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The Fed has recently backed up on its stated intent last fall to raise rates two or three times to none in 2019. That original announcement of continued tightening spooked the market in the fourth quarter, fueling the severe market downturn through December. This also included a planned shrinking of the Fed’s balance sheet in addition to higher rates. Now, Chairman Jerome Powell assured us the Fed remains “data dependent” and that it could adjust the balance sheet based on “financial and economic developments.” He suggested the FOMC would do what it thinks is right and let asset prices go where they will. Since the financial crisis of 2008, the Federal Reserve has maintained lower than normal interest rates. It is very interesting that the independence of the central bank is being tested on several fronts. When the Fed signaled their intention to normalize interest rates, it was an attempt to give itself room to ease next time there was a crisis. A “standard” crisis includes lowered rates, sometimes up to 400 basis points (i.e. from 5% to 1%).

Well, President Trump (with the power of appointment of the Federal Reserve Chairman and other board members) is using his bully pulpit. Trump reasons that if the Obama administration received the benefit of low rates for eight years, it is also reasonable for them to remain lower near term .

By appointing to the Fed board economist Stephen Moore from the conservative Heritage foundation and possibly Herman, another fiscal conservative, it is clear he wants monetary and economic policies to align. This would at least give him the opportunity to use some of the lower cost leverage the previous administration enjoyed.

The direction and the valuation of the stock market is a function of Fed activity by the following:

- ◆ is the Fed currently adding to or removing liquidity?
- ◆ is the Fed raising or lowering interest rates that would add to the competitive valuations of the markets?
- ◆ is the Fed expanding or contracting their balance sheet?

These few factors currently drive the equity markets. With Trump’s insistence that higher price levels of equities is a measure of his policy success , Fed activity is being fashioned politically more then ever.

	1Q	12-Mo
Dow	11.15%	7.57%
S & P	13.06%	7.03%
NASDAQ	16.48%	9.38%
10-Yr Treasury		2.50%
10-Yr Municipals		2.25%
Fed funds Rate		2.50%
Gold		\$1292
Silver		\$15.12

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“Darkness cannot drive out darkness only light can do that. Hate cannot drive out hate only love can do that.”

Martin Luther King

Instead of normal business cycles, Peter Boockvar (a noted economist market analyst) declares we now have credit cycles, and blames the Fed's artificially low interest rates for creating them.

Here's how he put it in one of his letters:

"To me, it is a very simple message being sent. We must understand that we no longer have economic cycles. We have credit cycles that ebb and flow with monetary policy. After all, when the Fed cuts rates to extremes, its only function is to encourage the rest of us to borrow a lot of money and we seem to have been very good at that. Thus, in reverse, when rates are being raised, when liquidity rolls away, it discourages us from taking on more debt. We don't save enough."

The problem is, over time debt stops stimulating growth. Debt-fueled growth is fun at first but simply pulls forward future spending. Debt also boosts asset prices.

That's why stocks and real estate have performed so well. If financing costs rise and buyers lack cash, the asset price must fall. And fall it will. Since debt drives so much GDP growth, its cost (i.e., interest rates) is the main variable defining where we are in the cycle. Debt controls cost, so we all obsess on Fed policy.



The Fed and interest rates

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Fixed income

Federal funds rate expectations

FOMC and market expectations for the federal funds rate

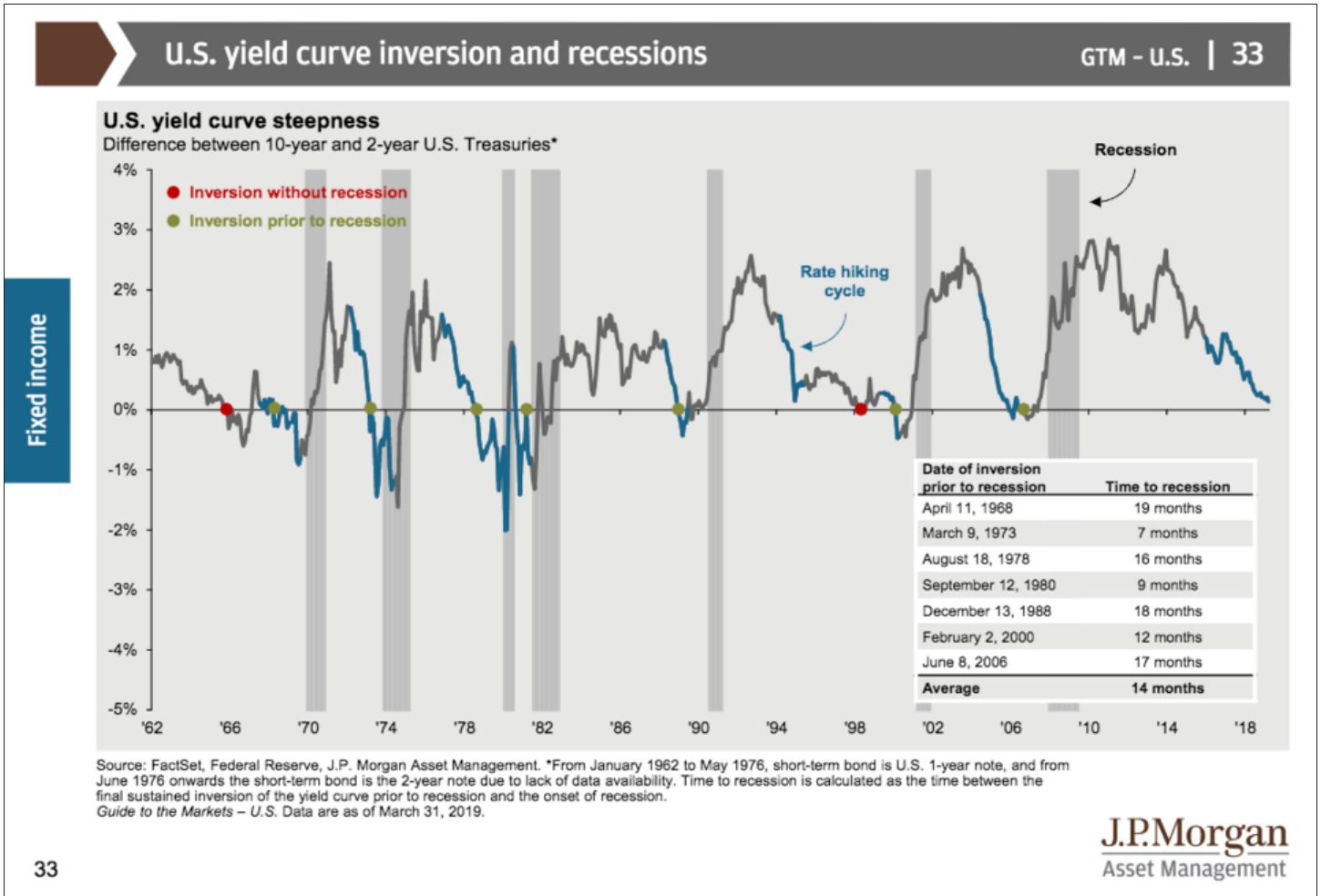
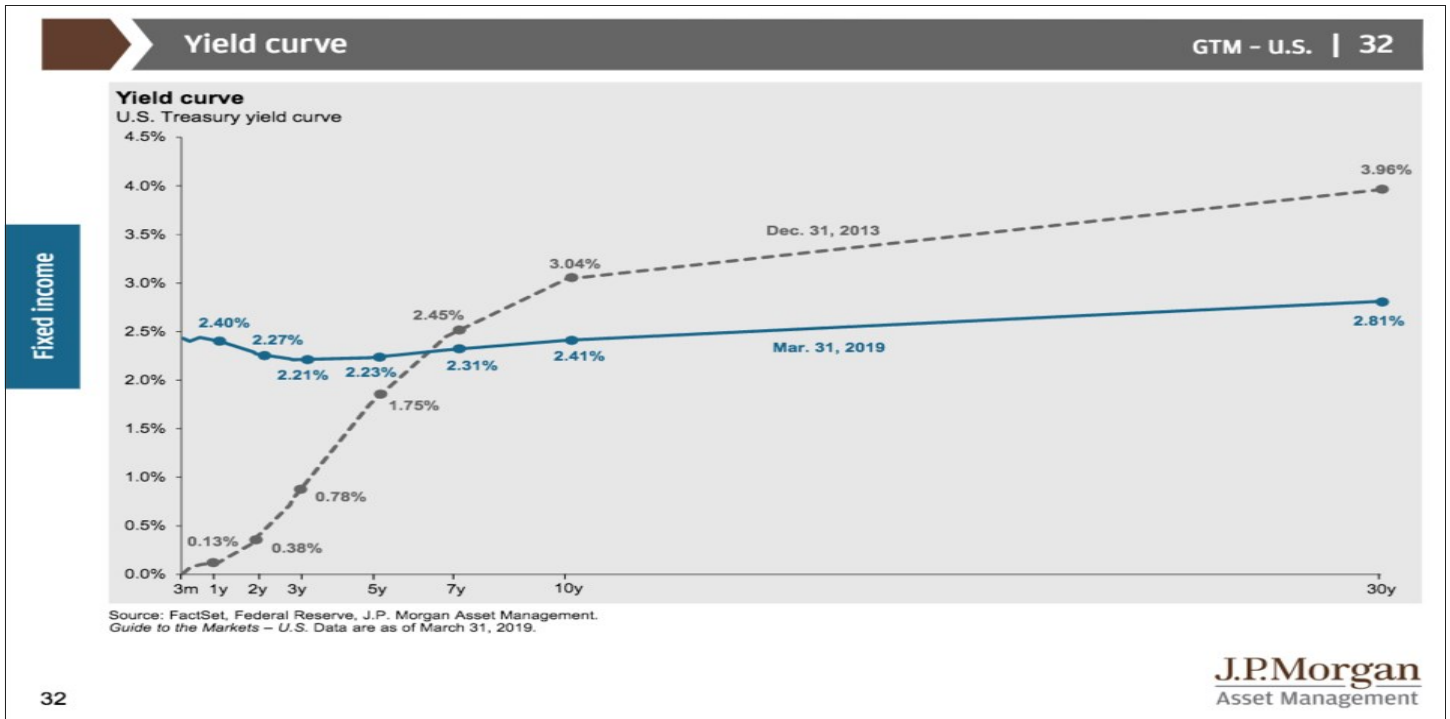
FOMC March 2019 forecasts				
Percent	2019	2020	2021	Long run*
Change in real GDP, 4Q to 4Q	2.1	1.9	1.8	1.9
Unemployment rate, 4Q	3.7	3.8	3.9	4.3
PCE inflation, 4Q to 4Q	1.8	2.0	2.0	2.0

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.
 Market expectations are the federal funds rates priced into the fed futures market as of the date of the March 2019 FOMC meeting and are through December 2021. *Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy.
 Guide to the Markets - U.S. Data are as of March 31, 2019.

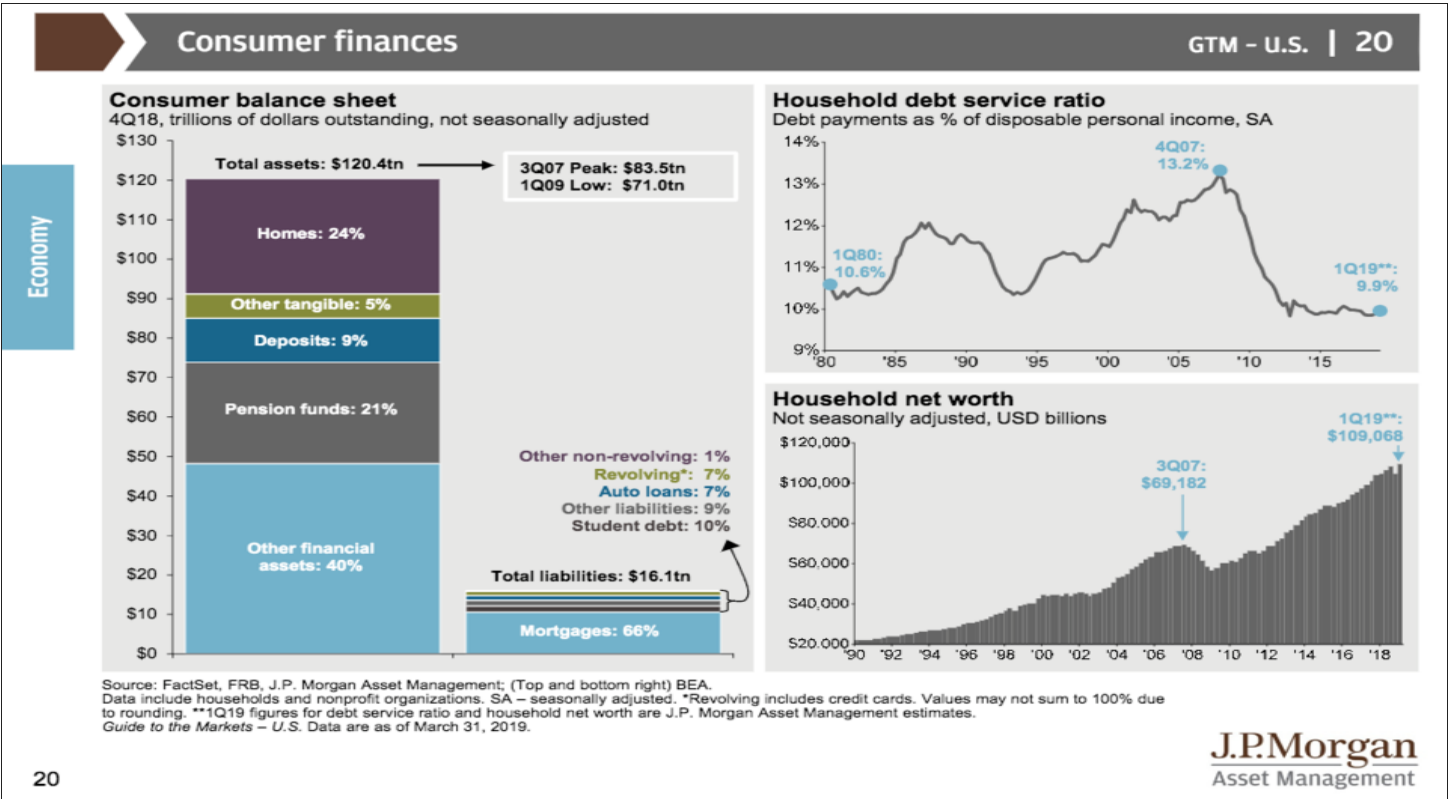
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J.P.Morgan
Asset Management

While the interest rate yield curve below signals a slowdown, it does not necessarily signal a recession.



The consumer continues to play a big part in bolstering our economy with decreasing debt and the largest percent in rising income since 1966. If this trend continues, there is room for the market to go much higher.



Herbert R. Smith & Company has been providing investment advice to institutional and wealth-management clients for almost 50 years. Our expertise in managing assets has assisted our clients in meeting their financial goals without moving beyond reasonable risk guidelines. Our mission statement is:

To provide professional investment advisory services helping clients accumulate and maintain financial wealth through conservative long-term investment strategies.

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