Newsletter

State of the Economy March 2015

It's March Madness time, and while many focus their attention on college basketball, American and foreign investors concentrate on what the Central Bank will do next. For investors, the Federal Reserve's decision on when to raise interest rates is as hot of a topic as whether Kentucky will remain undefeated throughout the Tournament. At this point, both answers seem to be anyone's guess.

The buzz surrounding the anticipated moves by the Fed appears to increase with each monthly press conference. It is difficult to deny the amount of influence the Fed's prior decisions had on the global market and economy over this past decade. The various bond-buying programs put into place after the financial collapse ended in the 2009, helped drive down interest rates and forced investors into buying riskier assets. As an asset class, stocks have particularly benefitted from lower interest rates, and have surpassed their all-time highs set in 2007. The Fed was the catalyst for this recovery; the largest so far in stock market history. Now, 6 years after the financial crisis, the Federal Reserve is destined to change their course. After ending their latest quantitative easing program in October 2014, the Fed also acknowledged their plan to start raising interest rates from near zero.

When Fed Chairman Janet Yellen spoke last Wednesday, the world economy focused on every word of her press conference. The goal was to find any indication of how the most powerful bank in the world would act moving forward. By the end of that trading day, investors overwhelmingly turned from terrified to jubilant. This was evidenced by the highest one-day bump in the market since January. Nevertheless, the dollar had one of its biggest declines in months that same day. So, what did we actually learn from Yellen's press conference? What does the value of the dollar have to do with the Fed's decision? It seems the barriers to raising rates are still pretty high at the present time. The Federal Reserve removed the word "patient" from their report but indicated they were not going to be impatient ether. The Fed is looking to see an increase in inflation before raising rates. Inflation has declined in light of the continuing appreciation of the dollar. Overall, it looks like the expected rate hike set for June has now been pushed back and the stock market and it's investors could not be happier.

The economic news pertaining to the US has been mixed in recent months. The bright lights seem to particularly be shining on the labor market and the banking industry. The latest jobs report surpassed industry estimates by 60,000, causing a dip in the unemployment rate to 5.5%. As the job market continues to improve from the collapse, the big banks have also benefitted. The 31 largest US banks all passed the Federal Reserve's annual stress test in March, for the first time since testing began in 2009. The big banks are well capitalized and appear better prepared for distressed economic conditions. However, production is down. Last Wednesday, the Fed highlighted this point stating that growth has moderated somewhat. Several economists lowered their estimates of GDP growth for the first quarter, citing weak trade and car sales. Additionally, the value of the dollar continues to hurt exports. The importance of these numbers cannot be understated, as productivity is the ultimate source of a rising standard of living.

The tide towards easy money is going in the opposite direction with American's counterparts abroad. The European Central Bank listed the terms of its long-awaited bond buying program, which consists of purchases totaling 60 billion euros per month. The People's Bank of China followed suit by becoming the last of 20-odd central banks to cut rates this year. China lowered its growth target to around 7% in early March, which is the lowest rate it experienced in two decades. As monetary policies around the world help spur growth abroad, the strength of the dollar continues to rise. The Euro reached a 12-year low earlier in March, and foreign bond yields are tumbling.

The current state of the economy represents a perfect example of why you need to be diversified globally in your retirement portfolio. Investors tend to compare the performance of their retirement account to the S&P 500 but that is not the right comparison. As we have seen, markets move in cycles. If you only invested in US Large Cap stocks over the last 5 years you would have outperformed the International market every year but one. However, it now appears that having equity exposure outside the United States, specifically in Europe, would be extremely beneficial. The impact of Europe's bond-buying program should be comparable to what occurred in the US the past few years. Current conditions are also benefiting European companies, and should make European stocks attractive. A weaker euro is enhancing exports and cheaper oil is helping manufacturing. Little wonder why euro-zone consumer confidence has been rising lately, particularly in Germany, where the latest retail sales figures were surprisingly high.

When reviewing your long-term strategy, don't be pigeonholed into only investing in the United States. The world has so much to offer.

Sincerely,

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