

Path to Higher Interest Rates

September 15, 2014

Introduction to the Federal Reserve and Monetary Policy

Federal Reserve

- Created by Congress in 1913
- Responsible for promoting a sound banking system and driving a healthy economy
- Headed by the Board of Governors, which is led by chairman Janet Yellen
- 12 regional Federal Reserve Banks located around the country

Monetary Policy

- Actions taken by the Fed to influence the amount of money and credit in the U.S. economy
- Interest rates and the performance of the U.S. economy are impacted by changes to the amount of money and credit available

Monetary Policy Tools

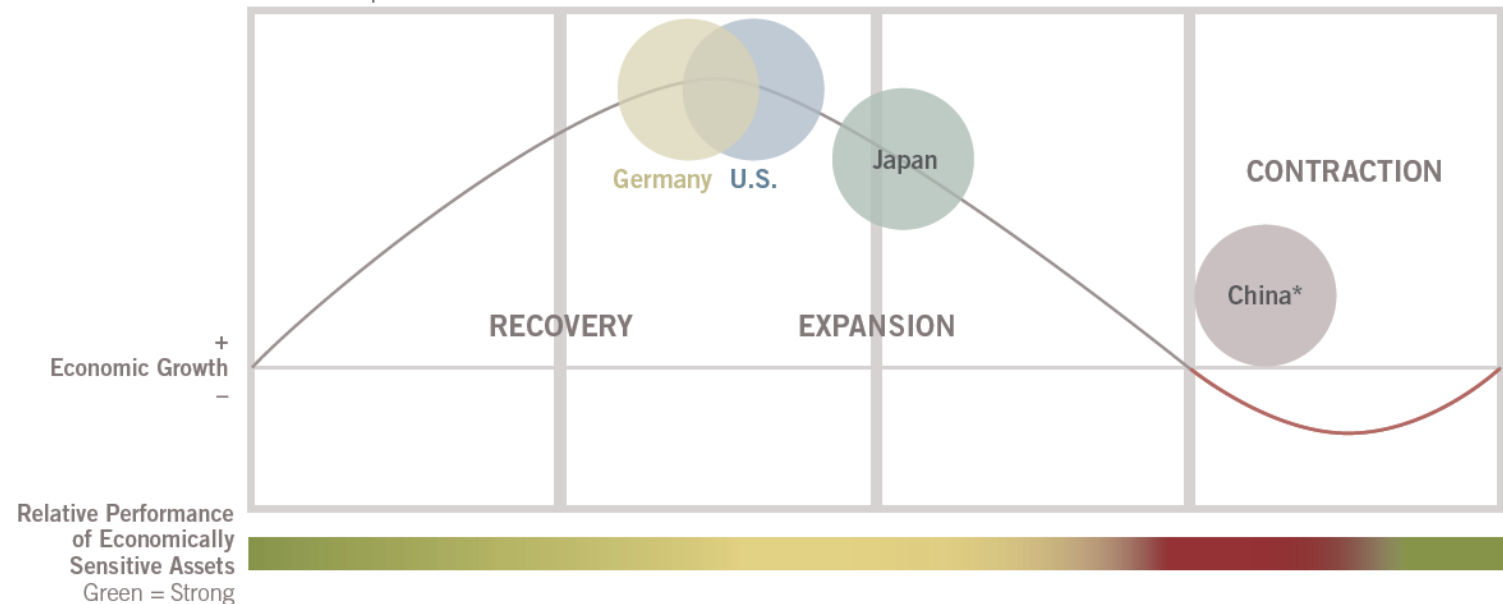
- Open Market Operations
- Reserve Requirements
- Discount Rate (Interest Rates)

US Remains Solidly in Mid-Cycle Expansion

Inflationary Pressures
Red = High

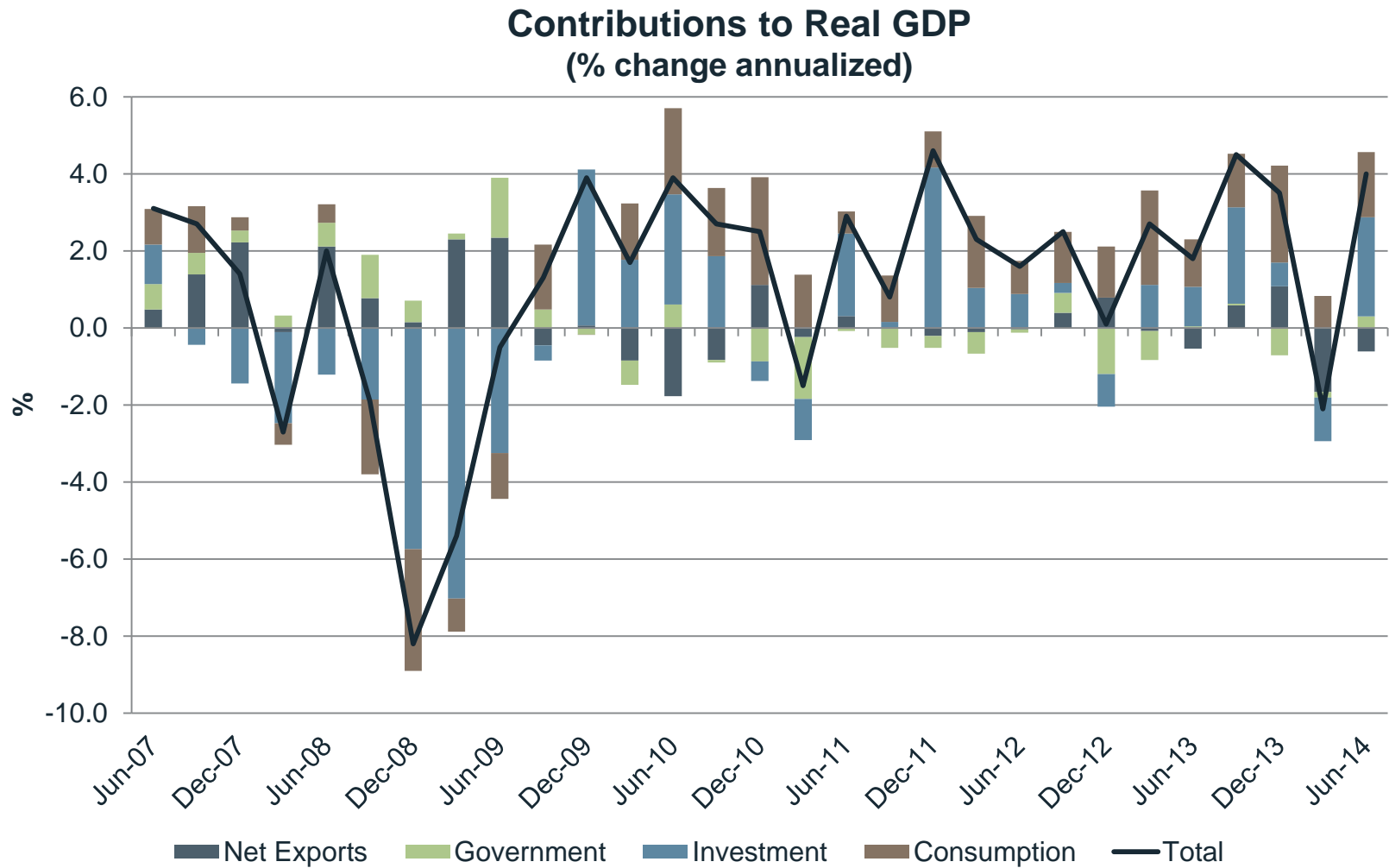
EARLY	MID	LATE	RECESSION
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|---|---|--|---|
| <ul style="list-style-type: none"> • Activity rebounds (GDP, IP, employment, incomes) • Credit begins to grow • Profits grow rapidly • Policy still stimulative • Inventories low; sales improve | <ul style="list-style-type: none"> • Growth peaking • Credit growth strong • Profit growth peaks • Policy neutral • Inventories, sales grow; equilibrium reached | <ul style="list-style-type: none"> • Growth moderating • Credit tightens • Earnings under pressure • Policy contractionary • Inventories grow; sales growth falls | <ul style="list-style-type: none"> • Falling activity • Credit dries up • Profits decline • Policy eases • Inventories, sales fall |
|---|---|--|---|



*For developed economies, we use the classic definition of recession, involving an outright contraction in economic activity. For developing economies, such as China, we have adopted a “growth cycle” definition because they tend to exhibit strong trend performance driven by rapid factor accumulation and increases in productivity, and deviation from trend tends to matter most for asset returns. Source: Fidelity Investments (AART), as of 6/30/14.

Lackluster GDP Growth Despite Historic Fed Policy



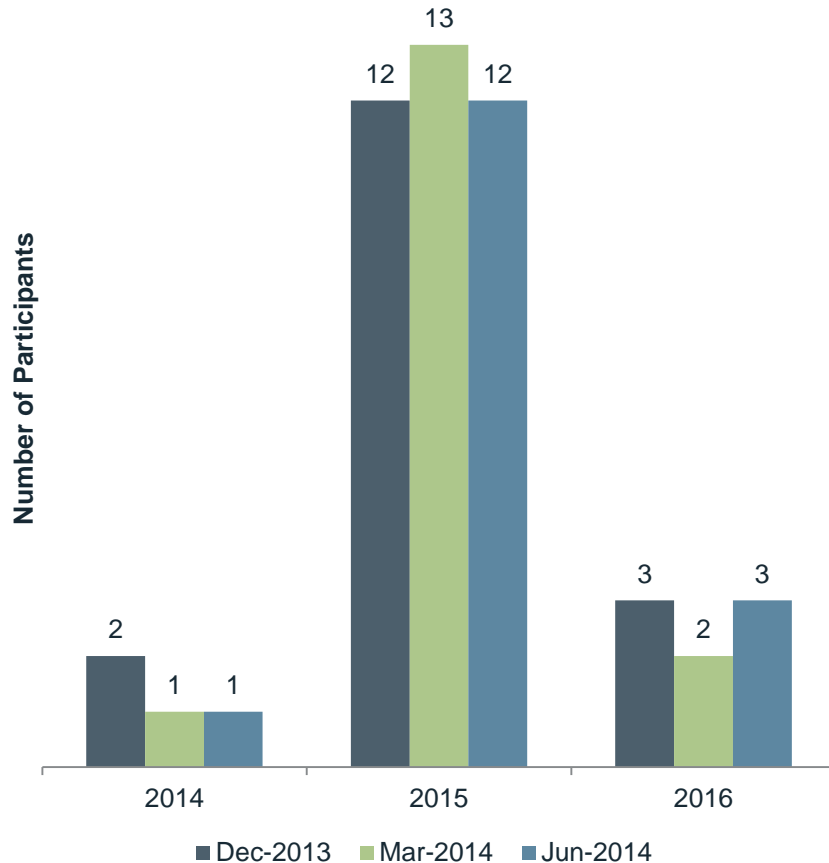
Source: Bureau of Economic Analysis as of 7/30/14
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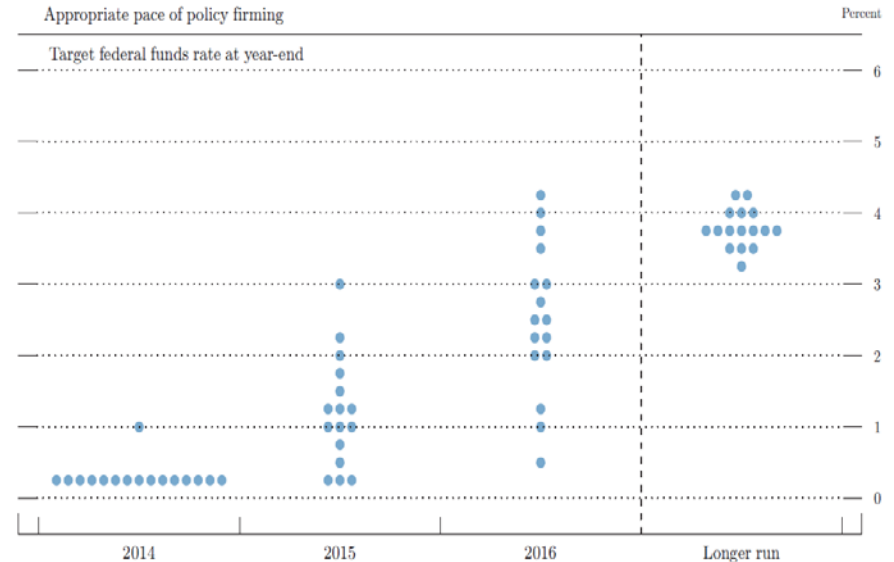
Consensus Builds for a 2015 Rate Hike

Federal Reserve Board Rate Expectations

Appropriate Timing of Policy Firming



Appropriate Pace of Policy Firming
(June 2014)



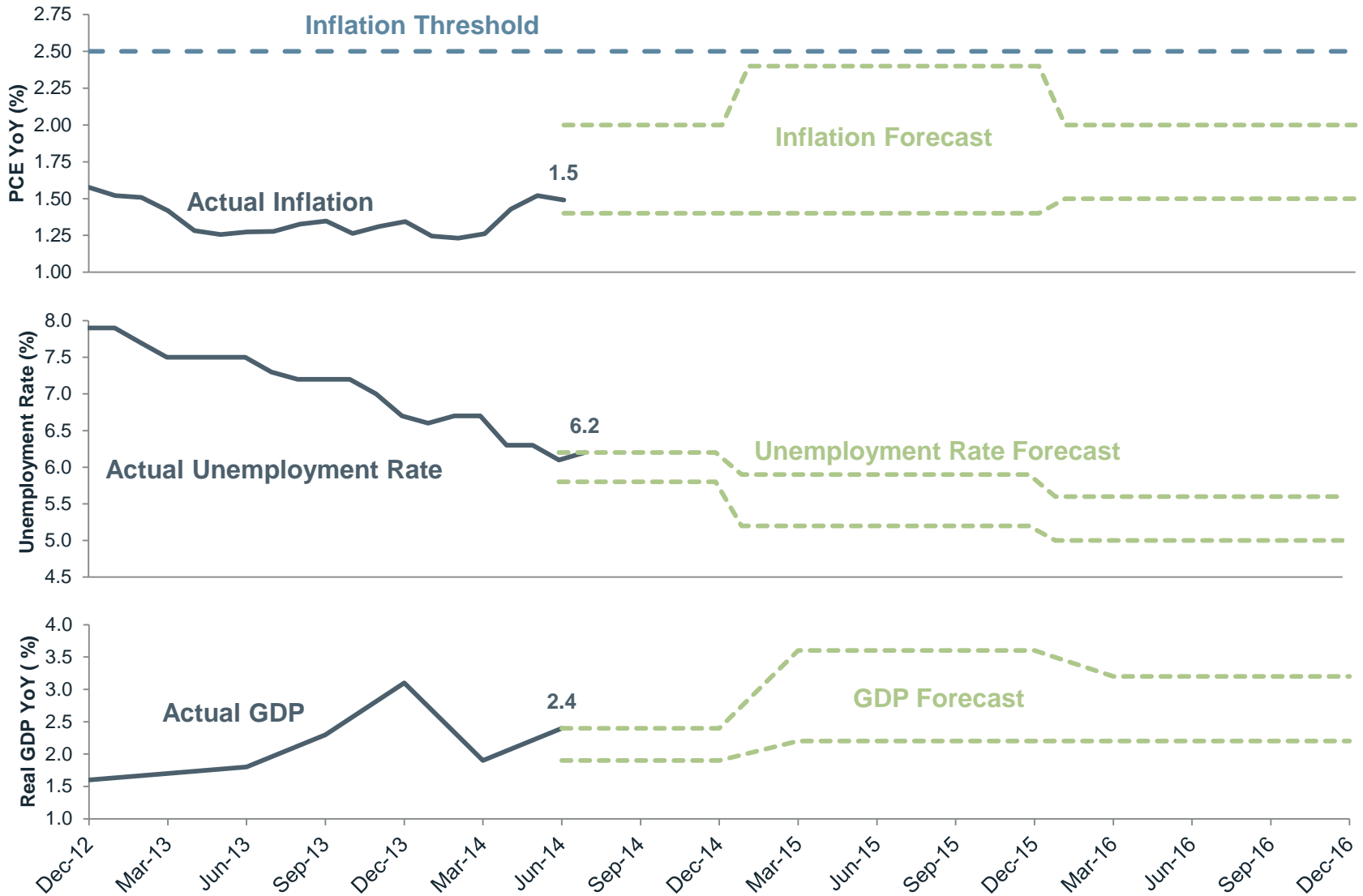
Median Target Fed Funds Rate at Year End

Fed Meeting Date	2015	2016	Longer Run
Jun-2014	1.13	2.50	3.75
Mar-2014	1.00	2.25	4.00

Source: Federal Reserve as of 06/18/2014
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Federal Reserve's Economic Projections



Source: Bloomberg and Federal Reserve
FOMC Forecast as of 06/18/2014

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Market Expectations for First Rate Hike

Forward Fed Funds Futures

