

When the Fed Talks Inflation, Bond Investors Listen

Most recently, you may have read that Federal Reserve Chair Jerome Powell announced a change in how the Fed views inflation. In the past, the Fed said it would consider adjusting short-term rates when inflation approached 2 percent. But in light of 2020's many challenges, the Fed's new policy may allow inflation to run above 2 percent for a period of time before any shift in monetary policy is considered.¹

For many, bonds are a critical component of their overall investment strategy. So any change in Fed policy regarding inflation may influence a portfolio. That's why it's so important to understand that the market value of a bond will fluctuate with changes in interest rates. In other words, when interest rates rise, the value of existing bonds will typically fall.²

There's no doubt this will be a subtle change for many. But for bond investors, the policy shift may indicate that the Fed has given itself more flexibility in the future.

But, what does that mean for the outlook for the bond market as a whole? It's unclear. However, lower levels of unemployment in recent years have not led to higher inflation. This new phenomenon runs counter to the Phillips curve, a concept which states that inflation and unemployment have a stable and inverse relationship. With this data in mind and the changes announced by Chairman Powell, it could be argued that the Fed believes the relationship between unemployment and inflation has changed.³

Keep in mind that if an investor sells a bond before maturity, it may be worth more or less than the initial purchase price. By holding a bond to maturity, an investor will receive the interest payments due plus your original principal, barring default by the issuer. Investments seeking to achieve higher yields also involve a higher degree of risk.

Kind Regards,



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¹ Schwab.com, August 27, 2020

² Asset allocation is an approach to help manage investment risk. Asset allocation does not guarantee against investment loss.

³ Investopedia.com, May 19, 2019