The Federal Reserve Remains Patient

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"Ms. Patience"

The minutes to the Federal Reserve's January 27-28 Federal Open Market Committee (FOMC) meeting indicated a willingness to keep the lower bound of the Federal Funds rate at 0% for a longer period of time. The minutes also revealed a growing uneasiness of the US dollar's strength because it would act as a restraint on the US economy.

The Federal funds rate has now been at 0% since December of 2008. Since that time, the US economy has posted 20 consecutive quarters of positive growth. The unemployment rate has fallen from a peak of 10.0% to 5.7%. US car sales have risen from an annualized rate of 10.2 million to 16.6 million. The S&P 500 Index has gained 156.6% and 10-yr Treasury yields have fallen from 2.7% to 2.1%. Inflation, as measured by the core Personal Consumption Expenditures (PCE), has ranged from a high of 2.00% to a low of 0.95% with a December reading of 1.30%.

There are plenty of indicators that argue for the Federal Reserve to begin normalizing rates.

The picture of the US economy, illustrated above with a robust equity market and very strong car sales, begs the question of why is the Federal Reserve being so *patient* in taking the first step to normalize interest rates? We all know that former Fed Chairman Ben Bernanke was given the moniker of "*helicopter Ben*" for his willingness to ease monetary policy aggressively in order to defeat deflation. His predecessor, Fed Chairman Alan Greenspan was known for the "*Greenspan Put*" for keeping interest rates low to encourage growth in the stock market. The current Fed Chairman, Janet Yellen may be known as "Ms. Patience" for her willingness to maintain the Fed's 0% interest rate policy so as not to roil financial markets.

The Federal Reserve is now in its 6th year of maintaining 0% interest rates - the longest period of time where the Federal funds rate has been unchanged. Nearly everyone seems to expect that once the Federal Reserve begins to move the Federal funds rate higher, it will mark the end of demand for risk assets. In particular, for stocks that have done so well during this period of time. This is not our view as we expect that the Federal Reserve will exhibit a great deal of patience once it begins to raise interest rates in order to make sure that the markets have been able to absorb the change in rates.

Fed Chairman Janet Yellen will testify before Congress and the Senate next week to update them on the state of the current monetary policy and the economy. It is unlikely that her testimony will reveal any change in the Federal Reserve's view of the economy or monetary policy that would be inconsistent with the release of the most recent minutes.

Investors should exhibit the same amount of patience as the Federal Reserve before materially reducing exposure to equities. A positive backdrop for recommending risk assets is the strengthening of the US consumer. Walmart announced that it would increase pay for 500,000 of its hourly workers to at least $9.00/hour by this April, followed by an increase to $10/hour by next February. Walmart's willingness to increase pay to its workers may be an early sign that wage pressures are beginning to surface. If so, then the consumer will have plenty of spending power to support the US economy moving forward.

Consumer discretionary stocks, banks and technology stocks should all benefit from a pick up in consumer spending. Banks would benefit from an increase in loan demand, especially from lower quality borrowers.

In the fixed income market, we would focus on the high yield sector as a source of attractive incremental yield.