NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

Four More Years...Of Zero Rates

We're back. As we suggested, just before we went on vacation, we are moving to a new distribution format. We plan to share our thoughts no less than twice a month or as markets warrant. We are also re-branding our note entitled, "PCG Capital Market Chronicle." If you wish to hear from us more frequently, just pick up a phone or send us an email. We are always eager to discuss our views.

On Wednesday, the Federal Reserve Open Market Committee (FOMC) announced the results of the two-day September FOMC Meeting. This was the last FOMC meeting before the U.S. presidential election on Nov. 3. While it was widely anticipated that no change would be made to the overnight borrowing rate, investors were keenly focused on the Fed's Summary of Economic Projections, or SEP. Four times a year, the FOMC provides investors projections for GDP growth, the unemployment rate, inflation, and the appropriate overnight borrowing rate (Fed Funds). The summary also provides insight into policymakers' views regarding the uncertainty and risks attaining their outlook. The projections give expectations on what Fed Governors believe will most likely prevail in the current year, the subsequent two years, and over the longer run. According to the September SEP, investors should expect rates to be on hold until at least 2023, **implying four calendar years of the Fed Funds Rate of no higher than 0.1%.** Also, policymakers expect GDP growth of negative 3.7% in 2020, compared to negative 6.5% as of the last SEP release in June, then a growth rate of 4.0% and 3.0%, in 2021 and 2022, respectively. Further, the full-year 2020 unemployment rate is expected to fall to 7.6%, from 8.4% currently, and down from June's SEP projection of 9.3%. By year-end 2022, the Fed expects unemployment of only 4.6%, trending toward their long-term expectations of 4% by 2023. Inflation is also expected to tick modestly higher than previously projected, up by 1.5% compared to 1.0% back in June. **After all – that is the entire purpose of this ZIRP (zero interest rate environment), right?** Well, following the 2 pm release of the news, equity markets initially rallied over 0.6%. However, at roughly 2:40 pm, the S&P 500 began to sell off, losing over 1.2% through the remainder of the trading day. At the same time, the 10Yr Treasury initially found a bid, but also sold off through the rest of the day as well, closing at close to 0.70bps, the highest yield levels in almost a week.

What's Our Take: While the price action in both bonds and stocks didn't suggest too much at first glance, we found it interesting that both asset classes sold off by the end of the day. We think the back-up in yields (lower prices for bonds) and the sell-off in equities occurred just as Chair Powell conveyed his confidence that the Fed will meet its inflation expectation of 2.0%. And in fact, Chair Powell suggested an accommodative environment for rates to trend "moderately above 2% for some time, so that inflation averages 2% over time." **This implies inflation could run as hot as 4% before the Fed steps in.** Simultaneously, the SEP suggested better than previously forecasted economic conditions (unemployment/GDP) while the prospects of a therapeutic or vaccination in the coming weeks are gaining traction. So perhaps equity investors think that equity risk premiums and negative real rates have bottomed. **So our position is that while on the surface, the Fed delivered a dovish release, markets are already looking toward potential hawkish undercurrents.**

Moving forward, with only 46 days until the election, we continue to position client portfolios, in general, for more volatility, increased policy uncertainty, and the negative impact from a contested election. Capital markets do not like uncertainty. So while forward multiples are down from early September highs of 23x (+3 standard deviations), they remain elevated at 22x on a forward 12-month basis. Said differently, stocks remain rich.

We'd love to hear your thoughts.

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