The Chairmanship of Jerome Powell

On November 2, 2017, President Trump announced Jerome H. Powell as his choice to become the 16th Chairman of the Federal Reserve, succeeding Janet Yellen when her four-year term as Fed Chair concludes on February 1, 2018. Assuming Powell is confirmed by the U.S. Senate, the question for investors is what will his chairmanship of the world's leading central bank mean for Wall Street and global markets? To answer this question, let's look at Mr. Powell's background and temperament as an existing member of the Federal Reserve Board of Governors and as a voting member of the Federal Open Market Committee (FOMC) for the past five years.

Who is Jerome Powell?

Fed Chairman nominee Jerome "Jay" Powell, age 64, was appointed to become a Federal Reserve Governor by President Obama in 2012, a somewhat surprising pick given that Powell is a registered Republican. He has a law degree and extensive business and banking background in the private sector, which would make him the first Fed chairperson since the late 1970's to not hold a doctorate degree in economics. Some see this as an impediment on his resume and according to Paul Ashworth, chief U.S. economist at Capital Economics, "not up to the standards we expect of a Fed Chair nominee." Yet others disagree. Mark Gertler, an economics professor at NYU, who worked closely with former Fed Chairman Ben Bernanke, said of Powell "he earned the respect of his peers and I don't see any problem within the economics community."

Before joining the Federal Reserve, Powell was notable for being a bipartisan consensus builder. During President Obama's first term, when Republicans were threatening to default on U.S. government debt by not raising the debt ceiling, Powell, then a visiting scholar at the Bipartisan Policy Center, visited Capitol Hill and urged lawmakers to fully understand the risks of a default on the U.S. economy. Additionally, Wall Street respects him for his reputation of being dovish on monetary policy, as he has not once dissented from any rate decisions since becoming a Fed governor. Stated another way — his views may be seen as a continuation of Ben Bernanke's and Janet Yellen's slow but steady rate normalization policy.

On the other side of the coin, former Fed Chairman Ben Bernanke, in his memoir Courage to Act, said Powell indirectly contributed to the events now known as the "taper tantrum," when bond yields surged in the wake of a suggestion (made by Bernanke himself) that bond purchases would slow "As Jay told me," said Bernanke," we needed an 'off ramp,'" from quantitative easing and zero interest rate policy. Powell himself has since made it clear he's a proponent of the "off ramp," as he voted along with Janet Yellen to begin reducing the size of the Fed's $4.5 trillion balance sheet. In a June speech, Powell also forecast that the Fed balance sheet, which increased to over $4 trillion due to bond purchases, probably would not get below a range of $2.4 trillion to $2.9 trillion. Overall, Bernanke labels Powell as a "moderate and a consensus builder."

Historical Perspective

As Chart 1 illustrates, from a historical perspective dating back to the Federal Reserve's formation in 1914, the Dow Jones Industrial Average has declined, on average, by just 0.3% six months after a new Fed chair assumes leadership.

Chart 1:
Change to the Dow Jones Industrial Average after a New Fed Chair

Fed Chairman	Term Start	Appointed by	DJIA Chang 1 Month	DJIA Change 3 Months	DJIA Change 6 Months
Charles Hamlin	8/10/1914	Woodrow Wilson	0.0%	0.0%	-19.8%
William Harding	8/10/1916	Woodrow Wilson	5.1%	19.1%	-3.4%
Daniel Crissinger	5/1/1923	Warren Harding	0.3%	-9.3%	-10.5%
Roy Young	10/4/1927	Calvin Coolidge	-7.2%	0.9%	7.8%
Eurgene Meyer	9/16/1930	Herbert Hoover	-17.1%	-30.2%	-20.9%
Eugene Black	5/19/1933	Franlin Roosevelt	16.5%	20.3%	23.9%
Marriner Eccles	11/15/1934	Franlin Roosevelt	1.2%	7.5%	15.0%
Thomas McCabe	4/15/1948	Harry Truman	4.6%	4.1%	2.4%
William Martin	4/2/1951	Harry Truman	-2.6%	2.9%	1.2%
Arthur Burns	2/1/1970	Richard Nixon	5.8%	-1.4%	-1.3%
George Miller	3/8/1978	Jimmy Carter	2.5%	14.8%	19.3%
Paul Volcker	8/6/1979	Jimmy Carter	2.1%	-3.5%	3.3%
Alan Greenspan	8/11/1987	Ronald Reagan	-3.9%	-29.1%	-28.6%
Ben Bernanke	2/1/2006	George W. Bush	0.6%	4.1%	2.2%
Janet Yellen	2/1/2014	Barack Obama	4.4%	5.2%	5.1%
Jerome Powell ?		Donald Trump			
		Average Change	0.8%	0.4%	-0.3%

Source: Tower Square Investment Management, FactSet

The Senate's stated goal is to confirm Jerome Powell as Federal Reserve Chair by the end of the year. Powell may face a challenge before the politically-divided Senate Banking Committee and, after that, a full Senate vote on his nomination. President Trump noted Powell was supported by senators on both sides of the aisle when he was confirmed as Fed governor in 2012 and again in 2014, so there is a chance that there will be little opposition to his nomination.

Reaction to Nomination

In a statement, the American Bankers Association welcomed Powell's nomination and said he has "demonstrated a keen understanding of the important relationship between monetary policy and sound regulatory policy, and how the two can work together to reinforce economic growth."

While volatility increased on uncertainty ahead of Powell's nomination, there has not been much market reaction afterwards, signaling investors think Powell will continue Yellen's slow pace of rate increases and have a lighter touch on regulation. In a short statement, Janet Yellen congratulated Powell and said she was "confident in his deep commitment to carrying out the vital public mission of the Federal Reserve." She also pledged to work with the new Fed Chair to ensure a smooth transition, but has so far refrained from saying whether she would stay on at the Fed after her term as Chair expires, as her seat on the Board of Governor lasts until 2024.

Summary and Investment Implications

In summary, we believe that a Jerome Powell-led Federal Reserve would not take a large step away from present policy views under Fed Chair Janet Yellen and likely represents policy continuity for global markets. In fact, during a recent speech to a banking conference, Powell discussed how emerging markets would react to Fed policy normalization saying, "One factor that favors easier adjustment in emerging-market economies is that U.S. monetary policy normalization has been and should continue to be gradual, as long as the U.S. economy evolves roughly as expected." Therefore, consistent with our view of continued U.S. economic improvement, we believe that Fed policy will remain on the path of slow and steady wind down of monetary accommodation.

With this in mind, we stick to our forward-looking recommendations expressed recently in our Fourth Quarter TowerView outlook report titled "Markets Continue Positive Trajectory." Among our views on fixed income, we reiterate the importance of being underweight duration-sensitive bonds, such as mortgages and Treasuries, since the reward (yield) is low relative to the risk (duration) of these bonds. Additionally, exposures to higher-grade bonds serve to buffer against equity volatility. Lastly, we urge investors to broadly diversify among asset classes and mitigate unforeseen volatility by retaining an allocation to alternative investments which have low correlations to traditional investments

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Glossary

*The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.*

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