Market Summary – March 20, 2017

For the week ending March 17

This summary is provided by BMT Wealth Management.

Twice in Three Months, And More to Come

The Federal Reserve (the Fed) held its second scheduled meeting of 2017 last Tuesday and Wednesday (March 14-15). As was widely anticipated, the Federal Open Market Committee bumped interest rates higher by 25 basis points (+0.25%), to a new targeted range of 0.75% to 1.00%.

This was the second time in the past three months that the Fed has increased rates, having also done so at its December 2016 meeting.

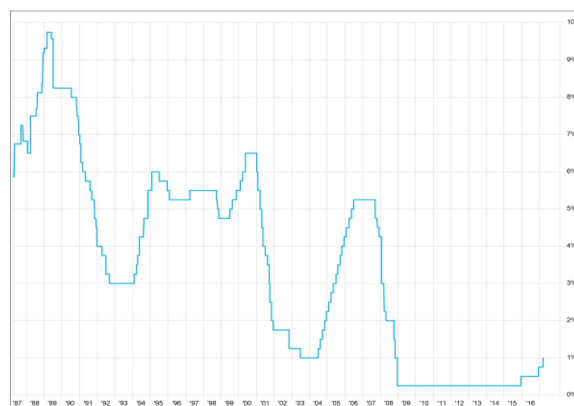
The aggregate rate increase over the last 91 days stands at 0.50%. While that may not sound like much, it is clearly a sea change from the recent past. Further, the Fed continues to expect two more rate increases over the balance of 2017, and three additional increases in 2018.

To put this recent flurry of actual and expected activity into context, one need only look at the history of the federal funds rate, which was held constant – at near zero – for roughly seven years.

The chart below details the upper range of the federal funds target over the past 30 years. The move to near-zero rates was initiated by then-Fed Chairman Ben Bernanke in December 2008, in the depths of the financial crisis (later dubbed the Great Recession), when the federal funds target range was cut to 0% to 0.25%. The rate was held at that level for the balance of Mr. Bernanke's term.

Janet Yellen continued that policy from the time she was named Fed Chairwoman in February 2014, until late 2015, when the federal funds rate was finally increased to a range of 0.25% to 0.50%.

Federal Funds Target – Upper Range
30 Years: 1987 – 2017



Source: FactSet, Inc.

During the time of near-zero rates, the Fed also expanded its balance sheet to $4.5 trillion, through the purchase of Treasury and mortgage agency securities. This was done in an attempt to keep longer-term interest rates low, as the economy healed from the financial crisis.

At last Wednesday's (March 15) press conference, Ms. Yellen indicated that there are no current plans to unwind the positions of debt securities. While that may be the case, the recent steps indicate the Fed is now clearly in a mode of moving toward a more normalized Fed policy.

Equities

The stock market took the Fed's rate decision in stride and ended last week with modest gains, as the S&P 500 advanced 0.28%. For the year, the S&P has moved higher by 6.72%.

Interestingly, despite all the talk about bad trade deals with foreign countries, international stocks are outperforming in 2017. The MSCI EAFE Index of developed international equities has posted a year-to-date return of 7.29%. Emerging markets equities have done even better, with the MSCI EM Index up 12.18% since the start of the year.

Fixed Income

Last week was volatile in the credit markets, as evidenced by the yield on the 10-year U.S. Treasury bond, which started the week at 2.58%. Yields ticked higher on Monday (March 13) and finished the day at 2.61%, a rate last seen in September 2014.

Then, in the wake of the Fed announcement on Wednesday (March 15), rates plunged more than 10 basis points (-0.10%), as bond traders clearly viewed the recent increase in rates as overdone.

The 10-year U.S. Treasury bond largely marked time for the balance of the week, to finish at 2.50%.

Our View

With the Federal Reserve now in a tightening mode, albeit from low levels, the backdrop for financial assets is undoubtedly changing.

To date, the rate hikes have arguably had little impact on the economy, which continues to grow at a slow and steady pace. Bond prices, on the other hand, have been greatly impacted, as evidenced by the volatile trading this past week.

With two weeks left in the first quarter, earnings season will soon be in full swing. As these reports are issued, they will provide important evidence as to how corporations are performing in the changing interest rate and political environment.

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