Bell Bank
Wealth Management

EQUITY & FIXED INCOME OUTLOOK MARCH 2018

Federal Reserve Monetary Policy

The next Federal Reserve interest rate increase should be announced March 21. That would raise the top range of the Fed funds rate from 1.5 to 1.75 percent. The prospect of further rate increases and the strength of the economy are still debatable topics. The market estimates two more rate increases after March's announcement, though it's possible we'll only see one more increase this year.

Inflation

The year-over-year inflation rate for February was 2.1 percent. We expect it to drift a bit higher when the next rate is announced March 13. We anticipate the annual rate rising to 2.3 percent at that time and then holding around that level for April. We are not as afraid of inflation noticeably rising as the market seems to be.

Economic Activity

What could help keep a lid on inflation? First, corporations could use the tax cut to reduce the market price of their products in an effort to capture more market share. Second, capacity utilization suggests there is room to produce more goods and services without creating inflation. Third, the labor force participation rate suggests, even though the unemployment rate is low, there is more labor available, which should help control wage inflation.

Several conditions could result in the longest economic expansion in history:

- Developed countries around the globe, including the United States, are on stable economic footing.
- Growth is stable, though lower than historical patterns of growth.
- Unemployment is low, more labor is available, and wages are rising in a controlled manner.
- The leading economic indicator index is as high as it has ever been.
- The housing market is stable.

It will take another 18 months of economic growth to tie the 120-month record, which occurred during the tech boom that ended in 2001.

It's important to remember that recessions don't start when the economy is weak; recessions start when the economy is good, and something happens to change it. Anyone who started investing over the last eight years experienced annualized stock market returns of 15 percent. That is simply not the case over long time horizons. The best way to meet long-term investment goals is to maintain an investment allocation consistent with those goals. To get a better perspective of average market returns, look beyond the last eight years.

Fixed Income

What a difference a couple of months make. The 10-year U.S. Treasury bond finished last year at 2.46 percent, and currently yields 2.86 percent. That 40 basis point interest-rate increase means the price of the 10-year U.S. Treasury bond declined 3.5 percent. The market continues to expect rising long-term rates as the Fed expects to raise short-term rates and the threat of inflation remains to be determined.

Rising interest rates make debt more expensive for companies, governments and consumers. But rising debt costs do not mean the economy will slow down. Growing income and wages can offset rising debt costs, and the economy can remain on track. We will be watching this development closely.

Stock Market

Volatility has increased in the stock market. We anticipated a 10 percent correction this year but didn't expect it to happen so quickly. Valuations in the stock market still appear stretched. Perhaps economic conditions justify these current levels. It also means stocks may be more sensitive than normal to any news that could be interpreted as negative.

This could be the point in the cycle where the economy looks good and the bond and stock markets lack conviction, leading to more bouts of volatility. That serves as another reminder to have an allocation that is consistent with your long-term investment goals.

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