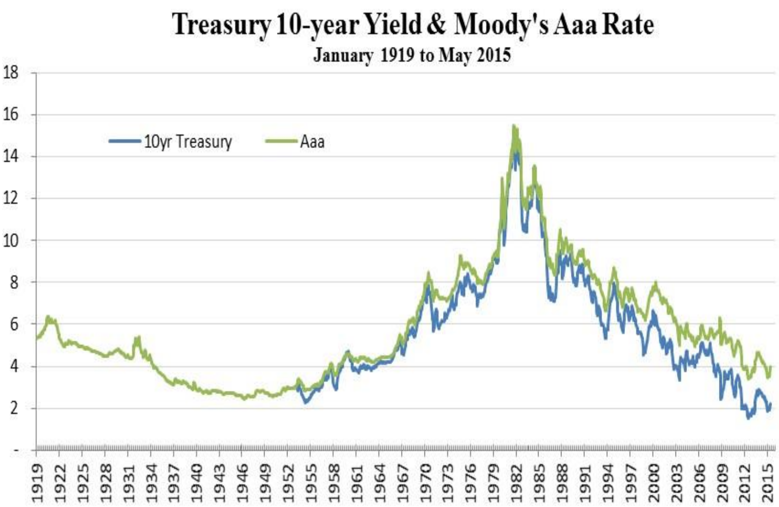
As We See It

"Weather forecast for *tonight*: dark." ~ George Carlin

Some forecasts can be made with abject certainty. Others—like the future direction of interest rates—are more difficult to ascertain. Perhaps one of most frequent debates we hear concerns how soon the Federal Reserve will raise interest rates. At current levels, the conventional belief appears to be that the Fed must raise rates—and soon. However—looking at historical precedents—the Fed may be in much less of a hurry than the market commentators would have us believe. We have spent a considerable effort looking into the historical points when the Fed raised interest rates to see the impact on not only interest rates but also the overall markets.

To begin with, much of the market's belief that the Fed must raise rates is due to the not-so-distant memory of double-digit, short-term rates in the 1970s and 80s. When you review market interest rates over longer periods of time, current rates are considerably less of a deviation from the historical averages. Whether we view the historical yields of 10-year Treasury notes or Moody's Aaa-rated industrial bonds, the picture is clear: current interest rates are not terribly out of line with historical averages. In fact, the period in the 1970s and 80s which weighs so heavily on our collective memory was, by far, the exception.



Another conventional point of view is that when the interest rates rise, the stock market swiftly ends whatever positive trajectory it had been on before that point. Interestingly, this conviction would also appear to be unfounded. Of the four most recent interest rate increases by the Fed, only the hike in late 1993 saw lower stock prices twelve months later. Even in this instance, the S&P 500 was down less than 5% a year later. After the rate hikes in 1988, 1999, and 2004, the S&P continued to climb over the next twelve months.

What does this mean for the interest rates and the stock market? We have seen that interest rates can and have stayed persistently low for long periods of time. We fail to see a clear precedent that requires the Federal Reserve to raise interest rates simply because they have been low for so long. It would beg the question as to what the crowd predicting an imminent rise in interest rates has used to justify their conclusion. As we have seen, the historical data may not support that conclusion. As for the stock market, it would also seem the conventional wisdom that the market must fall when rates rise may also lack sufficient precedent. While we can never predict the future levels of interest rates or the stock market, perhaps we can take comfort in that the market's concern about the potential impact of higher interest rates on stocks may be unfounded.

July 2015

450 Regency Parkway, Suite 410 | Omaha, Nebraska 68114-3701 | *tel* 402.392.2606 | *fax* 402.392.2597 | www.lawsonkroeker.com