Equity & Fixed Income Outlook April 2014

Federal Reserve Monetary Policy

- At the next Federal Reserve meeting on April 30, we expect the Fed to leave rates unchanged between zero and 0.25%. It still looks like 2015 will be when the fund rate begins to shift higher.

Inflation

- The year-over-year consumer price index (CPI) released in March shows inflation at 1.1%. Look for the level to be 1.3% to 1.5% on the April 15 release date. Many people feel inflation is much higher than reported levels, and we agree.

Economic Activity

- The news media seems to have forgotten about massive federal debt levels now that the debt ceiling has been suspended until March 2015. We like to watch the progression as a way of judging how much economic growth is organic (from the consumer) and how much is artificial (as a result of government intervention). Federal debt now stands at $17.6 trillion compared to $16.7 trillion at the end of the last fiscal year on September 31, 2013. Deficit spending is alive and well in Washington, D.C.
- The consumer seems to be getting more comfortable with economic conditions. The service sectors of the economy look to be doing fine. Manufacturing capacity utilization continues to be stable. The index of 10 leading economic indicators is positive. Wage increases remain a challenge, especially considering that price increases for the consumer appear to be noticeably larger than the consumer price index reports.
- The profits that businesses retain and have available to provide wage increases to workers are the same source of money businesses use to cover benefit costs. Increases in healthcare premiums are up double-digit percentages again this year, leaving very little left for wage increases. The consumer, in turn, continues to face stagnant wages and stagnant standards of living.
- The Fed moved away from predetermined goals and is three steps into reducing the quantitative easing (QE) program. Does this mean the Fed sees better economic growth moving forward? Maybe, but perhaps not for the reason most people think. This action by the Fed may be more psychological than real. If the Fed gets out of the QE program, which was put in place in response to a weak economy (many economists feel it has failed to support economic growth), perhaps consumers will develop a more positive outlook about future prospects and begin contributing to more growth with their increased spending. This might be a "chicken and egg" theme. Consumers need to earn more money before they can spend more money without taking on more debt.

Fixed Income

- The yield on the 5-year Treasury note moved about 20 basis points higher, to 1.75%, after the last Fed meeting suggested that the Fed fund rate might increase sooner than expected in 2015. Good quality corporate bonds in the same maturity range only have a yield of about 2.1%.
- These interest rate levels continue to frustrate investors looking for interest income. Even though interest rates are low, bonds have less volatility than stock.

Stock Market

- There appears to be a push-pull battle in the stock market. It looks tired. Some days, investors still see value in stocks, and their purchases push the market higher; those days seem to be nearly matched by the days when investors sell, pulling the market down. We still don't see a catalyst that would support much upward movement until first-quarter earnings releases. Even at that time, there is risk that revenues and earnings may not meet expectations.
- The S&P 500 index is trading at 17.44 times earnings. This is above the long-term average.

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