

# What The Fed Was Watching...



***... While You Were at the Beach***

**Webinar for Interactive Brokers Clients**  
Tuesday, September 19, 2017 at 12pm



## 1. What's Changed?

- Economic Data
- Fed Messaging
- Other Central Banks

## 2. Three Scenarios

- *Calm Seas...* No Hike / No Taper
- *Gentle Breeze...* Rates Steady and a Plan to Taper
- *Surf's Up...* Dual Plan for Rates and Assets

## 3. Have We Been Here Before?

- Yes and No
- Previous Rate Hike Examples
- Lessons Learned

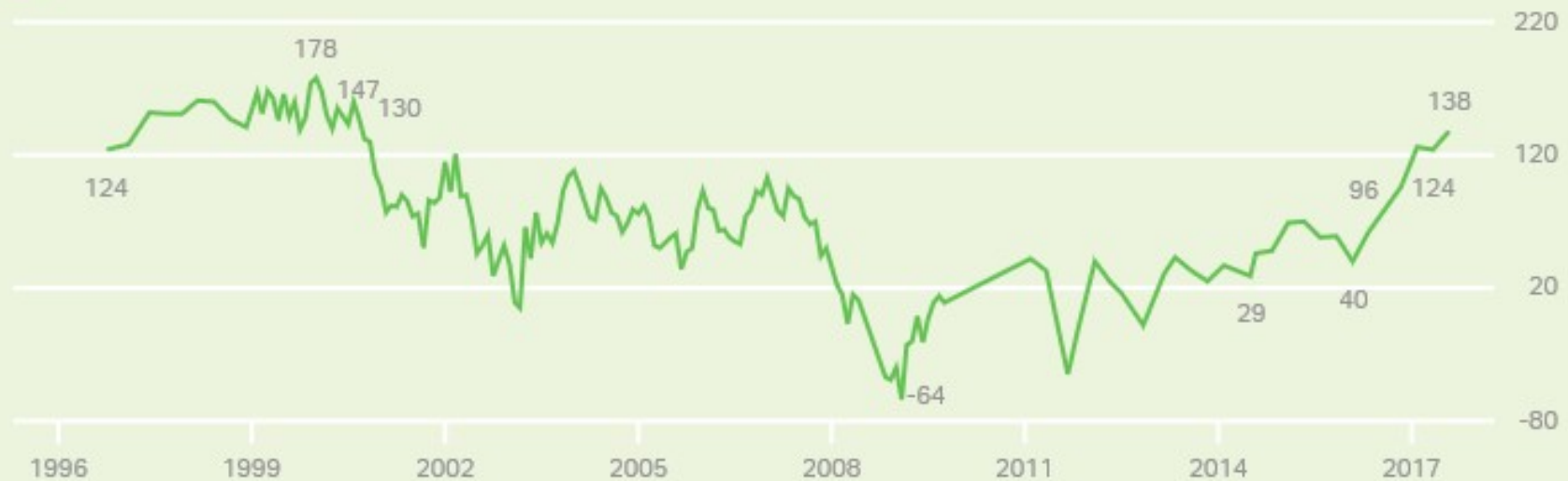


# How We Feel... Best Since 2001

## U.S. Investor Optimism, 1996-2017

Wells Fargo/Gallup Investor and Retirement Optimism Index

■ Index score



WELLS FARGO/GALLUP

*Wells Fargo/Gallup Investor and Retirement Optimism Index survey (7/28-8/8) of U.S. investors with \$10,000 or more invested in stocks, bonds or mutual funds.*



## Improving Economic Picture

	Current	Last Year	
Unemployment	4.4%	4.9%	<b>0.5% Better</b>
Hourly Wages	\$26.39	\$25.74	<b>2.5% Better</b>
Avg. Home Price	\$299k	\$285k	<b>4.9% Better</b>
Real GDP Growth	3.0%	2.2%	<b>0.8% Better</b>
Inflation (CPI)	1.7%	0.8%	<b>0.9% Better</b>
S&P 500 Earnings	9.6%	-0.7%	<b>10.4% Better</b>

Source: Bloomberg, Bureau of Labor Statistics, Nat'l Assoc. Realtors, U.S. Commerce Department



## But Not a Straight Line



- *Better than expected data adds to the index... worse than expected subtracts.*
- *After the “soft patch” last Spring, recent data has surprised to the upside.*
- *The Caveat: Impact of Hurricanes Harvey and Irma*



# Fed Chair Yellen in July

## Rates Near-Term

*"Because **inflation is currently quite** low by historical standards, the federal funds rate would not have to rise all that much further to get to a neutral policy stance."*

## Rates Long-Term

*"**Gradual rate hikes** over the next few years."*

## Tapering Fed Assets

*"We've been trying very carefully to lay out our plans to **reduce the size of the balance sheet.**"*





# Fed Dot Plot

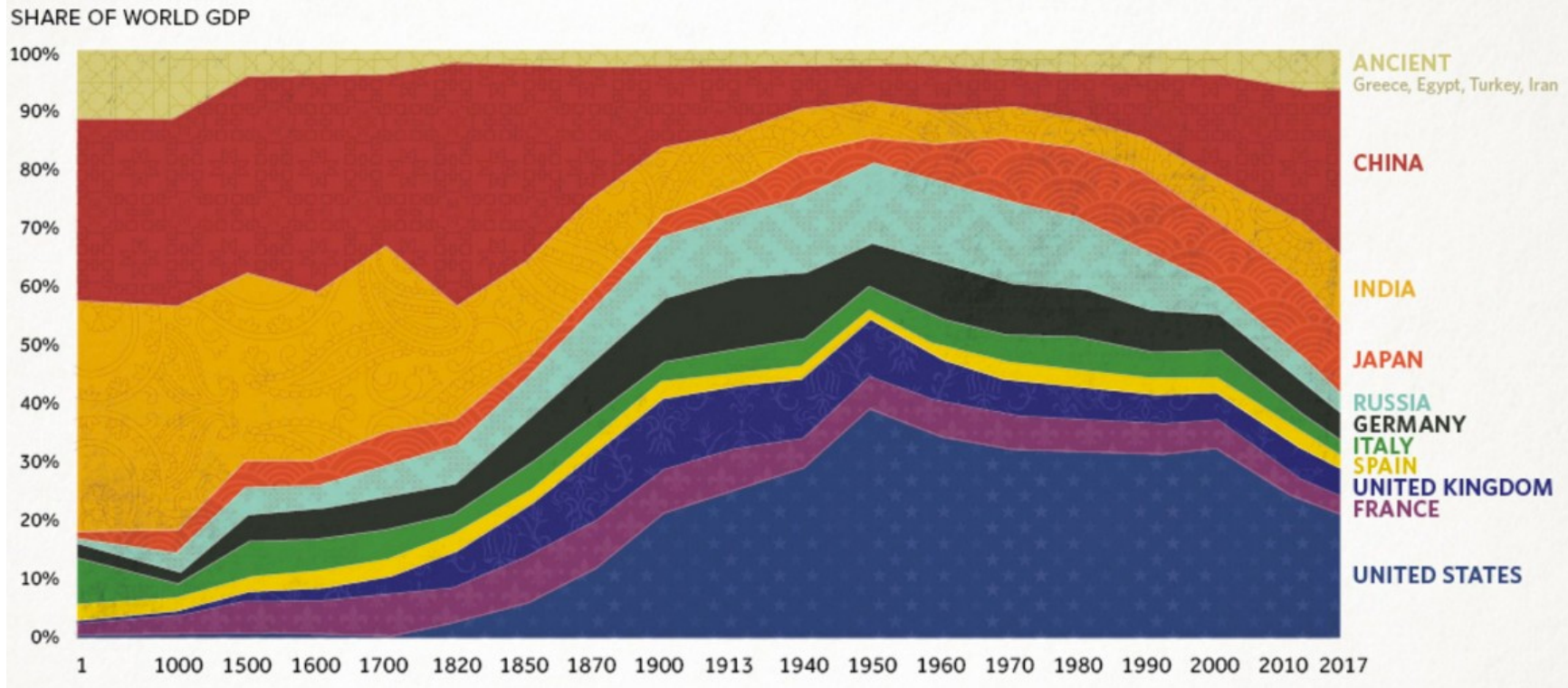


Source: Bloomberg

*FOMC members generally see higher rates but dispersion is wide*



# Why the Fed Matters... U.S. Still #1



Source: @WhatILearnedTW



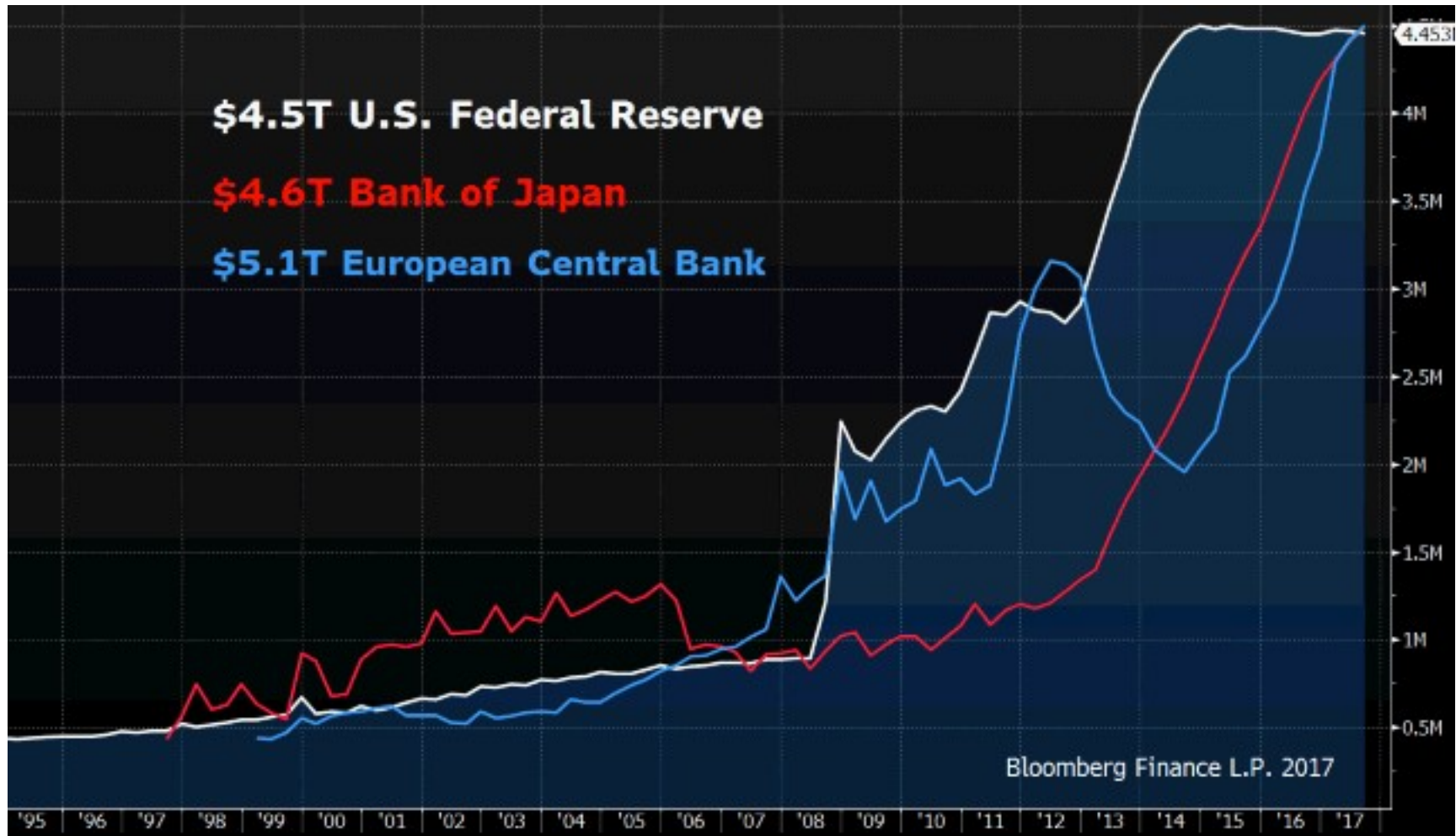


# Three Scenarios for Fed Policy

	Interest Rates	Balance Sheet
<b>Calm Seas</b>	<ul style="list-style-type: none"><li>•No more rate hikes this year</li><li>•Mention hurricane impact on GDP</li><li>•54% odds per Fed Fund Futures</li></ul>	<ul style="list-style-type: none"><li>•Taper plan announced</li><li>•Plan not activated until mid-4Q</li></ul>
<b>Gentle Breeze</b>	<ul style="list-style-type: none"><li>•Fed telegraphs one more hike for Dec</li><li>•Guides 2-3 hikes in 2018</li><li>•<i>Dot Plot</i> implies only 2 hikes in 2018</li></ul>	<ul style="list-style-type: none"><li>•Taper plan announced</li><li>•Plan effective beginning in Oct</li><li>•Taper starts small but rises over time</li></ul>
<b>Surf's Up</b>	<ul style="list-style-type: none"><li>•Clear indication of a Q4 hike</li><li>•Opens door to potential 2nd 2017 hike</li><li>•Guides to three hikes for 2018</li></ul>	<ul style="list-style-type: none"><li>•Taper plan announced</li><li>•Plan effective immediately</li><li>•Taper is straight line</li></ul>

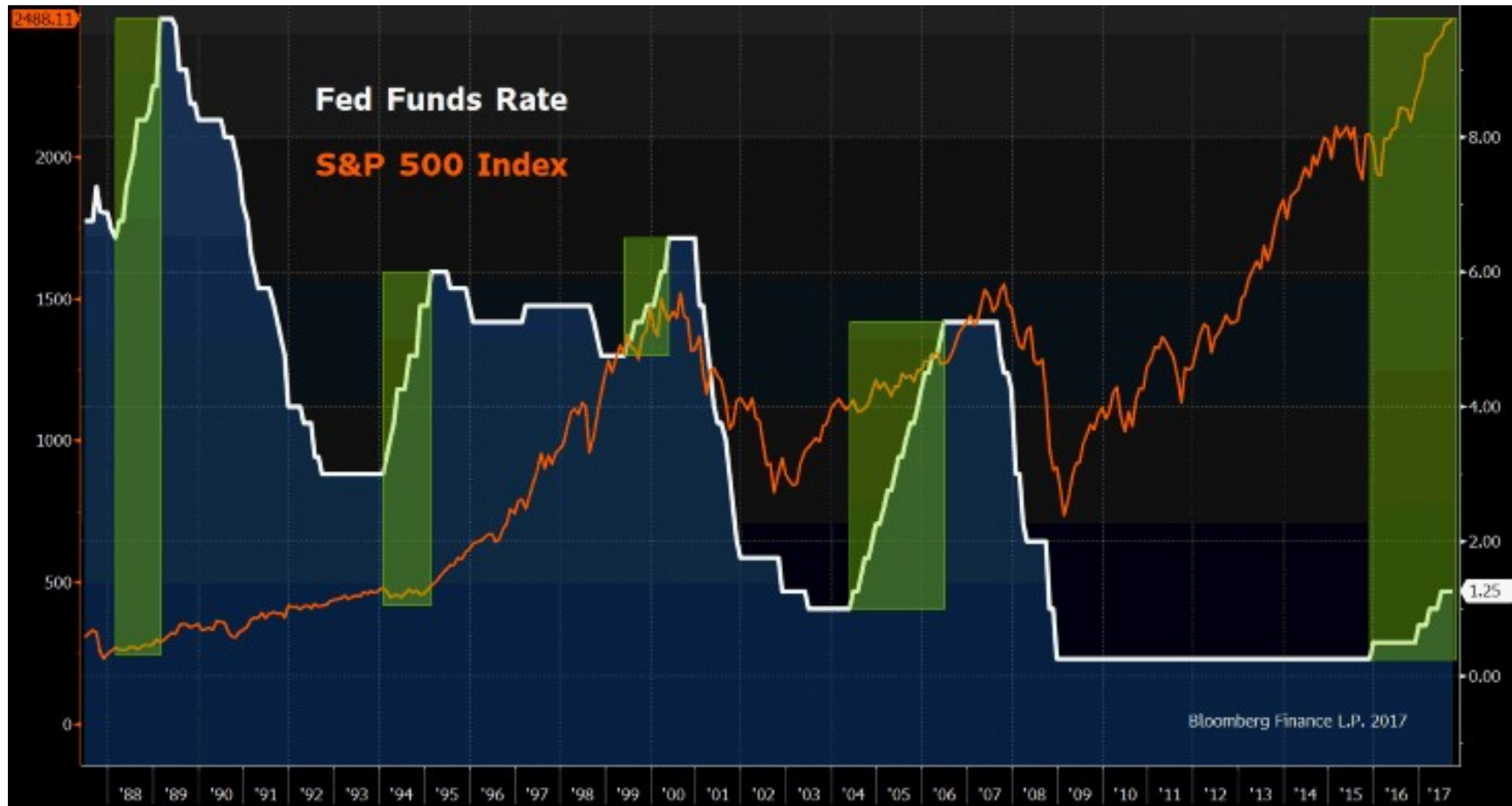


# We've Never Been Here Before





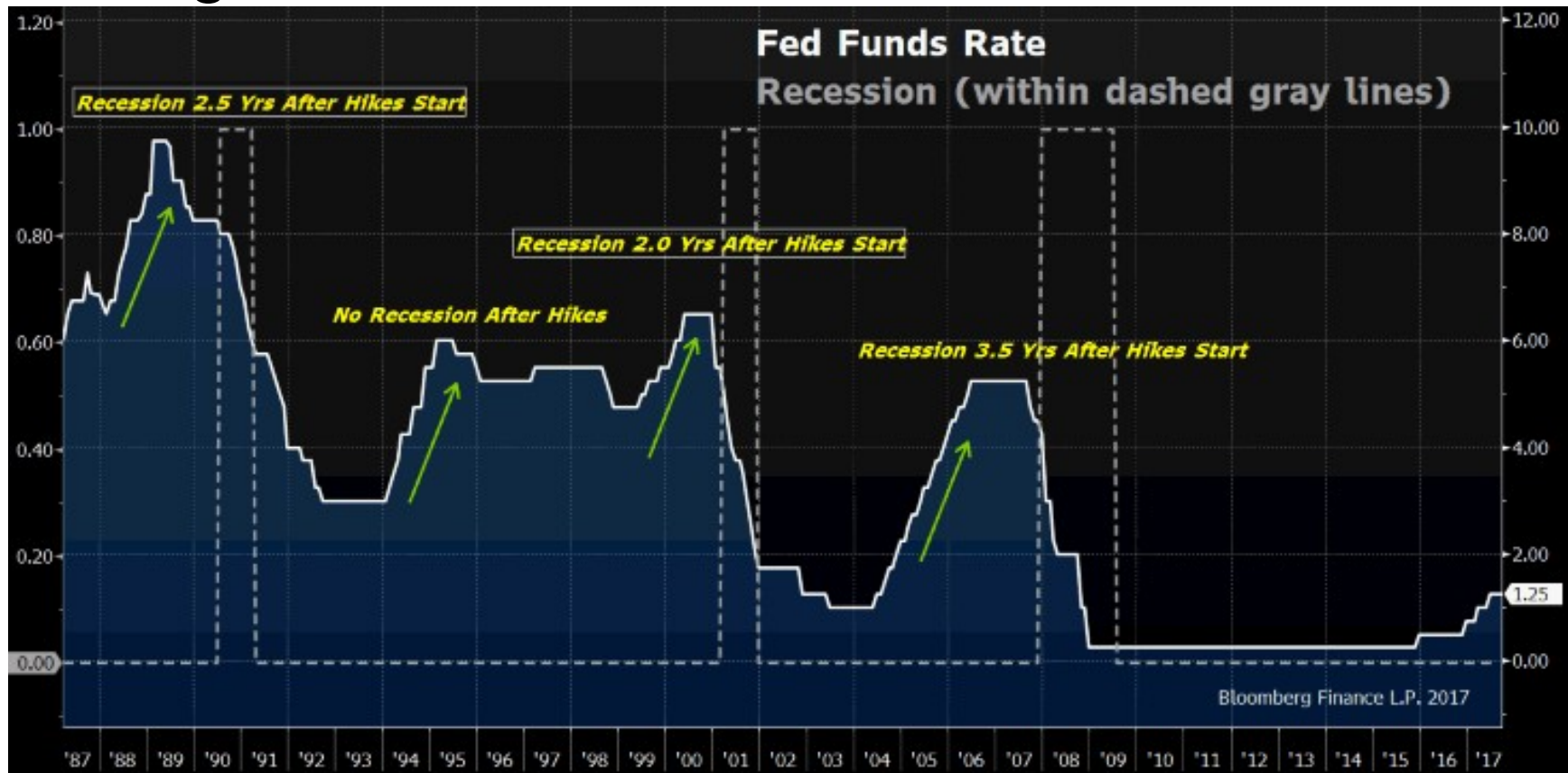
# Can Stocks Rally as Rates Rise?



*Yes... Rising rates are not a negative on S&P 500 Index performance.*



# Do Higher Rates Lead to Recessions?



*No... While previous rate hike cycles preceded recession 3 out of 4 times since 1987, the economy continued to expand for 3 years on average after hikes began, suggesting little causation between rate hikes and recessions.*



## 1. What's Changed?

- 2Q and 3Q Economic data improved from “soft patch”
- But the Fed has reiterated a Gradualist Approach
- The ECB has also scaled back Taper Talk

## 2. Three Scenarios

- *Calm Seas...* likely based on Fed Funds Futures
- *Gentle Breeze...* possible given Fed Dot Plot
- *Surf's Up...* unlikely unless major policy pivot at Fed

## 3. Have We Been Here Before?

- Yes and No
- Balance Sheet creates unprecedented challenge
- Stocks can continue to rally as rates rise

## 4. Q&A