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INVESTMENT GROUP

September 21, 2015

THE STRATEGICVIEW

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We believe that economic data in Europe shows an accelerating economic recovery, and that low unemployment and low gas prices will allow the Japanese and US economies to reaccelerate. If we are correct, the Fed will be raising rates before the end of the year; and, the past few days indicate that equity markets will welcome this change in US monetary policy.

Dovish Fed, Unhappy Market

Last Thursday the Federal Reserve left interest rates unchanged, an outcome that was largely expected by financial markets; however, the statement that accompanied this decision was far more dovish in tone than the Fed's previous statement released on July 29th. This time, the Fed appeared to explicitly acknowledge that volatility in the Chinese economy and its equity markets could have a negative impact on the global economy:

> *Recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term.*

After a short attempt to rally, global equity markets turned sharply downward at the end of last week, as the Fed appeared to validate the current market narrative that a slowing China presents significant risk to global growth.

Over the weekend, several members of the Fed's rate-setting committee attempted to refute the notion that the Fed is worried about an eminent economic slowdown. Fed Regional Presidents Williams, Bullard, and Lacker all emphasized in weekend interviews that the decision to keep rates close to zero was an extremely close one. These statements appeared to have calmed market concerns and helped spur today's modest rally, in our view.

We believe that the mixed messages emanating from the Fed may be driven by the conflicting needs of the Fed and other central banks across the global economy. The Fed needs to begin a process of normalizing interest rates in the US, but it would prefer to do so without spurring another dramatic rally in the dollar. As the recent devaluation by China attests, a sharply higher dollar places strain on many emerging markets. Because China's currency is pegged to the US dollar, a rising dollar puts Chinese exports under competitive pricing pressure. Meanwhile, indebted Latin American economies face higher debt burdens as their dollar-denominated obligations would rise in value along with the currency. By delaying a US interest rate increase and putting out a fairly dovish statement, the Fed may be creating a window in which overseas central banks can provide additional monetary stimulus without necessarily triggering a destabilizing rally in the dollar.

Market reaction since the Fed's announcement demonstrates, in our view, that global equity markets no longer feel that an aggressive Fed is an essential requirement for higher equity prices. Instead, equity markets appear to want higher rates in the US because such a change would affirm a positive economic outlook for the global economy.

We believe that economic data in Europe shows an accelerating economic recovery, and that low unemployment and low gas prices will allow the Japanese and US economies to reaccelerate. If we are correct, the Fed will be raising rates before the end of the year; and, the past few days indicate that equity markets will welcome this change in US monetary policy.

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In a rising interest rate environment, the value of fixed-income securities generally declines.

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