After seven long years of zero-interest-rate policy, the ten voting members of the Federal Open Market Committee (FOMC) unanimously decided to raise its key federal funds rate by ¼ point to a new target range of 0.25%–0.50%. The committee's policy statement emphasized that "future rate normalization (increases) will occur gradually" next year. The U.S. Federal Reserve's official new forecasts call for its key interest rate to end 2016 at 1.375%, implying four additional ¼-point rate increases in 2016 from today's new target range. Notably, the policy statement phrase "the timing and the size of future (rate) adjustments" means that the Fed retains flexibility for increases greater than ¼-point, if warranted. The Fed also raised the interest it pays on excess reserves that banks hold at the Fed from 0.25% to 0.5%. Likewise, key banks raised the Prime Rate from 3.25% to 3.5%.

Today's Federal Reserve action begins reducing its still historically-low accommodative interest rate policy. The FOMC embarked on its last tightening cycle in June 2004, with its last increase occurring in June 2006. Following the financial crisis, policymakers steadily lowered rates and moved to a near-zero (0% - 0.25%) rate stance in December 2008.

We identify four main takeaways surrounding the December FOMC policy statement and updated economic forecasts:

- The Fed believes economic activity continues to expand at a moderate pace.
- The Fed's gross domestic product (GDP) growth outlook remains at 2.1% for 2015, while revised higher for 2016 to 2.4% from 2.3%. For 2017 and 2018, the Fed continues to project GDP growth of 2.2% and 2%, respectively.
- In her press conference, regarding the $3 trillion worth of quantitative-easing (QE) monthly-acquired bond holdings,

Fed Chair Janet Yellen said the Fed will keep its balances high until normalization is long under way.

- The Fed believes future rate hikes will be "gradual" and dictated by economic outlook changes and incoming data, as inflation rises toward its 2% target.
- We believe the Federal Reserve's description of gradual future rate increases will be on the light side and stay lower for longer.
- We continue to recommend an allocation to equities in line with long-term investment objectives, and we maintain a somewhat defensive position in fixed income, with an overweight to credit sensitive bonds and a shorter duration. However, with the expectation that interest rates may remain lower for longer, it is possible that there will be fewer headwinds for bonds in the near-term. If that is the case, it may be prudent to start reducing the defensive positioning.

A rate increase also has farther reaching financial implications than simply effect on investment markets. Here is what the rate increase may mean to the rest of your finances:

- Mortgages -- Rates are likely to increase. Some recently polled economists expect the 30-year mortgage rate to rise in 2016. Many adjustable rate mortgages reset periodically, so an increasing variable rate could be dependent on the number of times the Fed raises rates before your periodic reset. It may not be a bad time to revisit your loan if you have not already locked in a long-term fixed rate. Credit card rates are also likely to tick up.
- Car Loans -- Because car loans are generally much smaller than a conventional mortgage, a small rate increase like we have just experienced is not likely to have a material impact

on your cash-flow. If rates continue to increase, this may have an impact on future auto sales.

- Savings -- I would not expect a major shift in savings accounts or CDs at banks just yet. Unless there are further rate increases, I think we can expect more of the same on short & mid term CDs.

I hope this commentary gives you some perspective on yesterday's increase. Please feel free to reach out to me if you have any questions or wish to revisit your financial plan in early 2016.

Happy Holidays,

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Investing involves risks including the potential loss of principal. No strategy can assure success or protects against loss. Past performance is no guarantee of future results.

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