
MV Capital Management Weekly Market Flash

Kabuki in the Eccles Building

March 20, 2015

It's still a Fed market. The Kabuki drama that is the two-day Fed Open Market Committee conclave raised itself to new heights of artfulness this week. In her best imitation of a photon being a wave and a particle at the same time, Janet Yellen maintained that the Fed can be patient without actually being...well...patient. And assets did what assets do: follow the Fed. Stocks, bonds and any currency not called the US dollar soared back into the heavenly realms on Wednesday after the white smoke emerged from the Eccles Building. There was a bit of second-guessing on Thursday as markets gave up some of those heady gains. But by Friday morning everything was right as rain again. The S&P 500 is closing back in on its March 2 all-time high, 10-year yields remain below 2%, and for now it seems that the extraordinary times continue.

The Veiled and the Seen

The Fed's mandate is to direct its monetary policy towards the dual objectives of maximum employment and stable prices. Would a 25 or 50 basis point increase in the Fed funds rate really be directly counterproductive and harmful to those goals? That seemed to be the intent of the 3/18 communiqué's hard-hitting first paragraph: economic growth has moderated, household spending is likewise moderate, housing is slow and exports are weak. Yes, we are on the right course, but it still may take time. Just look at where inflation is now, relative to our 2% target. Look at below-trend market-based compensation measures. Look at slowness in the housing market. Those data points imply "patient" so that we don't actually have to say it.

All of which is laudably transparent, as far as it goes. And there is nothing wrong with, as the communiqué notes, taking into account current market trends such as export weakness and "international developments", a somewhat veiled reference to the dollar's dominance over almost all other currencies in the foreign exchange market. What is concerning is the notion that Fed policy would be directly reactive to asset market trends. Prolonging the low rate environment as the best way to achieve the Fed's dual mandate is fine; prolonging zero rates to specifically jawbone down the dollar is not fine. There is a nuance there, but it is an important one. Targeting specific asset market outcomes in pursuit of policy is tantamount to market manipulation, which is the opposite of transparent. It provides fodder to the many cynics who have long argued the Fed is doing just that.

Tail, Meet Dog

It also signals a lack of confidence; forming policy in reaction to changing market events is the tail wagging the dog. The Fed should not have a near-term target number in mind for the dollar, or the S&P 500, or even the 10-year Treasury. That is beyond the scope of its mandate. If the policy prescription is correct, then eventually the wisdom of the policy should manifest itself in economic data and asset prices alike. Let markets be markets.

The non-cynical way to look at Wednesday's communiqué and briefing is to applaud the Fed for freeing itself of the "patient" language without roiling markets. That deft linguistic sleight of hand could actually make it easier for the FOMC to act sooner, even in June, if wage growth and prices perk up enough between now and then. But the chains remain. Short-term hissy fits surely continue to lurk under the surface, waiting for a sign that the rate hike is nigh. The right thing to do, when the time comes, would be to fire away and let the babies have their (probably short-lived) tantrum. That would convey real confidence, and we believe markets would recognize it as such.

Masood Vojdani
President & CEO

Katrina Lamb, CFA
Head of Investment Strategy & Research

Investment Advisory Services offered through MV Capital Management, Inc., a Registered Investment Advisor. MV Financial Group, Inc. and MV Capital Management, Inc. are independently owned and operated.

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by MV Capital Management, Inc.), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from MV Capital Management, Inc. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. MV Capital Management, Inc. is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of the MV Capital Management, Inc.'s current written disclosure statement discussing our advisory services and fees is available for review upon request.