Laura Gross Siebert Monthly Client Newsletters (Through November, 2014)

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The Beat Goes On

Better-than-expected third quarter corporate earnings united with clear signs of a strengthening U.S. economy, a mid-term Republican Senate victory and indications that central banks abroad may pick up the Federal Reserve's mantle of easy money to trounce last month's negative investor sentiment and drive equity markets higher for four straight weeks through November 14 as we write to you early this month in advance of the Thanksgiving Holiday.[1]

From their mid-October closing lows, at which the S&P 500 almost entered correction territory, the S&P 500 and Dow Jones Industrial Average took only 12 market sessions to rather spectacularly rebound to new record highs on October 31. Since then, starting November 5, they hit five more new records in a row through November 11. The Dow hit two more records November 13 and 18 and the S&P 500, three more, on the 14, 17 and 18. The 12-session moves through October 31 were stunning in their scale, with the S&P up 8.4%, marking the index's best two-week gain since 2011, and the Dow up 7.9%. The Nasdaq reached its highest level since March 2000. The rapidity of the rebound may have

acted to reinforce the perspective that trying to time the market can be dangerous for the average investor. As of November 18, the S&P 500 closed at record highs 43 times this year, and the Dow, 26, and many professionals say historic precedents indicate there may be more upside to come before the end of the year and well into next.[2-9]

Happy New Year

While historical precedents cannot guarantee future results, according to the Stock Trader's Almanac, in the past 65 years, the best combination of quarters in the election cycle are the fourth quarter of a midterm year and the one immediately following it, which together averaged a total gain of 16%. Since 1946, following 17 midterm elections, the S&P 500 was positive 100% of the time from October 31 of the midterm year to October 31 of the next year, with an average gain of 17.5%, according to S&P Capital IQ Chief Equity Strategist, Sam Stovall. This particular midterm election produced the political scenario the S&P 500 seems to like best, with a Democrat controlling the White House and the Republicans controlling Congress. Since 1946, that mix has outgained other combinations for an average increase of 15.1%. Moreover, the third year of the four-year presidential cycle typically outperforms the other years.[10-13]

Seasonality is also contributing to current optimism about what many see as a secular bull market with years to run. November through January has been the best three-month period for stocks over the past 100 years, and mid-October through late April has been the strongest six-month period in which to own stocks.[14-16]

Individual investors are the most optimistic they've been all year, with 52.7% projecting that stocks will rise over the next six months, according to the American Association of Individual Investors, and the percentage in the bullish camp has been above the historical average for 13 of the past 14 weeks.[17]

Add to these potential positives the facts that stock buybacks are forecast to rise 18% next year, which has the effect of increasing share prices, and that the U.S. economy is growing at a faster clip than other developed economies, except for the United Kingdom, engendering what some asset managers say is an avalanche of investment from abroad, and it may be understandable why many respected strategists are calling for the S&P 500 to end the year around 2100 and keep gaining next year. As we wrote to you in January, according to S&P Capital IQ, the index gained an average of 10% since 1946 in the 21 years following those in which it increased more than 20%, as it did last year.[18-30]

With the market's trailing 12 month price/earnings ratio, by most measures, about 19, a bit above its last-decade average of 17, many strategists say that future share growth is likely to pace earnings growth. Forecasts vary, but many analysts expect high single-digit earnings for next year. More than 90% of earnings reports are in for the third quarter of this year and S&P 500 companies, overall, handily beat reduced estimates, with profits up 10.2% over last year and revenues up 4%.[19, 31-32]

Negative Energy

Despite fears about the potential impact of slow global growth on sales of U.S. companies abroad, S&P 500 revenues would have been 5.3% without energy stocks, which have taken a drubbing as the price of oil, pressured by slowing global demand, oversupply and the U.S. dollar at a four-year high against a basket of other currencies, has declined by about 30% to four-year lows since June. The fall-off has occurred amid what some see as a stand-off between Saudi Arabia, the world's largest oil exporter, which is fighting to maintain market share among other OPEC countries, and a booming U.S. shale oil industry that for the first time in 30 years, the week ended November 7, caused America to produce an estimated 9.06 million barrels a day of crude oil, compared with Saudi Arabia's

about 9.6 million barrels a day. Many analysts say that U.S. oil production can continue to be profitable at prices above $70 a barrel but some highly-leveraged operations may begin to suffer before that. OPEC meets November 27 and members are reportedly divided on whether or not to cut production. If they do, it would likely boost prices, which, as of the week ended November 14, fell below $80 a barrel for both crude oil benchmarks, Brent and West Texas Intermediate. With oil prices in the low $80's, analysts say many oil-exporting countries such as Venezuela, Russia, Iran, Iraq and others may have difficulty balancing their budgets. Saudi Arabia also is included in that group but is thought to have enough surplus cash to withstand lower prices.[33-39]

Captain America to the Rescue

It is possible that any earnings weakness in the energy sector, which comprises 9.2% of the S&P 500 by market capitalization, may be offset by strength in other sectors. The flip side of the potential negative impact of low oil prices on oil producers is a positive impact on global oil consumers, in particular the American consumer, whose spending continues to be the major driver of U.S. and global growth. Many analysts say that the benefit to consumers of lower gas and oil prices will far outweigh any potential harm to U.S. oil production, which only

accounts for 1% of gross domestic product. Consumer spending accounts for nearly 70%.[40-42]

Lower gas prices act as a tax cut, potentially giving consumers more money to spend. Next year, the U.S. Energy Department forecasts gas prices will continue to average under $3 per gallon, which, based on today's consumption of $1 billion a day, is projected to generate a savings of $61.1 billion that can be used for other purposes.[43-44]

Retail sales, which account for about a third of consumer spending, rose broadly in October and the core measure, stripping out volatile components such as gas and food, was stronger than expected, indicating consumers may be spending what they are saving at the pump. Although food prices have been rising lately, the retail sales data jives with November 14 data on consumer sentiment which reached its highest level since July 2007, reflecting a better job market, lower gas prices and stocks back at record highs.[45-48]

An acceleration in consumer spending may boost the already-strengthening U.S. economy, which advance estimates peg to have grown 3.5% in the third quarter. If the estimate holds, third quarter would be the fourth of five quarters GDP will have grown 3.5% or more, and together with 4.6% growth in the second quarter,

would mark the strongest six months since the second half of 2003. Economists forecast overall growth of 3% next year, which would be the first time the GDP grew that much for a full year since 2005, two years before the recession.[49-51]

Made in America

Behind increased optimism about the economy is solid improvement in the labor market, which added more than 200,000 jobs per month for nine straight months through October, putting it on pace to add the most jobs in a year since 1999. The unemployment rate fell to 5.8% in October from a high of 10% during the recession and much closer to the 5% it was prior to December 2007 when the recession began. The broader measure of unemployment that includes discouraged workers who've given up looking for jobs and involuntary part-timers who would prefer full-time work, fell to 11.5%, the lowest since September 2008.[52-55]

As of the week ended November 8, first-time weekly claims for unemployment insurance were below 300,000 for nine weeks in a row, the longest such run in 14 years. On November 13, the Labor Department's Job Openings and Labor Turnover Survey (JOLTS) showed that both the number of people being hired and those voluntarily quitting their jobs reached the highest point in over six years. A

strong quit rate is considered healthy because it indicates workers are confident enough to seek better jobs, typically for higher pay. Stagnant growth in wages, along with large percentages of new jobs in lower-paying professions and part-time work during the recovery, has often been cited as a constraint on consumer spending, but some economists see nascent signs of rising pay, which they expect to strengthen as the job market tightens further.[53, 56-58]

It is possible that a tighter labor market and higher wages may produce inflationary pressures that could impel the Federal Reserve to begin raising interest rates sooner than markets expect, but slow global growth, lower energy and import prices as well as strong investment from abroad in American safe-haven Treasuries may compensate. In its most recent post meeting statement, the Fed noted that "…inflation in the near term will likely be held down by lower energy prices and other factors," but said, "…the Committee judges that the likelihood of inflation running persistently below 2% has diminished somewhat since early this year." Since the Fed's dual mandate calls for maximum employment within a context of price stability, the inflation outlook is key in its decision-making about when to raise interest rates.[59-61]

A Body in Motion

Other recent economic data showed the economy is still expanding, although probably not as fast as in the third quarter. Auto sales are on pace for their best year since before the financial crisis, but production declined in October for the third straight month. Manufacturing expanded more than projected in October, although industrial production recently slipped slightly, which analysts say could reflect pressures from slow growth abroad. This also may have showed up in a drop in September exports from prior record highs. The much larger service sector, still at a strongly expansionary level, cooled somewhat from August's six-year high. Although homebuilders were more confident in November, based on improved buyer traffic and the outlook for sales, housing continues to struggle due mostly to higher home prices and a dearth of first-time home-buyers constrained by flat wage growth, high levels of student debt and tight lending standards. When first-timers cannot enter the market, existing home buyers cannot sell up, so the impact is broad.[62-69]

The economy may get a further boost from the diminishing fiscal drag of 2011's automatic government spending cuts and 2013's higher taxes, which the Commerce Department says sliced 1.9% off last year's annual growth.[70-71]

The End of an Era – Maybe

The biggest prop for the economy may continue to be a still-supportive Federal Reserve Board whose extraordinarily accommodative monetary policies have brought it from the depths of the worst recession since the Great Depression to a recovery that appears to be on the verge of becoming self-sustaining.[72-73]

At its last meeting on October 28-29, as expected, the Fed ended its third round of monthly bond purchases, stating that, since its inception in September of 2012, "…there has been a substantial improvement in the outlook for the labor market..." The Fed removed a phrase stating, "…there remains significant underutilization of labor resources" and said, instead, "On balance, a range of labor market indicators suggests that underutilization of labor resources is gradually diminishing." [61, 72, 74]

The Fed will continue to support the economy by keeping the federal funds target interest rate at 0%-0.25%, where it has been since December of 2008, for a "considerable time," which markets currently interpret to mean at least until June of 2015, and will continue to reinvest proceeds of maturing bonds which, they said, "…should help maintain accommodative financial conditions." In its ongoing effort to telegraph future moves in advance, the Fed said, "…if incoming information indicates faster progress toward the Committee's employment and

inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur sooner than currently anticipated. Conversely, if progress proves slower than expected, then increases in the target range are likely to occur later than currently anticipated.” [61, 72, 75]

Critics of the Fed’s unconventional easy money experiment begun in November 2008 during the dark days of the recession contended that it would cause the value of the dollar to plummet and inflation to surge. The opposite has happened. The dollar is up 8% this year and inflation has run below the Fed’s 2% target for 29 straight months through September. The Fed’s near zero interest rates in combination with three unprecedented rounds of bond purchases have left the American economy far better off than other developed nations with the exception of the United Kingdom, which also employed quantitative easing and record low interest rates. Austerity policies in the eurozone have stifled growth and invited deflation. Now, the European Central Bank has instituted looser money policies and on November 17, President Mario Draghi said they may buy sovereign debt if other measures fail to boost inflation. Japan, the world’s third largest economy, announced a dramatic expansion of its quantitative easing program on October 31, but on November 16, released data showing that a sales

tax increase earlier in the year caused its economy to contract for a second quarter, technically marking a recession.[72, 76-81]

Tailwinds, Headwinds and Volatility

Stimulus from the ECB and Bank of Japan may help to offset the end of the Fed's bond-buying program, buttressing global economic growth and creating a potential tailwind for equity markets. That doesn't mean that interest rate hikes will be easy for financial markets to take once they come. Even some Fed officials have suggested there is likely to be volatility and a period of turbulence as monetary policy is normalized. In addition, there is always potential for markets to be disrupted by other factors. Growth continues to slow in China and other major emerging markets, Ebola has not been cured and geopolitical tensions remain high with conflicts continuing in the Middle East and between Russia and the Ukraine. If the October pullback in the markets was not the long-awaited correction, then markets may still be due for a drop of 10% or more, because they haven't had one since 2011, well beyond the typical 18-month average. [82-87]

What a Difference a Month Makes

Unlike in mid-October, these issues haven't gotten the market down. For now, as we write on November 18, the glass seems half full. Both the S&P 500 and the

Dow hit new record highs today, and the Nasdaq, a 2014 high, after a better-than-expected report of German investor confidence and postponement of another sales tax increase in Japan, along with expectations of further economic stimulus there and in the eurozone. There is no question that this bull market likes the idea of economic stimulus, as more than five and a half years of gains with an S&P 500 that has more than doubled since March of 2009 can attest.[3]

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The Fall Arrives

There seem to be more explanations for the equity market's recent volatility and mid-October fall-off from September highs than can possibly be enumerated. Here are some of the most popular which, taken together with the short-but-sharp stampede of investor pessimism they engendered, may constitute the most likely.[1]

It's October, historically a brutal time for the market. It's Ebola, a terrible disease and with its even-so-far-limited geographic dispersal, a frightening development that has incited a frenzy of uncertainty around the world. It's the end of easy money with the Federal Reserve Board expected to stop bond-buying at the end of the month and raise interest rates next year. The global economy is not

growing as strongly as previously forecast, with the international Monetary Fund (IMF) dropping its outlook for world growth by 0.1% to 3.3% for this year and 0.2% to 3.8% for next, despite modest to moderate growth in the U.S. and U.K. The IMF said global growth faces a "new mediocre" if bold steps are not taken to stimulate economies rather than focus on budget-tightening, particularly in the eurozone. The eurozone is at risk of recession and possible deflation on a slowdown in its German industrial powerhouse whose leadership continues to back fiscal prudence over monetary stimulus, despite faltering demand for its own exports from still-struggling neighbors and formerly high-growth emerging markets. These include China, Brazil, which entered recession in the first half of the year, and Russia, whose conflict with the Ukraine has prompted sanctions that have hurt trade with Germany. On top of flat growth and ongoing high unemployment, eurozone inflation in September was 0.3%, the lowest in nearly five years. Although the European Central Bank is doing what it can, it is constrained by the area's structural issues and political differences, which has dented confidence by some in its ability to stave off a 1990's Japan-like slide into deflation. Even Greece came back to the world stage in the last month with political uncertainty and bond yields just shy of 9%.[2-16]

Weakness abroad forced the U.S. dollar up to levels some consider too high and, along with a glut of oil that OPEC seems unwilling to staunch, pushed the price of oil down to what some consider too low, which, if it continues falling, may pressure the profitability of U.S. shale oil producers. China, the world's largest buyer of commodities and second largest economy, continues to struggle with its conversion from an export-driven to a domestically consumption-driven economy, with some economists expecting that it may sputter short of its 7.5% growth target this year, potentially depressing demand for imports from abroad. Japan, the world's third largest economy, contracted 7.1% in the second quarter after a consumption tax increase and its central bank downgraded growth prospects while continuing monetary stimulus with the economy in a "moderate recovery trend."[17-27]

Deflationary pressures have been bubbling up all over the world. Prices of industrial commodities have fallen on weakening global demand while food prices have fallen on stellar harvests. The price of oil has fallen by 25% since June. U.K. inflation surprisingly tumbled to its lowest level in five years. China's consumer inflation is the lowest since January 2010. Prices in Israel and Sweden are falling. The U.S. and U.K., brighter spots amid the recent gloom, are fearful of catching as-yet-nonexistent deflation from the eurozone and elsewhere.[28-31]

Then, there are the multitude of political strains and conflicts. Russia and the Ukraine are still fighting and political tensions between Russia and the West are high. ISIS is battling through Iraq and Syria on the ground; the U.S. is striking Iraq and Syria from the air. Other conflicts continue throughout the Middle East. Pro-democracy students in Hong Kong are protesting and anti-democracy protestors are fighting back.

Sometimes the simplest explanation makes the most sense. Perhaps it's just time for that much-anticipated 10%-20% correction, which if it is, many investors welcome as a healthy development in the midst of what they see as a still-strong secular bull market with many more years to run, one that many still forecast will finish the year above 2000.[4, 32-35]

Rocktober!

Although stocks were already volatile coming into October, finishing the third quarter up, but September down, the first two and a half trading weeks of the month were like a roller coaster ride. The Dow Jones Industrial Average pitched up and down by triple-digits, intraday and day-to-day, and the S&P 500 behaved similarly as the optimistic forces for good U.S. economic and earnings growth battled with those focused on the end of easy money, Ebola, deflation, conflicts

abroad and slowing global growth. Energy stocks fell on the decline in oil and fears about global growth. Airline stocks dropped on concerns about Ebola. Some investors were forced to sell long positions to cover soured short bets.[36-40]

Stocks haven't seen this kind of volatility since August 2011, in the midst of the eurozone sovereign debt crisis, when Standard & Poor's downgraded the nation's credit rating a notch to AA+ from AAA which preceded the 19.4% correction in the S&P 500 that bottomed in early October 2011. As we have noted for some time, three years is far longer than the typical 18 month average for declines of 10% or more. The good news, according to Sam Stovall, Chief Equity Strategist at S&P Capital IQ, is that in the 19 such drops of 10%-20% since World War II, the S&P 500 has only taken an average of four months to bounce back to break-even. He notes that the best three quarters for the market are the ones immediately after the worst two.[41-43]

Whipsaw Wednesday

It all seemed to come to a head on Wednesday, October 15, when surprise drops in U.S. retail sales, producer prices and the New York Fed's Empire State Manufacturing Survey combined with other concerns roiling the markets to produce the highest-volume day ever for U.S. government debt and the highest

for equities since 2011. High-frequency traders, hedge funds, short-term bond investors and others who just a month earlier had positioned themselves for the possibility of higher oil prices, higher bond prices and an earlier-than-expected interest rate hike from the Fed on solidly good news from the U.S. economy found themselves wrong-footed in the face of U.S. and global economic news that no longer seemed to them as supportive of those views. All the gloom since the end of September about slowing global growth set many investors back on their heels, causing them to reallocate assets to reflect a new perspective and reposition projections for when the Fed might raise interest rates by lengthening the timeline from the middle of next year to the end of the year. Their actions in both the stock and bond markets, along with a flight to the relative safety of U.S. Treasurys from abroad, pushed the benchmark 10-year Treasury bond into an historic 34 basis point free-fall from its 2.2% close the day before to below 1.9% in just six minutes after the Treasury market opened. Then, it bounced back in just 15 minutes to trade above 2%, again. The Chicago Board Options Exchange Volatility Index, VIX, which projects the market's expectation of volatility for the next 30 days and is used as an measure of investor fear, reached over 30 for the first time since 2011, still very far from its over-80 record reached in November 2008 at the height of the financial crisis. The Dow fell 460 points that afternoon,

before regaining most of that and, the next day, gained 263 points to close the week off 5.2% from its September record high and down 1% for the year. The S&P 500 traded in a range of 57 points during the day, the widest since August 2011 and, although it fell to an intraday low of 1820.66, 9.8% below its record intraday high of 2019.26 on September 19, almost marking a correction, it only fell a total of 7.4% on a closing basis from September 18 to October 15 and ended the week on October 17 at 1,886.76, down 6.2% from its record high, and still up 2% for the year. Through the tumult, the Dow fell about 6.7% from closing peak to closing trough, the Nasdaq, 8.3% and the Russell 2000, which wound up having its best week in 14 years as of October 17, 13%.[4, 44-59]

Markets Repriced

The stabilization of equity markets on October 16 and gains on October 17 caused some market-watchers to note that the "buy-the-dip" mentality that has characterized this bull market since 2009 is still in vogue. The gains, which continued into the next week, came on a combination of mostly better-than-expected U.S. earnings and economic data coupled with remarks from central bankers in England, China, the eurozone and Japan that produced hopes they would provide more economic support.[60-62]

On October 16, St. Louis Federal Reserve president, James Bullard, may have put a floor under markets when he said on a television interview that, given the Fed has "to make sure that inflation expectations remain near our target…" a reasonable response would be to… "pause on the taper (of bond purchases) at this juncture, and wait until we see how the data shakes out in December." The prior weekend, Fed Vice Chairman, Stanley Fischer said in the keynote address to the IMF/World Bank annual meeting in Washington, "If foreign growth is weaker than anticipated, the consequences for the U.S. economy could lead the Fed to remove accommodation more slowly than otherwise." The Fed meets next October 28-29 after we go to press. It has been expected to end its bond buying at that time but has emphasized that its actions are data-dependent. Whether new developments cause them to change their outlook or actions remains to be seen. Many market watchers do not believe they will extend bond purchases past October, and if they do, will only shift part of their last scheduled $15 million forward. Unlike last month, there is less chatter about them being likely to change guidance that states they expect to begin raising interest rates "a considerable time" after bond buying ends.[63-65]

Also on October 17, the Bank of England's chief economist said that they may need to keep interest rates lower for longer than previously thought. In addition,

China, in advance of releasing data on October 21 that showed a third quarter growth rate of 7.3%, the slowest in five years, announced it would inject $32.6 billion into 20 large banks to stimulate stronger growth. Perhaps most importantly, a member of the European Central Bank's executive Board announced the ECB would, within days, start buying asset-backed securities and covered bank bonds, which it began doing on Monday, October 20. He also soothed markets by stating that the ECB expects positive eurozone growth in the third and fourth quarter along with a gradual rise in inflation expectations. Further buoying markets on October 20 was an unconfirmed rumor that the ECB also may soon begin buying corporate bonds, and, on October 19, Japan's prime minister hinted that he may delay a planned hike in the nation's consumption tax from 8% to 10% if it might damage the economy.[66-73]

After the Fall

According to S&P Capital IQ, the market's gyrations through October 17 left the S&P 500 at what may be a reasonable value of 15.1 times expected earnings, compared with the average of 16.4 times forward earnings since 2001. Third quarter corporate earnings and revenues are coming in better than expectations for 6.9% growth in earnings on 4.1% growth in revenues. The U.S. economy,

which surged 4.6% in the second quarter, after contracting 2.1% over the winter, is still forecast to grow 3% or more for the year and economists hope wages will finally begin to rise, with unemployment down to 5.9%, jobs being created at a rate of 200,000 or more a month and weekly jobless claims at a 14-year low.[74-82]

Supporting market gains into the next week, September industrial production showed a better-than-expected gain and the average for a 30-year fixed-rate mortgage declined below 4% to 3.92%, the lowest since June 2013. The University of Michigan’s preliminary consumer sentiment index for October, an indicator of consumer willingness to spend, jumped to a seven-year high, possibly reflecting the strengthening job market and the impact of lower gasoline prices that have dropped below $3 in some parts of the country, the sunny side of oil prices at four-year lows. September housing starts rose 6.3% and building permits for future construction increased 1.5%, both at annualized rates of over 1 million, which may point to continued growth in the sector. September existing home sales hit the highest level of the year, up 2.4% from August for the fifth increase in six months, and, although sales of new single-family homes, which account for about 8% of the housing market, reached a six-year high in September, August's sales were revised sharply downward, making for a still-mixed housing picture. The Fed’s latest “Beige Book” survey of economic conditions in its 12 districts

released into the market turmoil on the afternoon of October 15 found continued "modest to moderate" growth in 11 of 12. Consumer price inflation has remained tame but not deflationary.[83-90]

Best House on the Block

Slower growth abroad may eventually dent profits of those multinationals which source substantial revenues from their overseas activities, but the U.S. relies far more on consumer spending, which accounts for 70% of GDP, than exports, which account for only 14%, and those to Europe, only 15% of that. Optimistic strategists believe that the world's problems are not enough to interrupt a strengthening U.S. job market that, along with years of deleveraging by consumers and businesses, stronger consumer confidence, lower mortgage rates and lower food, gas and fuel prices, are likely to put more money in consumers' pockets that they can spend to further economic growth.[29, 91-96]

On October 23 and 24, markets rallied on better-than-expected earnings from U.S. multinational industrials, a gain in the Conference Board's leading economic indicators pointing to growth for the remainder of the year and upticks in euro area business activity and China manufacturing. Along with positive sentiment expressed by central bankers during the recent market turmoil, this seems to

have, at least for the moment, placated the edgiest concerns about the impact of global growth on the U.S. economy and company profits. The VIX "fear gauge" fell to 16.22, just over half of its October 15th 31.06 intraday high for the year and a level that may correspond to less near-term market volatility. News of the fatal terror-related shooting of a Canadian soldier in Ottawa on the 22nd and a report that a doctor in New York was being tested for Ebola on the 23rd may have moderated weekly gains, but it was still the best week for the S&P 500 since January 2013. After falling for four straight weeks, the S&P 500 surged 4.1%. The Dow gained 2.6%, the most since last December and the Nasdaq jumped 5.3%, its largest percentage gain since December of 2011. As we write to you on October 26, the dust has settled, at least for the moment, with all three indexes less than 3% from their September highs and all up for the year.[97-100]

Tricks or Treats

Given the market's recent propensity for extreme reactivity, large daily swings may continue. October may still hold some late-month tricks or treats associated with upcoming U.S. economic news on the 29th, 30th and 31st. These include results of the Fed's October 28-29 meeting; the first estimate of third quarter GDP growth; personal income and outlays, including the Fed's preferred measure of

inflation, durable goods orders and the University of Michigan's second October consumer sentiment reading. There may be market-moving news from abroad, as well.[101-102]

If the economy continues to improve, earnings and the equity market may continue to improve with it, despite the potential for continued disruptions from abroad and for increasing volatility as the Fed moves away from its historically accommodative monetary policy. While some analysts think the long-awaited correction has come and gone, others say it has yet to come. Regardless of whether it has or hasn't, many bullish strategists believe that the strong dollar will continue attracting investors from abroad and stock buybacks, about 25% of which occur in November, the third best month for stocks since 1950, and December, the best, may continue to bolster stock prices into year-end, making for what may provide investors with a very happy holiday season.[34, 103-108]

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Too Much Ado

The old adage, "don't fight the Fed," was joined by a new one, "don't fear the Fed," after one of the most hotly-speculated about Federal Reserve Board Open Market Committee (FOMC) meetings in recent history ended up on September 17

stressing equity markets less than the preceding week and a half of controversy over its possible outcome. The Dow Jones Industrial Average and S&P 500 both hit fresh record highs the day after the meeting, and the Dow again the next day, and both indexes finished the week ended September 19 well up from the week ended September 12 when advance conjecture about what the Fed might do contributed to the indexes' first weekly decline in six. [1-11]

Since then, fears about slower global growth, particularly in China and the eurozone; the first drop in four months in existing U.S. home sales; U.S. Treasury action to deter companies from moving their addresses abroad for tax purposes, and the commencement of bombing by the U.S. and five Arab states of terrorist targets in Syria conspired to push the indexes off their highs and prompted some analysts to perceive potential buying opportunities against a backdrop of what many see as an improving domestic economy. Fueling that optimism, on September 24, as we write to you, an 18% monthly gain in new home sales and comments from European Central Bank President Mario Draghi that, "Monetary policy will remain accommodative for a long time," propelled the Dow up triple digits, leaving it just 69.68 off its September 19 record, the S&P 500 up 15.53, just 13.06 off its September 18 record and the Nasdaq up 46.53, 38.21 off its September 18 recent high.[12-17]

Rate Hike Jitters

In its post-meeting statement, the Fed was optimistic about the economy, but apparently not so buoyant that it felt the need to change key wording which markets feared could signal its intent to raise interest rates sooner than they expect, sometime in mid-2015.[18-19]

Before the Fed meeting, speculation was at a fever pitch that a raft of positive economic news in late August and early September indicated a U.S. economic recovery finally self-sustaining enough to force policymakers into a quicker-than-expected hike in interest rates. These included better than expected 4.2% gross domestic product growth in the second quarter powered by the largest increase in business investment in more than two years; broad-based increases in manufacturing activity and retail sales; consumer sentiment at a 14-month high and a measure of consumer confidence at a seven-year high; the biggest one-month jump in orders for factory goods since records began in 1992; a surge in construction spending to a five and a half year high; the highest level of growth in service sector activity since August 2008; the best auto sales in a decade, and the narrowest trade gap in six months on record exports. Even fewer-than-expected

jobs created in August were mostly discounted against other data showing the strongest hiring since 2007 and job openings near a 13-year high.[20-33]

An Economic Letter published by researchers at the San Francisco Federal Reserve Bank on September 8 added to anxieties when it said "…the public seems to expect more accommodative monetary policy than Federal Open Market Committee participants." This sent shudders through stock and bond markets, which feared the Fed might change a phrase in its post-meeting message that has stated since March, "it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time" after it ends its current program of quantitative easing monthly asset purchases, expected in October. Markets thought a change to the words, "considerable time," which the Fed did not make, could mean interest rates might start to rise as soon as six months after the asset purchases end, despite Fed Chair Yellen's repeatedly saying all year, including at her first press conference as Chair in March when she tried to define "considerable" as "probably…something on the order of around six months or that type of thing," that the Fed's decisions are entirely data-dependent. Pressed on the issue at the Sept. 17 press conference following the two day FOMC meeting, she reiterated, "I know 'considerable time' sounds like it's a calendar concept, but it is highly conditional and it's linked to the Committee's assessment

of the economy." She also said, "if the pace of progress in achieving our goals were to quicken, if it were to accelerate, it's likely that the Committee would begin raising its target for the federal funds rate sooner than is now anticipated and might then raise the federal the federal funds rate at a faster pace. And the opposite is also true, if the projection were to change."[34-40]

Steady As She Goes

The Fed's post-meeting statement said, "economic activity is expanding at a moderate pace…Household spending appears to be rising moderately and business fixed investment is advancing, while the recovery in the housing sector remains slow." The Fed's dual mandate calls for it to foster maximum employment and price stability. The policymakers said, "Inflation has been running below the Committee's longer-run objective," which is 2%, and Chair Yellen noted in her press conference following the meeting that, since the depth of the recession following the financial crisis, "…while unemployment has come way down from the slightly over 10 percent level it reached, at 6.1 percent it remains significantly above the level that most FOMC participants would regard as consistent with normal in the longer run, 5.2 to 5.5 percent. So there is significant underutilization of labor resources."[18, 40-41]

Prior to the meeting, there was also some anticipation that creation of an average of more than 200,000 jobs over the past three months might prompt the Fed to remove language stating there was still "significant underutilization of labor resources," which, some industry observers believed might also have suggested it was closer to the first interest rate hike, but Chair Yellen said, "There are still too many people who want jobs but cannot find them, too many who are working part time but would prefer full-time work, and too many who are not searching for a job but would be if the labor market were stronger." The Fed's statement said, "The Committee currently judges that there is sufficient underlying strength in the broader economy to support ongoing improvement in labor market conditions."[9, 18, 40-43]

The central tendency for forecasts from FOMC participants for growth for 2014-2016 dropped somewhat from June's, for this year, to 2%-2.2% from 2.1%-2.3%, for next year, to 2.6%-3%, for 2016 to 2.6%-2.9% and to 2.0-2.3% in the longer run. Projections for 2017 were provided for the first time and growth was projected at 2.3%-2.5% for that year. In her press conference, Chair Yellen noted that, "Over the next three years, the projections for real GDP growth run somewhat above the estimates of longer-run normal growth."[18, 40, 44]

The Fed post-meeting statement said, "…even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run."[18]

On To Monetary Normal

By getting closer to ending the monthly asset purchase program it began in September 2012, its third round of extraordinary and unconventional monetary stimulus in six years, the Fed has begun a journey through uncharted territory back to normal monetary policy. In addition to monthly purchases of Treasury and mortgage-backed securities, the Fed has kept the target level for its federal funds interest rate, on which many market interest rates are based, at the historically-low level of 0%-0.25% since December 2008, all in an effort to stimulate borrowing, boost economic growth and support job creation.[45-46]

Some economists, including some at the Fed, itself, are concerned that the Fed may wait too long to raise interest rates and find itself having to play catch up to contain an overheating, inflationary economy and any potential bubbles that might be brewing due to its stimulus policies. Others believe raising rates too soon could stall what has been an on-again-off-again recovery by squelching job

creation and associated increases in wages that have barely budged since the recession, pressuring both consumer spending, which accounts for about 70% of economic activity, and already below-mandate inflation.[47-50]

The meeting may have been a pivotal one for the Fed under Chair Yellen as she released revised plans for normalizing monetary policy in the longer-term, even if some timeframes are necessarily uncertain due to their dependency on incoming economic data. The plans were contained in a separate document called***,*** *Policy Normalization Principles and Plans*, which detailed the mechanisms the Fed will use, once a less accommodative monetary policy is appropriate, to begin raising interest rates and to allow its portfolio of bonds to shrink. Chair Yellen said the latter process could take to the end of the decade. The release of these measures reflects the expectation that the Fed will move, as it has throughout the exit process, with advance notice and as gradually as possible toward normalization of monetary policy and will not leave the economy without support until the recovery is well-entrenched.[40, 51-53]

Hawks vs Doves

In reaching new records after the Fed meeting, the equity market seems to have taken the post-meeting statement and Chair Yellen's comments as dovish in that

they pointed to a continuation of highly-accommodative monetary policy. However, the bond market seems to have focused more on FOMC members' individual projections for interest rates over the next three years, released on a "dot plot" Summary of Economic Projections (SEP), interpreting them as a bit more hawkish than in the past because they indicate a slightly higher and faster rate of interest rate increases than prior projected. The new SEP showed an increase in the median forecast for the federal funds rate at the end of next year to 1.375% from 1.125% projected in June and at the end of 2016 to 2.875% from 2.50% in June. The median forecast for the end of 2017 was for 3.75%.[44, 54]

Short-term bonds are particularly sensitive to the Fed's short-term interest rate policies. Even before the meeting, fearing a shorter time frame for the first interest rate hike, bonds, whose prices move inversely to yields, began to sell off and by the day after the meeting, yields on two to five year Treasury bills reached levels not seen in more than three years. The benchmark 10-year Treasury bond reached 2.629%, the day after, the highest level since July 3, up from its low of 2.33% in late August, but still well below the 3% at which it entered 2014.Since then, it declined to 2.529% on September 23 as concerns about uneven global growth boosted demand for safe haven assets. Yields on longer-term bonds are

more influenced by inflation, which indicates growth in a healthy economy, and by demand.[55-61]

Global Crosscurrents

Yields on long-term Treasuries, which, like all bonds, move inversely to prices, are being pressured by strong demand from overseas investors fleeing lower bond yields abroad, as weak growth and expectations of additional currency-pressuring monetary stimulus in the eurozone and Japan make their currencies and bonds less attractive compared to U.S. bonds and dollars, which may strengthen even more as U.S. interest rates rise. A flight to safety in a world of escalating geopolitical conflicts also contributes to demand for U.S. Treasury bonds.[50, 54, 62-63]

Anticipation of higher rates here and slow growth abroad also has added momentum to the dollar's ten-week rally, the longest since 1967, that propelled it close to a six-year high against the Japanese yen and a 14-month high against the euro the week ended September 19. Since oil is priced in dollars, the dollar's strength, together with a glut of oil supplies and lower demand, especially from the world's second largest, but struggling, Chinese economy, which is also the world's largest consumer of commodities, pressured the commodities prices,

including global benchmark Brent crude oil to its lowest on an intraday basis in more than two years in mid-September, where it remains as we write.[64-68]

This underscores the interconnectedness of the global economy and financial system, which may bring potential risks to the U.S. if world growth slows markedly but may also benefit the U.S. through a stronger dollar and lower cost of imported oil. Lower oil prices mean less imported inflation and lower gas prices. With the boom in fracking of oil and natural gas in the U.S., which has made the U.S. the world's largest energy producer, there may also be the potential for a boost to the domestic economy from new industries and new facilities to be built near new energy sources.[69-74]

Bully for the Fed!

The Fed's easy money policies have contributed to the fourth longest bull market in history. Some investors are concerned that the end of easy money may mean the end of the bull, but many analysts point to still-low interest rates and still-tame inflation in a steadily growing economy, rising corporate profits, expanding business investment and a Fed that is being transparent about the factors it is taking into consideration and the actions it is planning as counterweights to that argument. They see no U.S. recession on the horizon, which many say is what

typically stops bull markets, and, with the likelihood of increased easing by other central banks and a dearth of higher-yielding investment alternatives both here and abroad, many predict that U.S. equity markets may continue to gain.[75-79]

For now, August, historically the second worst month of the year for the S&P 500, turned out this year to be its best month since February and the best August in 14 years. We cannot know what the end of September, historically the worst month of the year, will bring. As we write on September 24, the bulls have just halted a three-day decline for the S&P 500 and Nasdaq and a two-day decline for the Dow. Although some analysts believe a consolidation in advance of what they expect to be a positive third quarter earnings season may be at hand, others believe the declines are over for now.[61, 80-82]

The market has not seen a traditional overall correction of 10% or more in just shy of three years, far longer than the typical 18 months. Some analysts say the longer the market goes without a correction the worse it may be once one comes. Others say that history does not write the future and, in what they say is a secular bull market with many years to run, internal sector rotations and mini-corrections along the way may have limited the potential for a large downturn. Since October 2011, seven of the 10 industry groups in the S&P 500, the Nasdaq Composite and

the Russell 2000 small cap index all have experienced declines of more than 10%, some more than once.[75-79, 83-86]

Predictions from many recently-quoted analysts for where the S&P 500 will end 2014 are higher than its current level and, for next year, range from 2150-2350. This market has become famous for investors putting floors under any declines by taking the opportunity to buy the dips. Despite the potential for turbulence as the Fed gets closer to normal monetary policy and for geopolitical disruptions along the way, many analysts see little reason to believe that may change any time soon. As they say, “the trend is your friend…until the end when it bends.”[75-79, 84-86]