News or Noise: Busy Next Couple of Weeks

By David Fisher, Chief Investment Officer

The next few weeks will be extremely busy. This week will see the much-anticipated Federal Reserve meeting and announcement on Thursday. Between now and month-end, Pope Francis will visit Washington, D.C., New York and Philadelphia. The Pope will likely make several public comments about issues such as income inequality and climate change during his visit. In addition, Chinese President Xi Jinping will be in the U.S. for more than a week, first making stops on the West Coast, then traveling to D.C. for an official state visit and finally making a stop in New York City for a speech at the United Nations. All of this comes at a time when markets are monitoring events closely, volatility has picked up and fears about a broader and longer market correction are in place.

From our perspective, we maintain the view that a holding pattern on portfolio decisions should remain in place. There are issues to be concerned with, namely that valuations in the U.S. remain elevated and the health of global markets is weaker than it has been for a few years. However, it seems that the odds still slightly favor a more positive outcome and a modest rally into year-end. Given the headwinds, this bounce may be milder than in the past few years, but all of the conditions for a deeper correction or bear market don’t seem to exist. We remain open to a change of opinion, and we will continue to provide our thoughts via weekly communications.

No. 1: Key Fed Meeting Is Finally Upon Us

The much-anticipated Fed meeting is finally upon us. Most investors and analysts seem to have the patience of 6-year-olds just before their birthday—unable to focus on anything else. The two-day meeting will get underway on Wednesday, and
the announcement and press conference will be after lunch on Thursday. The Fed seems to have become boxed in with current and future policy decisions. At this point the markets are only pricing in about a 1-in-3 chance of a rate increase, so a move could create initial sell-off. However, if Fed officials do hold off, many could view the decision as an indication that they have concerns about the future of the economy given recent volatility.

The data are very much split along the Fed’s two main goals: Job creation is strong and improving, yet price pressures have yet to materialize and inflation expectations have recently come down and are below targets. The majority of press we read last week pointed out that the Fed has not historically raised rates when equity market volatility is as high as it has been recently. Further, many have raised concerns about the ongoing impact of a strong dollar and the fact that this economic headwind has already tightened policy significantly from a year ago. Offsetting this are the comments from Federal Reserve Vice Chair Stanley Fischer that we covered in News or Noise two weeks ago.

The concern for this meeting is that with markets and analysts so divided on what should happen, no matter the result a large group will find fault with the decision, which could add to market uncertainty and lack of clarity about what comes next. We continue to believe a binary decision at this meeting is less important than the communications that follow about pace and trajectory of future changes.

No. 2: Importance of Immigration Crisis in Europe

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Over the past few weeks another European crisis—immigration—has placed a spotlight on the ineffectiveness of the European Union decision-making process. As far back as 1999 some EU leaders expressed the need for a common answer to migration; however, other countries pushed for a policy to maintain control at the national level. This now looks to be a mistake, with countries at odds with one another over how to handle the crisis. Over the past few weeks, Germany, France and others announced policies to accept immigrants. The countries most affected—Hungary, Greece and Italy—have been asking for help for months.

The most recent plans account for about 30,000 relocations, while officials say the need is likely at least three times that amount. This crisis again amplifies the lack of central coordination across the EU. A central tenet of the European Union is freedom of movement within the countries of the EU, a principle that derived from the Schengen Agreement in 1985. Several recent events—the rise of nationalistic political parties, terrorism and now immigration—have increased calls for adjustments to the Schengen Agreement. And given the fast growing group of immigrants, border controls were re-established on the German-Austrian border as well as within Slovakia over the weekend. Certain changes to the Schengen seem reasonable, but a complete retreat from the principles would be dangerous. As Stratfor wrote in a recent piece, “The likely reforms to the Schengen Agreement will hurt this basic principle [of free movement]. Once a basic principle is weakened, the door is open for other freedoms to be similarly affected.”
No. 3: Brazil Sovereign Credit Downgraded

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Our view for some time has been that the negative feedback loop in emerging countries has become severe enough that we would have to wait for something to break before considering new investment. We could be getting closer to that as the situation gets worse in places like Brazil, South Africa and Russia.

On Friday, Standard & Poor’s downgraded Brazil’s sovereign credit to junk status. The country has been struggling for some time with declining exports due to dependency on commodities and China, which has pushed Brazil’s currency—the real—to much lower levels. This has pushed inflation higher, and the central bank held interest rates last week at 14.25%, nearly the highest in the world. The political dysfunction is also continuing as President Rousseff is losing popularity and is unable to push through needed reforms.

As fears of bigger problems rise, Brazil and South Africa are seeing their credit-default swaps—which measure investors’ fears of default—rise to the highest levels since 2009. Several articles in the past week point out that the challenges for emerging markets are not as acute as they were in the 1990s, but that is little respite when the problems could be chronic. For now we consider this story noise, as the markets have already downgraded Brazil via higher interest rates and a weakened currency. But the cycle impacting Brazil and other emerging-market countries is definitely newsworthy, and we are watching closely.

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.