# Equity & Fixed Income Outlook November 2014

## Federal Reserve Monetary Policy

At the next Federal Reserve meeting on December 17, we expect the Fed to leave rates unchanged between zero and 0.25%. The Fed ended its quantitative easing (QE) program on October 31. Talk is developing around delaying any raise in Fed fund rates until late 2015.

## Inflation

The year-over-year consumer price index (CPI) released in October was 1.7%. Low inflation is one of the reasons the Fed may delay its rate increase as it looks to stimulate inflation to a higher level. The next release is November 20. We expect the CPI to remain in this range.

## Economic Activity

The Federal Reserve has injected about $3 trillion dollars into the financial markets through QE over the last few years. It also has kept short-term interest rates very low. The Fed intended to use monetary policy to help the economy grow and to push inflation into the range of 2%. Has it worked? The answer depends upon whom you ask. Some homeowners benefited if they were fortunate enough to have strong credit scores and remaining home equity to refinance higher-rate mortgages. The real winners were large money center banks, leveraged investors, and stock and bond markets.

Now the Fed chair said she is concerned about the increasing wealth and income gap in the U.S. Are the Federal Reserve directors the only ones who don't realize their policies accelerated this gap? The beneficiaries of QE and low interest rates are people and institutions that already have money. These steps have done very little for the everyday consumer.

Consumers need job and income opportunities, not Fed-manipulated stock and bond markets. Consumers are the economy in the U.S. Without income, they are not able to contribute to the economy or increase their standard of living. The average employed American has not had an inflation-adjusted wage increase in six years. Also, in spite of unemployment reported below 6%, the number of eligible workers with a job is at a three-decade low. That is less than 63% of the eligible workforce with a job. If the working consumer doesn't have any more money to spend, who does? Federal social program spending is up more than 20% over the last four years. Federal debt is also much larger than four years ago. The bottom line is the federal government continues to spend money it does not have.

Will a mandatory minimum wage increase help the average consumer? Not really. It is best to have wages consistent with the job being performed and productivity of the worker. The federal government is the biggest beneficiary of higher minimum wages, since it will have a better chance of getting additional income and payroll taxes from more of the population.

## Fixed Income

The market is supposed to consist of rational investors. Two-year government bond yields are negative in France, Germany, Sweden, the Netherlands and Switzerland. What is rational about paying the government to hold your money for two years? Two ideas come to mind. Either investors are not rational, or there is a growing concern about deflation.

## Stock Market

Volatility is back. The S&P 500 started October at 1,970, then moved down to 1,820 by mid-month, and finished the month at 2,018, about a point below the record high on September 19. The market appears to be all about the S&P 500. Year-to-date returns on the S&P are 8.33%, with the Dow only about half that at 4.58%. Mid-cap stocks are up 3.19%, and small cap stocks are down -3.73%. A diversified portfolio is having trouble matching the returns of the S&P this year.

Investing based on fundamentals appears to be a distant memory as the stock market continues to trade on monetary stimulus programs from world central banks.

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