PGIM Sees No-Brainer in Betting Against Another Fed Pivot Trade

- Evidence for easing of US policy is thin: PGIM's Peters
- Fed officials have sought to quash 2023 rate-cut expectations

By Alice Gledhill

(Bloomberg) --

Investors counting on a Federal Reserve pivot any time soon are bound to get burned again, according to PGIM Fixed Income.

"We've seen this movie time and time again," said Greg Peters, co-chief investment officer at the Newark-based firm, in an interview. "The market gets hyped up on different narratives between inflation releases. I've been surprised by it, and we've been using it as an opportunity to sell into."

The firm, which manages assets of $790 billion, sold US Treasuries after a rally earlier this week sparked by speculation the Fed was about to turn more dovish. The market move proved short lived, backing its view that there's still not enough evidence to suggest policy makers will rein in aggressive interest-rate hikes.

The speculation -- fueled by a smaller-than-expected rate hike in Australia -- drove action across global markets in the first two days of this week, driving down two-year Treasury yields by nearly 30 basis points at one point to below 4%.

They've since jumped back up, following better-than-expected US economic data and comments from Fed policy makers Mary Daly and Raphael Bostic that tightening needs to stay in place to curb inflation that remains near a four-decade high.

"The thing that matters is the inflation data," Peters said. There's a risk that inflation slows but prices remain elevated, meaning rates will have to stay higher than people think, he added.

Fed Officials Say That Tackling Inflation Is Their No. 1 Job

The market's focus is now trained on Friday's non-farm payroll data, ahead of inflation numbers in a week's time. Traders are also assessing the impact of OPEC+'s decision to reduce production, which supports oil prices and threatens to stoke inflationary pressures further.

Rose-Colored

A major challenge for central banks is the lag effect of monetary policy, which amps up the risk that central banks go too far. Peters thinks the Fed will keep tightening to 4%-4.5%, from the 3.25% upper bound now.

While Daly warned the anticipation of rate cuts next year is misplaced, markets are still betting on one quarter-point cut next year and two more in 2024. For PGIM Fixed Income, part of Prudential Financial Inc., that could be another opportunity to bet against the herd.

“The market has been way too rose-colored in how it views the central bank’s ability to achieve a soft landing,” Peters said. “At the end of every cycle, the rate ends up being higher than inflation and I think there is a chance of that now.”

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