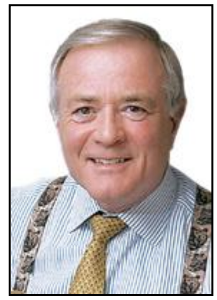
DJC
THE DAILY JOURNAL OF COMMERCE, PORTLAND, OREGON


William Rutherford

When all seemed lost, Yellen rescued markets

Published April 11, 2016

In the fourth quarter of 2015, investors were losing confidence in the Federal Reserve. The Fed speakers were out on the rubber chicken circuit spouting all kinds of opinions. "More rate hikes" would say one Fed President, "no rate hikes" would say another, and so it went.

The markets were dizzy with the contradictions. The global economy was weak, with China particularly unnerving. The price of oil was declining, along with other commodities; loans to commodity producers looked risky; and the banks, once again, looked shaky. The dollar was strengthening on the belief that the Fed was about to raise rates again. Multinational companies and emerging markets were hit. The dark clouds were everywhere. Albert Edwards, global strategist for Societe Generale, warned that the U.S. market could fall 75 percent. The voices of other market bears grew louder.

Into this mix, stepped the Fed with a December rate hike, ill-timed and not well received. Because of all the Fed speaker chatter, the markets believed the Fed was about to raise rates again in January. Clearly the Fed and the markets were out of synch. Not surprisingly the market took a nose dive.

The market began 2016 with the worst start in history, and then went down. At the peak of the pessimism, all indices were down more than 10 percent on the year, and the Dow was down 15 percent from its May 2015 record high.

In January, the Fed, perhaps realizing it was out of step with the economy, declined to raise rates again. The market began its recovery. On February 11, the same day the market bottomed, Jamie Dimon, CEO of JP Morgan, purchased $25 million – or half a million shares – of the banking giant. Also on the same day, the price paid for U.S. oil bottomed at $26.21 per barrel. At that point oil was down nearly 30 percent for 2016. Comments from the Fed suggested that there would be only one more rate hike this year, not three. The markets rallied to recover all the lost ground and then some. Treasury futures suggest there will be only one more rate hike this year and that it may not come before December.

With worries about Fed action on the sideline, the market has turned its attention back to fundamentals. Earnings top the list of concerns. If the dollar stays steady or weakens, U.S. multinationals have more opportunity to increase earnings. If the price of oil stabilizes, energy companies have a better chance of recovery and concern about energy loans lightens. Continued low interest rates keep pressure on financials which are 15.6 percent of the S&P broad market. It is too early to say how earnings will go, but with rate hikes off the table for now and the dollar weakening, there is some hope for progress. However, overall earnings for the S&P, at present, are expected to fall 7.1 percent, according to Thompson Reuters. Such a drop would be the biggest since Q3 2009, and the third straight quarter of accelerating declines. Tech is expected to be especially hard hit. The 4-1 negative earnings pre-announcements are worse than typical. There is an argument here that the economy is not as strong as the Fed suggests and its next move should be a rate cut.

The latest jobs report gave some hope for recovery. More people are working and more are participating in the work force. Wages are increasing slightly, with the headline being the effort of some states to raise the minimum wage to $15.00 per hour. The very slow and uneven economic recovery since the Great Recession has left wage earners in worse shape than before the crash. Many feel disenfranchised, especially since the financial markets and Wall Street have done well. This dichotomy has led to dissatisfaction among large portions of the populace. Many feel the "social contract" has been broken.

This has led to the rise of populist movements, one on the left and one on the right of the political spectrum, and hostility toward "the establishment" loosely defined as all those in elected office and on Wall Street. It is not the first time that we have experienced a "throw the rascals out" mentality, but the ferocity this time seems greater than ever. It remains to be seen how this all plays out, but we must be careful not to throw out the baby with the bathwater. The "burn the house down to get at the rats" mentality is self-defeating.

Despite this turmoil, history has shown us that the best long-term investment strategy is to be fully invested in a well-diversified portfolio.

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