BARRON'S

Yellen Calms the Storm for Now

By Ben Levisohn
February 15, 2014

The new Fed chair, speaking to Congress, emphasized continuity with Bernanke's policies, with low rates continuing.

A blizzard last Thursday forced Federal Reserve Chair Janet Yellen to cancel a second day of testimony on Capitol Hill. The reception to her appearance before Congress last Tuesday, however, was anything but stormy.

On Feb. 11, Yellen delivered her first prepared remarks since taking over as Fed chief from Ben Bernanke. In her testimony she not only emphasized continuity with her predecessor, but delivered it as well, by driving home two points: The Fed would continue to pare its bond purchases but short-term interest rates would remain low well into the future.

On the testimony, the 10-year Treasury yield rose to 2.73%, the highest since Jan. 28.

Yet as much as Yellen stressed continuity, much was different about her first Congressional testimony as Fed chair. Her prepared remarks ran to only five pages, about half Bernanke's typical eight to 12 pages. Yellen also spent an unheard-of six hours taking questions from just about everyone who had one.

But the most striking difference might have been the panel of dissenters that rebutted her testimony immediately after she finished, as if Yellen's remarks were no different than a president's State of the Union address. Stanford University economist John Taylor criticized the Fed for departing from "rules-based policy." The Cato Institute's Mark Calabria blamed the central bank for causing asset prices to rise without creating jobs.

STILL, THESE CRITICS, notes CRT Capitals' David Ader, were "broadly ignored." Indeed, Yellen's performance was widely praised. She dismissed concerns about emerging-market turmoil, which has been widely blamed on Fed tapering, noting that monetary policy is aimed solely at the U.S. She expressed concerns about the weak job market, despite a recent drop in the unemployment rate to 6.6%, near the Fed's 6.5% target. She even engaged in a wonky discussion about whether sluggish hiring was due to secular or cyclical factors.

In fact, many observers came away with the distinct impression that they now know exactly what to expect from the Yellen Fed. "She set the bar high on what it would take to stop tapering, while suggesting that rate hikes are as far away as you thought and it's safe to go out at night," says Kit Juckes, global strategist at Société Générale.

Risky assets around the globe rallied.

AS FOR TREASURIES, the quick pop in yields could either be explained by Yellen being less dovish than investors thought, or, more likely, the fact that investors went into her testimony with healthy positions in government bonds.

Ned Davis Research notes that large speculators had the largest positions in Treasury futures in some nine years. Don't be surprised if 10-year Treasury yields remain between 2.4% and 3%—where they've been since October—until something happens that could make the market once again begin questioning the Fed's monetary policy.

That something could be a break in the weather. Since December, just about every piece of economic data has been skewed by the frigid weather, from lackluster jobs reports to last week's drop in retail sales. For now, bond bulls can insist that it's a fair representation of a weakening economy, while bond bears can dismiss the poor readings as a product of the snow, slush, and wind.

In the latter camp, Brian Rehling, chief fixed-income strategist at Wells Fargo Advisors, recommends taking advantage of still-low Treasury yields to "reposition, especially for those investors who may be overconcentrated in longer-term fixed-income securities." CRT's Ader, however, wouldn't be surprised if Treasurys remain stronger for longer than many expect.

We probably won't know the truth until sometime in March. When we do, the real storm might begin.