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MARKET MATTERS: The Fed is a driving factor in the market


Joseph Matthews

It’s finally June, and while some may be wondering whether summer is really here to stay, those with a close eye on the market are asking themselves what the Fed is going to do with interest rates when it meets later this month.

Will they inch rates up or keep them stable for a while longer, perhaps until year’s end? That question appears to be one of the driving factors behind the last two weeks of instability in the market.

In the minutes released from the Federal Reserve’s April meeting, officials signaled that a rate hike in June was still a possibility if the economy continued on its path toward improvement.

But not everyone was on board with that possibility. Some analysts noted that while the Fed doesn’t want investors to rule out a June or even a July rate hike, it is more likely that it will occur in December. In my view, the world economy is not sufficiently strong and, more to the point, not showing enough recovery from earlier this year to justify a June hike.

Neither Japan nor most of Europe is showing the kind of strength that makes investors confident in the future, suggesting at least a temporary hold on a rate hike. This comes in spite of economic data out of China that signals improvement in their economy.

On balance, the U.S. economy has not improved much since the beginning of the year. For investors, that means taking a look at opportunities with a somewhat more balanced approach, versus the more bullish view taken on U.S. equities in the past.

While investors typically cheer when the Fed lowers interest rates, there isn’t necessarily similar joy attached to rising rates. Higher interest rates are typically associated with a reduction in disposable income and tightening of consumer spending. Additionally, banks may make fewer loans, which can impact the bottom lines of businesses across the board.

In its considerations to raise rates, the Fed continues to prioritize growth stimulation while keeping inflation under control at the same time. However, we have yet to see much evidence to support real concerns for any significant inflation. And while there is a constant balancing act between inflation, deflation and stagnation, I believe we need increased and steady growth first.

The odds of a June rate hike now stand at about 34 percent, according to the CME Group’s FedWatch tool. It’s worth noting that the Fed has not raised its benchmark interest rate when the CME estimated probability was less than 60 percent since at least 1994.

In late May, stocks rose to some of their highest levels this year driven by good news in domestic monthly home sales and economic support for the Greek economy. This news came as a report measuring business investment showed a drop for the third month in a row, impacting the manufacturing sector. This pattern of good economic news followed by economic news that does not meet expectations often drives the good and bad days in the markets.

Overall, investors hope for a constant direction regarding the Fed's monetary policy to smooth out these cycles. Keeping interest rates low can help drive the market back toward a long-term positive — a market that still is showing volatility and nervousness. While some analysts say they don't worry too much about the Fed, it is obvious that many investors do, and often react according to the most recent news.

But even when we see negative results for several days in a row, the market is still overall trending up indicating basic underlying confidence that is occasionally impacted by jitters or momentary uncertainty.

We should be able to catch a breath and see at least temporary stability after the Fed meets on June 15, depending upon what it signals for the future.

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