MARKET PERSPECTIVE

BY RICHARD SKEPPSTROM

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Slower, longer, lower?

The markets seem to be suffering a bout of schizophrenia after U.S. Federal Reserve Chair Janet Yellen's dovish comments after the last Federal Open Market Committee meeting. Bad news is good, then it's bad, then it's good again. The Fed's words carry much weight … too bad their meaning is debatable and their shelf-life unknowable. I guess the traders like it. For sanity's sake, I prefer a longer view. We've been at the zero interest-rate limit for years with underwhelming results. The central bank continuously douses the economy with gasoline but the fire sputters. The impotency of this extraordinary accommodation is an unsubtle reminder that something unusual is going on. But nobody's exactly sure what that is. It's troubling. I'd much rather see rates rise (some) in response to a stronger recovery but that's not the path we're on.

To be honest, the Fed didn't say much and our markets have been in a trading range so maybe I should just move on but it's an unhappy fact that the Fed has had to lower its growth forecast for the Nth time. And it's been clear for some time that the Fed's move higher would be data-dependent but the damnable data aren't cooperating. Perhaps the weakness really is just an unusually harsh February but that just means a stronger second quarter won't mean much so we'll have to wait and see what the third quarter brings. The Fed may have axed the word patience from its commentary but I'm beginning to wonder if extreme patience may be called for. There are plenty of smart people who've been saying that for years. Close relatives have described my patience as childlike so you can imagine my joy when I contemplate a low-growth, low- (no-) interest-rate environment for the rest of my career.

Martin Wolf, the chief economics commentator for the Financial Times, recently wrote on the subject of low interest rates. He referenced the theory of "secular stagnation" – a persistent lack of demand – developed by former U.S. Treasury Secretary Larry Summers. Wolf wrote, "The most plausible explanation (for low rates) lies in a glut of savings and a dearth of good investment projects. These were accompanied by a pre-crisis rise in global current-account imbalances (think China excess) and a post-crisis overhang of financial stresses and bad debt. The explosions in private credit seen before the crisis were how central banks sustained demand in a demand-deficient world." He went on to say, "We should view central banks not as masters of the world economy but as apes on a treadmill. They are able to balance demand with potential supply in high-income countries only by adopting ultra-easy policies …." He ends with, "Those who bet on inflation and a bond-market rout will continue to be disappointed. The depression has been contained. But it is a depression, all the same." That's strong stuff coming from arguably the most highly regarded economics commentator in the Western world.

I've repeatedly argued that the U.S. economy is on relatively solid footing (still is) but I may have to admit that 2 percent-ish growth is as good as it gets. I've favored stocks because they offer better earnings yield (and still do) but the earnings-growth environment will eventually be more difficult if we don't have stronger economic growth. We've enjoyed extraordinary margin leverage during this cycle but more revenue growth is desirable. I don't believe we're there yet but we should expect higher volatility and low returns if the earnings advance peters out. Don't panic. I'm not talking disaster. Valuations are full but not stupid and, as Wolf points out, the Fed may have to be supportive essentially forever (if you're my age). As for bonds, I admit I've been fearful of a rout. However, the inaccuracy of my interest-rate forecasting checks my enthusiasm so I've made no big bets. I've mostly just been watching and muttering.

King Dollar?

I'll finish with a little on the dollar's strength. Last year, I believed the dollar was undervalued and I kept my international exposure hedged. The U.S. economy was undeniably stronger than most, the Fed was continuing its asset purchases while the Europeans dithered. Now that we're near parity with the euro, the European Central Bank has started its asset-purchasing program and the Fed has reconfirmed its perennial dovishness, it's hard for me to have conviction either way. I have unhedged a portion of my European exposure. Full disclosure: Reasoning that clear and prudent is almost certainly flawed in some important way. If I had to guess and with personal experience as my guide, I'd say the trade is either early or humblingly early.

Thank you for taking the time to read this month's Market Perspective. I hope you found it helpful.

Strategic Return Portfolio	
Equities	72%
Bonds	13%
Gold	2%
Cash & similar	13%
Total	**100%**

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Richard, an investment professional with more than two decades of experience, manages Eagle's Strategic Return Portfolio. His views are his own and may not reflect those of other Eagle portfolio managers.

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