose taxable municipal bonds came to market over a decade ago, have taken steps to call their taxable issues and refinance in the tax-exempt market at lower rates. Many BAB issues that remain outstanding contain an extraordinary redemption provision (ERP), which allows for the bonds to be called before the due date if a redemption trigger occurs. Recently, some issues have experienced a decrease in the percentage of interest that the federal government pays, and BAB issuers have claimed that this constitutes an ERP, allowing the bonds to be called.

Our Take: Bondholders owning BAB bonds subject to an ERP call may experience losses if the call price is lower than the current market price. Investors have been pushing back on issuers, arguing that the decrease in the percentage of interest that the federal government pays is not substantial enough to trigger an ERP. In some cases, investors have hired lawyers to challenge BAB issuer redemption plans. Many investors will be following these cases closely as there are currently $100 billion of BABs outstanding according to Bloomberg.

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