MARKET COMMENTARY – OCTOBER 1, 2015

Will-o'-the-Wisps
OR
Yellen-o'-the-Rates

Will-o'-the-Wisps have gone by many different names in countries across the world. They've been called friar's lanterns, ghost lights, fairy fire, or pixie lights to name a few. Even the familiar phrase jack-o'-lantern has its origins in these strange, deceptive phenomena that folklore tells us lead nighttime wayfarers astray. The reality is less exciting in that minute pockets of swamp gas combust over forest bogs in an event called ignis fatuus.

Janet Yellen's Federal Reserve is the latest incarnation of these deluding little creatures that lead unsuspecting children into the wilderness. After telegraphing for months that a rate hike was in store for September, her committee decided to hold steady. Yellen's explanatory speech did nothing to help matters, creating more fog and murk where in the days leading up to it had been bright sunshine.

Yet, despite holding the zero interest rate policy, markets actually experienced all the bad effects of a phantom rate hike with none of the benefits of an actual rate increase.

Let us explain. Negative market volatility increased markedly beginning in August. It slowed in September, but resumed with a vengeance after Yellen's remarks. Much of this volatility has its origins in her phantom hike. Market rates had climbed modestly in anticipation of the hike. Higher interest rates caused the dollar to surge. A high dollar was finally felt in China in August when they were forced to devalue the CNY. The higher dollar also means lower profits for international companies. That's the bad.

But what good could come from hikes? First, in our minds, the Fed missed a golden opportunity to raise rates for free! Market interest rates had already ticked up. Markets had already been volatile in the month leading up to the Fed meeting. Stocks had sold off. The harm was done. Had they raised rates just 0.25% and remained flexibly vigilant in their policy stance, market participants would have gained trust. Trust is now gone and all the damage may have to be replayed.

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We are advocates for Fed tightening, not because we think that the economy is over-heating or because we like to harm stock prices, but because we have been in an easing mode for years. When real trouble in the form of a recession does come, we have little left in the toolbox except more quantitative easing. One or two slight rate hikes today store up ammunition to fight future battles. Certainly our economy can withstand short term rates at 1% or less! Savers would mightily appreciate the gesture. An increase would also have given the marketplace trust in Yellen – that she will do what is necessary and not change broad policy based on the daily vagaries in stock prices.

Alas, Ms. Yellen did not consult us.

Looking forward into October we see hazards. Earnings season begins the week of the 5th with big companies like Pepsico and Yum Brands reporting early. Weeks ago we thought the dollar might settle and growth may remain slow, but steady, helping earnings level. However, recent pullbacks in Chinese economic activity and a still-strong dollar may prove to be headwinds this quarter.

The oil and commodity slowdown appears that it will persist. This glut is good for consumers, but deflationary for those employees and companies in the industry.

Still companies remain strong. Balance sheets, overall, are not as solid as they were a couple years ago, but corporations continue to run lean in their operations. Before the effects of the strong dollar, many outside the oil patch are still compiling revenue growth. Valuations, even with lowered earnings expectations, are fair.

Finally, the Fed has two more meetings to go in 2015. Will Yellen continue to be a Will-o'-the-Wisp? Or, will she choose to be a lighthouse, guiding the market's ships to safety?

Stirling Bridge Wealth Partners, LLC remains committed to providing customized investment solutions and robust financial planning wrapped in an exceptional service package for our high net worth clients throughout the country. We thank each of you for your dedication to us, for your trust, and for the referrals you've sent.

Sincerely

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