Archer Financial Services, Inc.

Trading the June Fed Meeting

By Matthew Krupski (June 9)

The U.S. Federal Open Market Committee has a scheduled meeting next week, June 13th and 14th. In addition to any changes in the target fed funds rate, investors will be interested in their Summary of Economic Projections and the press conference given by Chairwoman Yellen. Of key interest will be any clues to how and when the Fed will begin to lighten its balance sheet. These meetings can bring added volatility and unexpected moves in both interest rate products and stock index futures. There are several products that both speculators and hedgers can use to protect themselves or gain market exposure in anticipation of any moves caused by the meeting.

The most straight forward way to trade the Fed meeting is through the Fed Funds future. The Fed Funds contract is a cash product that settles to the average realized Fed Funds rate over the month. The implied rate of the Fed Funds Future can be found by taking the current Fed Funds Futures Price and subtracting it from 100. This morning, the July 2017 Fed Futures were trading at 98.86, giving an implied average Fed Funds Rate for July of 1.14% (100-98.86). Given that the current Federal Funds target rate is between 0.75%-1.00%, you can see that the market expects the Fed to raise the target band by about a quarter point. So while 25 basis point rate hike is already priced into Fed Funds Futures and the front-month futures shouldn't change much, baring a surprise, language in their accompanying statement and subsequent press conference can greatly affect longer dated Fed Funds Futures. The main questions for the Fed will be how many more rate hikes can be expected over the next 6-18 months. As a result, the Fed Funds Futures contracts that are longer dated may have more volatility based on the Fed's projections.

Surprise language from the Fed or deviations from market expectations can have reverberations across other markets, particularly the Stock Indices. The value of government interest rates affects the cost of borrowing for companies and is a large factor in their decisions to invest in their business. Additionally, bonds compete with stocks for capital as investors seek yield. Unexpected changes to interest rates have led to large market moves in the past. Weekly options offer a great way to hedge or speculate in the stock indexes around Fed meetings. In fact, the CME has listed weekly options in the e-mini S&P 500 that expire on Wednesdays. In general, the more time remaining to expiration the more expensive an option becomes, so a Wednesday weekly option that expires the day of the meeting is a great way to lower costs while still gaining the protection or market exposure traders seek on Fed meeting Wednesdays.

Finally, changes to short term interest rates can have consequences across the yield curve. Longer-dated interest rate instruments can be affected by short term interest rate decisions. This month, the CME Group has listed Wednesday Weekly Options in U.S. Treasuries as well. Traders can use options that expire on the day of the FOMC decision to gain exposure or hedge in the 2-year, 5-year, and 10-year notes as well as the 30 year bonds. The addition of Wednesday options has allowed investors greater flexibility to truly customize their portfolios for important FOMC meetings.

As always, remember that futures and options trading is not suitable for all investors. Consult a qualified professional to determine the suitability of any trades for your situation.

My many years of trading futures markets does make a difference. Feel free to call or email me if you have any questions or would like to open an account. Contact me at 312.242.7978 and matthew.krupski@archerfinancials.com.

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