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# What The Fed's Stance Means For Stocks & Bonds

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Markets

The Federal Reserve Headquarters in Washington DC on a sunny day. Credit: Getty

Since March 2009, the stock market has surged, largely due to the easy money stance from the U.S. Federal Reserve and other global central banks. A few years ago, the Fed moved away from an ultra-easy money stance and is now "gradually" raising rates. Once again, other global Central Banks followed and they are slowly moving away from their ultra-easy money stance. Just last week, the Fed raised rates by a quarter point and left the door open for more rate hikes in the  future.

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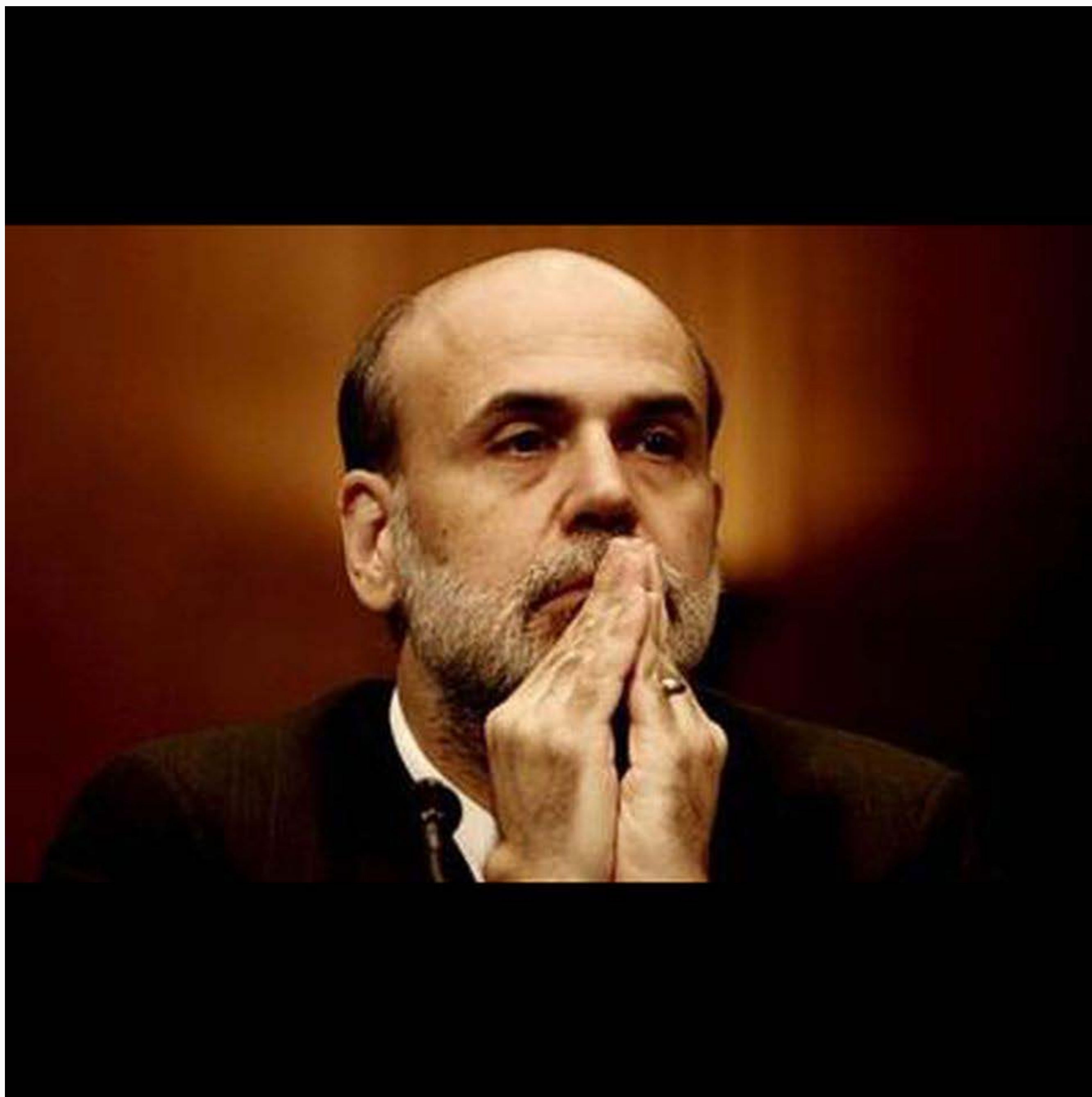

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**Forward Guidance**:

Several times a year, the Fed gives projections for future guidance and right now they are still on the slow and steady rate hike path. Remember, the Fed has a dual mandate: to combat inflation and help keep unemployment low. The good news is the economy is growing nicely and inflation is still not a threat. If the economy gets too hot, or inflation picks up, that will put pressure on the Fed to increase rates at a faster clip. If these events do not occur, then they will be fine and that bodes well for the market.

**What The Pros Are Saying**:

I spoke to Matthew Schmidt Portfolio Manager & Research Analyst at Violich Capital Management with $600 million in assets under management and he brought up a great point about what areas of the market will benefit in this environment. Matthew told me, "Given the direction of interest rate increases, the Federal Reserve has clearly instituted a restrictive period in the US which has historically been correlated with lower average returns for equity markets. Looking under the hood, some of the bigger beneficiaries on average during previous restrictive market periods have been commodities and interest-rate sensitive industries like banks. While investors can't simply look at companies or industries in a vacuum and the direction of Fed actions has been telegraphed for some time, we believe it's prudent to maintain if not tilt toward exposure to these areas."

Arthur F. Hazen Jr, President at Medallion Wealth Management, with $500 million in assets under management, pointed out that even though we have seen a few rate hikes, interest rates are still historically very low - and he is concerned about the yield curve flattening. Arthur told me, "As expected the Federal Reserve raised rates for the third time this year. Rates are now at their highest level since 2008. With another increase later this year likely and talk of three more in 2019 our concern is a continued flattening of the yield curve. Although the economy appears to be running hot an inverted yield often spells trouble. Flat

is not inverted however it appears it won't take much more to get there."

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Seth Meisler, CFA, CPA/PFS, CFP®, Principal and Chief Investment Officer, at Affiance Financial with $610 million in assets under management believes the longer-term outlook for stocks and bonds will be positive from the Fed's stance. Seth told me, "We believe increasing rates may be a positive sign, as it demonstrates the Fed's belief that the economy continues to improve. While in the short-term, rising rates will negatively impact bond prices, the longer-term outlook for bond investors may be positive, due to higher yields going forward. For stocks, the positive outlook for the economy will hopefully translate to increased future earnings, which may offset any decreases in valuation that the rising rates may cause."

**Bullish Fundamental Backdrop:**

The Fed and other central banks are giving investors a bullish fundamental backdrop by keeping rates low and raising at a very slow (i.e. "gradual") pace. Going forward, it is important for investors to watch the yield curve, the economy, and inflation to see if any of these factors will change the Fed's path.

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