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Prudent Portfolio: Low Impact Expected From Fed Interest Rate Increase

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By Kevin Peters

Oh, no! The Federal Reserve raised short-term interest rates by .25 percent! And there is the possibility that it can go up somewhat higher!

Is the sky going to fall, the earth leave its orbit around the sun? Will the Cubs win the World Series?

Not likely. In fact, for most people and businesses there won't be much of an impact at all.

Fed officials emphasized that they intended to raise rates gradually, and only if economic growth continues. Short-term rates will rise by about one percentage point a year for the next three years, Fed officials predicted.

Meanwhile, interest rates on various types of loans, including mortgages and savings accounts and other investments, are likely to remain low for years.

The first thing we should do with this "new normal," if rising interest rates are indeed to be the wave of the future, is not overreact. Since the Fed's announcement the stock market has gone up and down, as it will, and oil prices have gone down, and then down again, resulting in declines in oil-related stocks. But there has been no tsunami.

Mostly, investors seem to be taking the minimal interest rate hike in stride and appear to have adopted a wait-and-see attitude about the future. That could be very good advice for nervous investors as well. There are still many uncertainties regarding the economic direction of the United States and the rest of the world to accurately predict just what it will all mean to our portfolios.

Analysts don't seem to have a clear vision of whether the sluggish economic growth that has marked this decade is about to explode out of its doldrums or if it will continue on as it has. There doesn't even seem to be a consensus as to what is holding the economy back or even how large a talent pool exists with people wanting to find work but not having satisfactory opportunities.

The Fed has used the low interest rate policy to encourage borrowing and risk taking by businesses and consumers, but those incentives, apparently, will no longer be its primary focus as interest rates inch upward. Fed officials were basically trying to discern which of two possible versions of the economic reality was correct.

Even the Fed is divided on whether low interest rates have helped the economy build momentum and should see steady increases to control inflation, or whether low rates are the key to producing a more modest growth rate and rapid increases could bring on another recession.

One of the dominant factors in gauging the economy in recent years has been prices, which have increased slowly, indicating weakness. To that point, the Fed's index of personal consumption that excludes volatile food and oil prices rose only 1.3 percent in the year ending in October.

But officials also have argued that temporary pressures, such as the fall of oil prices and the strength of the dollar, are suppressing inflation and that the strength of the labor market is a more important indicator.

Only time will tell which version of economic reality is holding true, or if other factors will soon dominate the economy's movement. In either case, it is advisable to keep our heads while others may be about to lose theirs, figuratively speaking, and use tried and true solid market research to guide our future fiscal decision making.

We also should keep in mind that changes to our portfolios remain consistent with our overall financial objectives. A portfolio that is in balance both with our individual goals and with the changing financial world can help ensure that we ride out the downturns and flourish when the economy improves.

But to meet our objectives, regardless if they have stayed fixed for decades or evolved over the years, we must flourish in those areas that are consistent with our long-term goals.

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