Understanding the Federal Reserve Rate Hike

Frequently Asked Questions

On March 16, 2022, the Federal Reserve (Fed) raised the Fed funds target rate by 25 basis points (bps). In this document, we address frequently asked questions regarding the impact of the Fed's rate hike.

March 2022

Summary of Actions Taken by the Fed

What does the Fed's rate hike mean for the market?

Given wide expectations across the industry for a 25 bps rate hike, the Federal Reserve's 25 bps rate hike did not alter the economic or market outlook of most fund managers or market strategists.

Was the Fed's rate hike expected?

The 25 bps Fed rate hike was anticipated by market participants and generally signaled by policymakers. Fed funds futures were pricing in more than a 100% probability of a 25 bps hike - with anything over 100% implying the chance of the Fed moving 50 bps.

Does First American Funds expect more rate hikes this year?

Fed funds futures are pricing in approximately six more rate hikes in 2022, or a single 25 bps rate hike at each remaining meeting this year. USBAM believes the Fed may ultimately act in a less aggressive path based on expected declines in U.S. growth rates later in 2022, geopolitical risks, Fed aversion to inverting the yield curve, history of high energy and gas prices leading to recession and inflation measures – while still too high – trending lower after peaking in Q1. We expect the Fed to begin shrinking their balance sheet at some point in late-Q2 / early-Q3.

Have an investment goal? Let's talk.

Jim Palmer, CFA
Chief Investment Officer

Jeffrey Plotnik
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What are the factors that can change the Fed's rate policy?

Key factors to watch going forward include developments in Ukraine and eastern Europe, growth rates and inflation rates.

What Do the Fed's Actions Mean for First American Funds?

How does the Fed's rate hike impact money market funds net yields?

We expect MMF net yields to rise in the days following the Fed rate hike.

How long will it take to realize the rate hike in shareholder's yield?

Realization of Fed rate hikes depends on an individual fund's weighted average maturity (WAM), allocation to overnight and other very short investments, fund flows and the steepness of the short-term yield curve. In general, given most fund WAMs are below 30 days we would expect the bulk of any rate hike to be realized within one month, with the majority realized within the first days following the rate hike.

Why do shareholders not see the full rate hike in a fund's yield as soon as the Fed announces the change?

In general, rate hikes take time to be fully realized as fund managers re-invest maturing securities at new higher rates. Specifically for the March 16th rate hike, money market fund (MMF) yields will not fully realize the 25 bps rate hike as MMF will begin recapturing fee waivers initially implemented to ensure fund net yields did not go negative after the Fed pushed policy rates toward 0.00%.

How does the rate environment impact First American Funds' investment strategy?

A rising rate environment offers fund managers the ability to generate higher yields to money fund investors. Fund managers must balance market opportunities between extending WAM by investing in higher-yielding, longer-term debt vs. remaining in very-short instruments and resetting more quickly with each rate hike.

Are there any liquidity concerns in the funds?

First American Funds has no concerns over MMF liquidity.

Are there any purchase or redemption limitations?

By prospectus, First American Funds seeks to honor all redemptions as requested without limitation and First American Funds does not anticipate implementing any purchase limitations. As always, First American Funds appreciates receiving notification of large transactions as early in the trading day as possible for the benefit of all shareholders.

How has recent market volatility affected the funds?

As you would expect, given the nature, design and liquidity of MMFs, recent market volatility and equity market moves have had minimal impact on First American Funds. Fund management is aware of heightened investor concerns and remains focused on the two primary goals of MMFs: stability of principal and maintenance of liquidity. In general, MMFs tend to be more impacted by Fed rate policies.

For any additional questions you may have about First American Funds or the Fed's rate hike, please contact your relationship manager.

Definitions

Basis Point (bps) is one one-hundredths of a percentage point. This term is often used in describing changes in interest rates. For example, if a bond yield increases from 7.50% to 7.88%, it has moved up 38 basis points.