Bell Bank
Wealth Management

EQUITY & FIXED INCOME OUTLOOK APRIL 2018

Federal Reserve Monetary Policy

The Federal Reserve raised the Fed fund rate on March 21 from 1.5 percent to 1.75 percent, while indicating future rate increases were expected due to the strength of the economy and the prospect for increasing inflation. Ten-year Treasury bond market investors appear to have a different opinion about these topics. Since March 21 when the Fed fund rate increased 25 basis points, the 10-year Treasury bond rate decreased 14 basis points, from 2.88 percent to 2.74 percent.

Inflation

The most recent year-over-year inflation rate is 2.2 percent. We expect it to drift higher with the next rate announcement on April 11. We would not be surprised to see it increase to 2.5 or 2.6 percent at that time.

Economic Activity

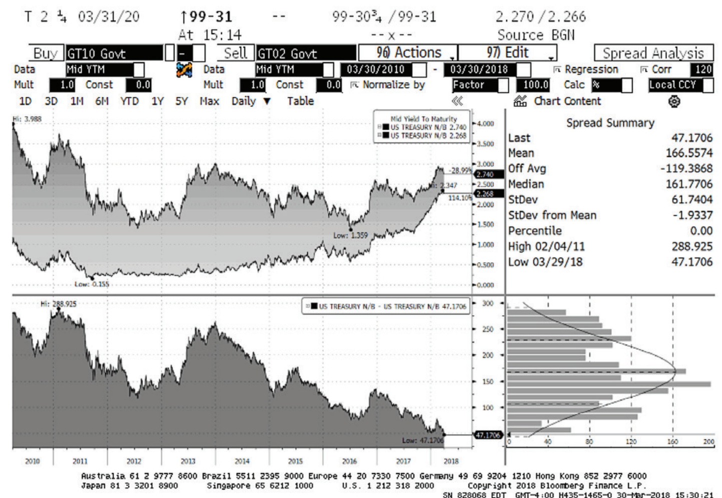
Unemployment is currently at 4.1 percent, and the Federal Reserve forecasts that rate to move below 4 percent. This is the lowest unemployment rate in almost 20 years.

Federal tax cuts had many forecasters calling for 3 percent economic growth. Don't be surprised if the actual growth rate remains in the range of 2.25 to 2.5 percent. Why? Consumer debt levels are already higher than they have ever been, suggesting a slow-down in consumer spending – unless wages grow more quickly than 2.9 percent, as reported by the Atlanta Federal Reserve. Consumer spending makes up about 66 percent of the U.S. economy.

Economies in developed markets are very large, and they don't bounce around daily (like the price of Bitcoin). Instead, they transition very slowly in one direction or the other over long periods of time. That's why it's so hard to base long-term investment and allocation decisions on daily stock market volatility. But the temptation is high to do just that, because as humans, we're "programmed" to stay alive by running from threats. That's one reason downward market volatility is much more sudden than upward market movement. What's the best way to address market volatility? Have an investment allocation that is consistent with long-term goals.

Fixed Income

The yield curve has been flattening. That means the difference between short-term and long-term rates is getting smaller and smaller. This is an indication that economic growth may be slowing, and investors are looking for safer assets, and also may show that inflation will not climb as high as some expected. Perhaps it is some of both. Our chart from Bloomberg (below) is a bit messy, but shows the declining yield spread between the 2-year U.S. Treasury bond and the 10-year U.S. Treasury bond (currently at a slim 47 basis points). This is something we are watching very closely.



Stock Market

Corporations begin to report their first-quarter earnings in April. We expect them to look good because of the change in corporate tax rates. We believe the market will look at this theme to consider underlying revenue growth and assess longer-term trends. If earnings are positive overall, the market should find some footing and stabilize. If they are not as strong as anticipated, expect volatility to remain in the stock market. If volatility continues, it could push yield spreads even tighter.

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32 years
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