Asset Management

# News or Noise: Lots of Activity, but Little News Last Week

**By David Fisher, Chief Investment Officer**

A lot happened last week, but we didn't find much that was newsworthy for this week's headline roundup. As we have said many times before, finding bits of news in the constant flow of information coming from the media is one key of investing today. Access to information is no longer a competitive advantage, but analyzing that information and understanding how it fits into the matrix of the current times is critical. For a story to be newsworthy in this regard, it has to provide new information, and revelation is what was missing last week. Sure, several important events happened, but none of it was new information and thus had little lasting impact for investors.

## No. 1: FCC Passes "Net Neutrality" Rules

☐ News ☑ Noise

The biggest event in political circles last week was the approval by the Federal Communications Commission to regulate Internet service providers under rules that, to date, have been applied to public utilities. The rule change marks the biggest government involvement thus far in the workings of the Internet. For all but the most informed technology insiders, the concept of net neutrality is a confusing and hazy idea. In fact, even some of the most influential figures in the development of the Internet are lined up on opposing sides of this issue, showing there is not a clear answer.

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The essence of the rule is that large service providers will be regulated like public utilities, which will allow the government to mandate rules regarding the services they deliver and the pricing of those services. Proponents of net neutrality include large Internet companies, such as Amazon, Yahoo and Twitter, that worry that powerful service providers could use their position to harm those companies if they become competitive in certain business lines. The opponents of net neutrality include service providers, such as AT&T, Verizon and Comcast, and large telecommunication hardware firms. They collectively argue that the regulatory environment will take away incentive for investment and innovation in the space and that regulatory creep could grow over time, getting the government too involved in the Internet.

The question that comes out of this entire discussion is “Who owns the Internet?” This is an important issue, to be sure. But we view the story as noise for the time being, as the battle is not yet over. Service providers will certainly appeal the rule change, a move that will take years to fight in court. Though President Obama championed the rule change, most analysts believe that the final decisions are not likely to happen before his final days in the White House.

## No. 2: Ms. Yellen Goes to Washington

☐ News ☑ Noise

As the head of the Federal Reserve Board, Janet Yellen is required to go to Capitol Hill twice a year and report to Congress. The requirement comes from the Humphrey-Hawkins Full Employment Act of 1978 and requires February and July monetary policy reports from the Fed. The first of these two reports for 2015 was delivered last week. The meetings provided Yellen a public forum to elaborate on the current Fed thinking on the subject of rate rises.

On this matter, she struck a balanced tone that hinted at removing the key “patient” word from the Fed’s statement at an upcoming meeting, possibly as soon as this month. But she was careful to caveat this with the key for the Fed going forward—data dependency.

With labor markets improving significantly over the past year, the main focus now is on inflation. On this point, data last week showed overall inflation figures were very low, but there has been significant impacts by the drop in energy prices. Stripping out those, inflation remains below the Fed target of 2% but is stable. The recent fears of deflation did affect measures of inflation expectations by investors, but these have recovered somewhat. A few months of inflation expectations trending higher will likely be enough to get the Fed talking about raising rates—either this summer or this fall.

The bond and equity markets gave a collective yawn to the report, showing that no new information could be taken from Yellen’s statements. But there was a subject that received questioning from several members of Congress—additional oversight of the Fed. Momentum has been building from both the Elizabeth Warren wing of the Democratic Party and the Rand Paul wing of the Republican Party for increased oversight of the Fed by Congress.

The Federal Reserve is not a full agency of the government but rather a private-public enterprise technically owned by the nation’s banks. The concept of independence has been a pillar of the Fed’s 100-year history. History shows central banks that come under the control of elected government eventually succumb to inflationary spending and imprudent practices. We would find it newsworthy if Congress passes, and President Obama signs, legislation providing significant new restrictions on the independence of the Federal Reserve Board. We believe the market would react negatively to this added uncertainty.

## No. 3: China Drops Rates Again

☐ News ☑ Noise

In a surprise move over the weekend, China lowered key interest rates in the country for a second time in four months. Given the deflationary pressures impacting China, the People's Bank of China felt it had the "room to move" without impacting the threat of inflation. That said, the policy change raises the question about how fast Chinese growth is slowing and how worried policymakers are at the outlook. As the country struggles with an overhang of debt and sagging real estate markets, policymakers are being forced to act proactively to try to speed up the transition to a consumer-led economic story.

The benefits or risks of this single rate change are rather insignificant, but we have been seeing more discussion about a devaluation of the yuan by the Chinese government. Although not a likely event, a devaluation would definitely be newsworthy and would be one of the larger negative risks on the near-term horizon.

China tethers the yuan to the U.S. dollar, though it has been expanding the allowed trading range in recent years. But with the dollar increasing rapidly since last summer, China has seen the value of the yuan rise by nearly 20% against a basket of foreign currencies. Given that Japan and Germany are two of its largest competitors in the export business, the country's manufacturing pace has slowed dramatically.

However, an outright devaluation of the yuan is likely a last-resort strategy for policymakers. As the country looks to challenge the U.S. as a global financial powerhouse, investors would look negatively on outright manipulation of exchange rates. In addition, the country has already been struggling with capital outflows by wealthy Chinese. A full devaluation would provide significant reason for these flows to pick up, placing the country in a potentially tight financial situation.

The bottom line, the policy changes in China are noise for now, but an unexpected move as significant as outright currency devaluation would become news very quickly.

***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.*