Donaldson
CAPITAL MANAGEMENT

What Does The Federal Funds Rate Increase Mean For You?
12-10-18

The Fed just raised the fed funds rate again. Why does it matter and how might it affect your portfolio?

Why It Matters:

The Fed just raised the fed funds rate for the 4th time this year and the 9th time in this hiking cycle, which began in 2015 under Janet Yellen's leadership. The fed funds rate is arguably the most important interest rate in the world. The Fed uses this rate to either slow or stimulate U.S. economic growth.

Here’s how it works. Member banks are required to keep a designated minimum amount of cash on hand each night – called their reserve requirement. When economic activity picks up, banks want to loan out more money to businesses and consumers, sometimes to a point where their cash balance would fall below their reserve requirement. Banks aren’t allowed to fall below this requirement, so they have to borrow from other banks to meet this requirement. By raising the fed funds rate and making it more expensive for banks to borrow money from each other, the Fed is attempting to tap the brakes on economic activity.

How Might It Affect Your Portfolio:

When the Fed raises rates too quickly, it poses a risk to future economic growth. Yesterday’s fed funds increase was expected, however, we're leery about the pace of future increases. The Fed is forecasting two more rate increases in 2019 and possibly more in 2020. As we often say, bull markets simply don't die of old age. Quite often a Fed policy mistake kills the bull and transforms it into a bear.

There is some good news for stocks. Fed chairman Jerome Powell said the path and pace of future increases is not on a predetermined path. The decision for future increases will be data dependent. If economic growth continues to soften from it's recent above average pace, the Fed will likely pause any further increases. If the pace of future fed fund increases slows, the bull market is likely to resume.

Yesterday’s Fed activity and future guidance likely means the recent market volatility will continue. While we’re hopeful the Fed will keep the current economic expansion on track, we can't be certain. Over the past few months, we've taken a more defensive posture in your portfolio to reduce volatility. We’ve taken profits in big gainers that had become too large of a position within the portfolio. We have also shifted to companies who thrive in all kinds of economic environments.

Your portfolio was built to withstand this volatility. Our rising dividend strategy and prioritized objectives of security, income and growth have and will continue to stand the test of time.

Please reach out to your advisor or any of us here at DCM if you have any questions or comments. We'd love to hear from you.

Blessings,

Your Investment Policy Committee