These Times Are Too Good
Andrew Schultz – February 2017 Monthly Commentary

This is a recent quote from Janet Yellen: “Waiting too long to remove accommodation would be unwise, potentially requiring the FOMC to eventually raise rates rapidly, which could risk disrupting markets and pushing the economy into a recession.” The Fed has raised overnight lending rates (the Fed Funds rate) twice in the past 15 months. With low unemployment and the potential (if not already occurring) for wage based inflation, I don’t envision the Fed discussing accommodative and stimulative policy the next time the markets drop. Prior to last July, every time the stock market went down for more than a few days or by more than a few percent the Fed would step in with dovish talk, calming markets and making everyone feel better. Then markets seemed to recover back up. Based on this quote and other Fed member statements, it would surprise me if the Fed spoke of “lower for longer and accommodation” if the stock market did have a pullback, and therefore markets may not rebound as quickly.

I would argue that portfolios need to be prepared for a lot more volatility. These are the good times now. It appears everything is working well year to date. This is what makes me nervous: over-valued stock markets tend to not do well in rising rate environments, yet so far the stock market has been rising steadily. If reality hits the market, correcting it to historically normal valuations, without a Fed stepping in, we may not get the quick swing back up that we have gotten so used to.

What should we do?

The most obvious solution is to reduce exposure to investments that are overvalued based on historical norms. The less obvious to retail investors is to place capital into investments that actually thrive on volatility and uncertainty. The key is to spread out across many different vehicles that have low or no correlation to each other and long term proven track records. They may not kick in and all work at the same time, but many may not tend to drop as hard, if at all, when the stock market does.

I am bullish on the US economy but that does not mean a stock market goes straight up and that caution should be thrown to the wind. The stock market appears to be expecting a lot from Washington. Let us see what we get.

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