

News or Noise: Fed Hesitant to Raise Rates

By Tom Clarke, Director of Research

In a weekend that included the headline “Saturday Might Be the Biggest Day Ever for Sports TV,” a lot of exaggeration exists about what is news and what is noise. Some is relative, of course. With eight lacrosse games involving my boys, the Kentucky Derby, the NFL draft and the boxing fight of the century, there was a lot of inaudible noise over the weekend. Last week presented some investment-related headlines that we will evaluate as relevant news or just noise. The stories we are evaluating are the outcome of last week’s Fed statement and the announcement that former Fed Chairman Ben Bernanke has joined PIMCO as an advisor.

No. 1: Fed Rate Hike Remains on Hold

News

Noise

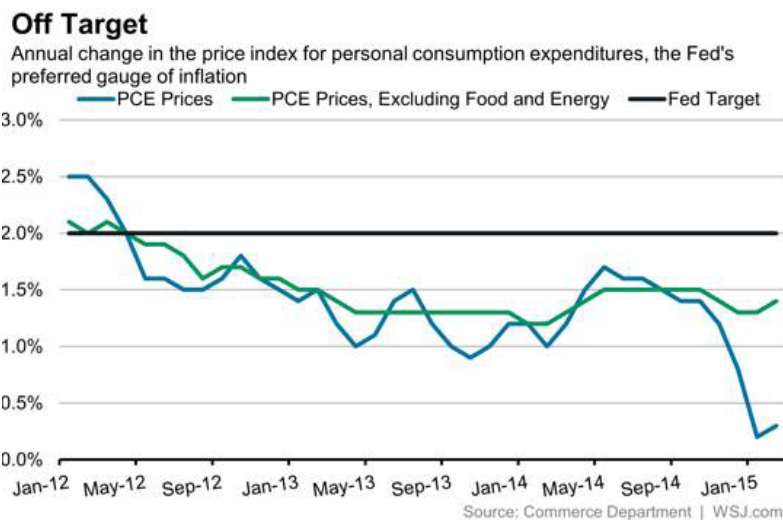
Last Wednesday the Fed issued a written statement about its assessment of the economy and its outlook for rising rates. Earlier that day, the Commerce Department announced that during the first quarter, the economy grew by a meager 0.2% over the previous quarter. The Fed’s statement repeated its assertion from March that “with appropriate policy accommodation, economic activity will expand at a moderate pace” and that the first quarter figure for gross domestic product (GDP) was suppressed by “transitory” factors, such as an unseasonably rough winter.

The meeting last March was the news event, as the dovish Fed emphasized its unwillingness to raise rates prematurely, stressing that the decision would be completely data dependent. The Fed’s statement and its implications surprised more than a few people, causing a small rally in equities and bonds. The Fed’s interpretation of the data, rather than just the data, remains important since the Fed has indicated it will begin raising rates once it believes inflation is moving toward its 2% target and it observes “further improvement in the labor market.”



“ In March, the Fed moved the goal posts on what it considers full employment from 5.2%-5.5% to a lower range of 5.0%-5.2%.”

As a reminder, employment and inflation “data” are the key statistics the Fed is following. In March, the Fed moved the goal posts on what it considers full employment from 5.2%–5.5% to a lower range of 5.0%–5.2%. As for inflation, data released last Thursday shows a 0.7% gap for the third month in a row between the Fed’s 2% inflation and the current rate of 1.3%, as shown in the chart below. The central reason we treat the recent Fed actions as noise is we continue to believe that the pace and the steepness of the rate increases matter more than the date of the first increase.



Source: <http://blogs.wsj.com/economics/2015/03/30/u-s-inflation-undershoots-the-feds-2-target-for-the-34th-straight-month/>

No. 2: Bernanke Joins PIMCO as Senior Advisor

News

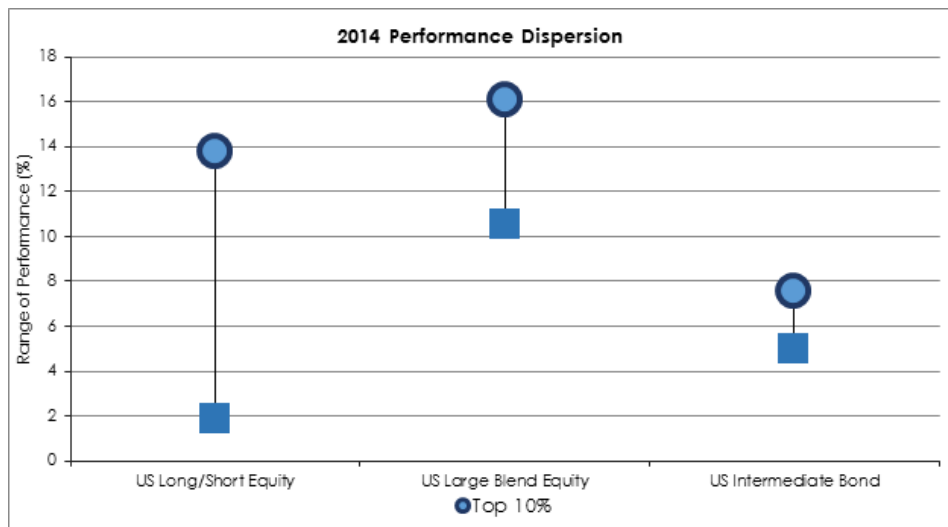
Noise

Last Wednesday was an exciting day here at SignatureFD. In addition to the Fed’s statement and the GDP report’s release, PIMCO’s market strategist, Tony Crescenzi, visited us. Earlier that morning, PIMCO announced it had hired former Fed Chairman Ben Bernanke as a senior advisor. Mr. Crescenzi told Bloomberg Television later that day that he is excited to have Dr. Bernanke on PIMCO’s team and said “his presence will be weighty” in the investment decision process.

This was actually the second time in two weeks that a major investment firm had hired Dr. Bernanke as a consultant. Dr. Bernanke will remain working full time at the Brookings Institution while maintaining an advisory relationship for both PIMCO and a Chicago-based hedge fund.

For now, we view his PIMCO engagement as noise that could develop into news. We would expect his presence to improve morale, as his expertise is a natural fit for PIMCO’s macro-driven decision process. The potential challenge for PIMCO is maximizing Dr. Bernanke’s insights in a competitive bond world. As the chart below reminds us, the performance dispersion between the top- and bottom-performing bond managers is not nearly as large as it is for stocks and alternatives. It is tough to outperform the bond benchmark on a consistent basis, and with a tight dispersion of returns, fees can eat into excess returns. However, good results are clearly

possible. In 2008, PIMCO’s leader said that recently retired Fed chairman Alan Greenspan “made and saved billions of dollars for PIMCO” while serving in a similar advisor capacity.



Source: Morningstar

What Is News or Noise?

Like most of you, we are inundated with information on our phones, in our email inboxes and on the Internet. Clearly, the world doesn't need another investing blog to reprocess stale information or reformat the day's useless headlines. Thus, in our investment blog, "News or Noise," we've taken up the challenge of sorting through the infinite bits of background noise and seeking the few truly newsworthy nuggets of information. What are the stories today that are likely to be meaningful for investors in the future? A very small number of headlines are important, and of those, many are immediately processed by investors. Only a tiny fraction of all the new data is truly relevant and underappreciated.

Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by SignatureFD, LLC), or any non-investment related content, made reference to directly or indirectly in this blog will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this blog serves as the receipt of, or as a substitute for, personalized investment advice from SignatureFD, LLC. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. SignatureFD, LLC is neither a law firm nor a certified public accounting firm and no portion of the blog content should be construed as legal or accounting advice. A copy of the SignatureFD, LLC's current written disclosure statement discussing our advisory services and fees is available upon request.