December 16, 2015

Chandler would like to offer our perspective on the historic interest rate hike that was made today by the Federal Open Market Committee (FOMC).

As widely anticipated, the FOMC increased the fed funds target rate to a range of 0.25%-0.50% from a range of 0.0%-0.25%. It was the first fed funds target rate increase since June 2006. Although the Federal Reserve (Fed) took its first step toward normalizing monetary policy, the tone of the FOMC statement suggests that the pace of additional policy tightening will be slower than historical Fed tightening cycles. Policymakers' median projection for the fed funds rate at the end of 2016 is 1.375%, which implies that the Fed could hike rates three or four times next year (in 25 basis point increments). By 2018, the Fed is forecasting a fed funds rate of around 3.25%. In the longer-run, the target fed funds rate is roughly 3.5%. In our view, the FOMC's fed funds rate projections are somewhat hawkish, even though today's policy statement and Fed Chair Yellen's public comments were mostly dovish. The FOMC emphasized that monetary policy adjustments will be gradual and that the path of the fed funds rate will depend on the economic outlook. Notably, the Fed will continue to reinvest principal payments from its holdings of agency and mortgage-backed securities and will continue rolling over maturing Treasury and Agency bullet securities until normalization of the fed funds rate is well underway. The FOMC is providing more latitude in extending the timeline for reinvesting principal and interest versus prior expectations, implying unconventional monetary policy will stay more accommodative for longer, which supports higher risk assets. Overall, monetary policy remains highly accommodative and the Fed is proceeding with caution as it moves toward a more normalized policy stance. We expect that uncertainty around the timing and pace of additional tightening will continue to fuel financial market volatility next year.

The FOMC cited further improvement in a range of labor market indicators as the rationale for today's rate increase. The FOMC acknowledged that market-based measures of inflation remain low, but they expect improvement as the transitory impact of the decline in energy prices fades. The Fed's dual mandate of full employment and stable prices will continue to steer monetary policy and the path of interest rates. However, the dual mandate presents a challenge given that the improvement in employment continues to outpace the improvement in the inflation outlook. The Fed's median forecast for unemployment in 2016 dropped by 0.1% to 4.7% while the 2016 median forecast for PCE inflation and Core PCE inflation also dropped by 0.1 to 1.6% for both PCE forecasts. Economic theory suggests tighter labor markets leads to higher inflation but the Fed's 2016 forecast goes against the trend. The "Dot Plot", which depicts the FOMC's assessment of appropriate monetary policy, remains above market expectations regarding the terminal federal funds rate at equilibrium, and will likely contract over the medium term.

Since the end of the 3rd quarter, Treasury interest rates moved higher across the curve, but with greater change in shorter maturities, consistent with a "bear flattening" trend. We anticipate that the current trends in interest rates will continue with shorter interest rates remaining under greater pressure to move higher compared to those with longer maturities. For investors dedicated to the fixed income asset class, the move by the Federal Reserve is a welcome development, creating better reinvestment opportunities.

Chandler's investment professionals have managed portfolios through rising interest rate environments in the past and will continue to monitor and analyze the market. We remain confident that our conservative investment philosophy with its emphasis on risk management prepares us to navigate our clients through dynamic market cycles as we have for over 25 years.

Treasury Yield Curve	9/30/15	12/16/15	Change
Two Year	0.63	1.01	0.38
Five Year	1.36	1.75	0.39
Ten Year	2.04	2.30	0.26
Thirty Year	2.85	3.00	0.15

Source: Bloomberg

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