Investment *Insight*

2018

First Quarter

Legacy Wealth Management®

The Federal Reserve (the Fed) just had its first meeting under the guidance of its new chairman, Jerome Powell. You will recall that the Fed influences short-term interest rates in the market to achieve the "dual mandate" set for them by Congress to maintain price stability (a stable inflation rate) and maximize employment. When the economy was in decline during 2008-2009, the Fed basically took short-term rates to 0%. Now that the economy is recovering nicely, they have been removing their accommodative policy by raising short-term rates slowly over time in small 0.25% increments, bringing their overnight lending rate target up to a range of 1.50-1.75%.

The fact that the Fed is raising interest rates indicates their conclusion that the economy is strong and growing stronger. The *Wall Street Journal* stated, "Fed officials justified their interest rate rise on steady job market gains and their ongoing expectations that weak inflation will soon return to their 2% inflation target." As we have stated in past issues of Legacy's *Investment Insight*, unemployment is low (4.1%) and is expected to continue lower, wages are expected to gradually move higher, and consumer confidence is very strong as a result. Fed officials also forecast better economic growth going forward than previously thought based in part on the recent tax cuts and increased government spending.

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The stock market likes predictability from the Fed and was reassured when the Fed said they would keep plans in place to raise rates three times in 2018. The market decline in February was in part a result of fears of higher-than-expected inflation. We have seen similar market volatility in recent days as the markets expressed their concern over President Trump's announcement of increased tariffs on several products from China, most notably steel and aluminum. The effect of increased tariffs and a potential trade war is an increase in inflation. If steel prices rise because of the tariffs, then those increased costs flow all the way through to the end products made with that more expensive steel. However, it is estimated by most economists that the impact would not lead to significant price increases for consumers.

Market fears about *unpredictable* inflation and *unpredictable* rises in interest rates will lead to continued volatility in the markets, but volatility is normal. Market volatility last year was almost nonexistent, which was certainly nice but not at all normal! As long as inflation stays near the Fed's 2% target rate, then we believe the Fed will continue with its predictable small increases in short-term interest rates. Long-term growth trends in the U.S. and world economies should continue to be supportive of rising stock markets, so don't let the normal bumps in the road knock you off course.

This First Quarter *Investment Insight* has been written by Legacy's Managing Director Duncan Miller.

Source: Derby, Michael. Wall Street Journal, March 21, 2018