

The Fed: More Noise Than Meaning

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Get on with it already! Don't get us wrong, we know this is the "Super Bowl" for business journalism (anyone have tix to the ESPN party?), but raising rates from 1/8th to 3/8^{ths} of 1%, after six years of economic recovery should be a no-brainer.

Our suggestion: spend the week analyzing companies and investment products. Don't get sucked into the idea that there is some genius trading strategy for how to deal with this.

That's right; ignore it. Don't read the statement and don't watch the press conference.

Let's say the Federal Reserve decides to raise short-term rates this week, a decision we would agree with and think is long overdue. Equities might sell-off immediately, but then rebound sharply as markets decide that if the Fed is raising rates it must be because the economy is getting better. Or, the market may rise first on a "buy the fact" rally and then fall. A decision to leave rates unchanged might spur an immediate rally followed by losses as investors wonder what dangers could make the Fed flinch from raising rates.

We have no idea and no one else does either. No matter what happens, short-term gyrations in response to the Fed are just noise, distracting investors from the fundamentals. Remember all the hoopla about tapering? The US economy continues to grow at a moderate pace and our models suggest a 25 basis point rate hike will not change that.

Remember, the Fed is not going to announce any breakthrough inventions on Thursday: no new drugs to cure diseases; no Apps to make our lives easier or more enjoyable; no new methods to further cut the cost of drilling for oil or natural gas, and whatever the Fed does will not stop the incessant guessing about what it may do next.

And yet, this week, the financial press and many investors will obsess over every change in verb tense in the statement and the potential significance of every sigh from Fed Chief Janet Yellen during the press conference.

Our view is that the Fed should raise rates. Nominal GDP growth – real GDP growth plus inflation – has grown at about a 4% annual rate in the past two years. The unemployment rate is 5.1%. This is one percentage point below where it was a year ago, in spite of tapering, and is now equal to the Fed's double-downward-revision of full-employment. Given the lags in the way the economy responds to monetary policy, more jobs and a lower unemployment rate are already in the cards even if the Fed had already started raising rates.

Yes, global equity markets have been turbulent lately, just like they were when people were talking about tapering. But there's never going to be a perfect time to start raising rates. If former Fed Chief Paul Volcker let financial markets push him around in the early 1980s, back when the jobless rate was 7.5%, inflation never would have been brought under control.

It's true, overall inflation is almost non-existent right now. But, if we exclude supply-induced declines in energy prices (which we should), inflation is low but remains near the Fed's 2% target. Rent (including regular homes, hotels, and dorms) is up 3.1% from a year ago and makes up almost one-third of the Consumer Price Index.

Whatever the Fed does on Thursday it is not a reason, by itself, to buy or sell. For those who believe in the primary importance of free-market capitalism, the ongoing process of discovery and production, what really matters for equities will be happening far from Washington, DC.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-15 / 7:30 am	Retail Sales – Aug	+0.3%	0.0%		+0.6%
7:30 am	Retail Sales Ex-Auto – Aug	+0.2%	-0.2%		+0.4%
7:30 am	Empire State Mfg Survey – Sep	-0.2	+0.5		-14.9
8:15 am	Industrial Production – Aug	-0.2%	-0.3%		+0.6%
8:15 am	Capacity Utilization – Aug	77.8%	77.7%		78.0%
9:00 am	Business Inventories – Jul	+0.1%	+0.1%		+0.8%
9-16 / 7:30 am	CPI – Aug	-0.1%	-0.1%		+0.1%
7:30 am	"Core" CPI – Aug	+0.1%	+0.2%		+0.1%
9-17 / 7:30 am	Initial Claims – Sep 12	277K	274K		275K
7:30 am	Housing Starts – Aug	1.170 Mil	1.138 Mil		1.206 Mil
9:00 am	Philly Fed Survey – Sep	6.0	2.7		8.3
9-18 / 9:00 am	Leading Indicators – Aug	+0.2%	+0.2%		-0.2%