

CHART OF THE MONTH

JUNE 2015

As a follow-up to our [Chart of the Month for May](#), we take a closer look at the impact of Fed rate hikes on the stock market and the economy. The conclusion to our findings is as follows: bull markets and economic expansions tend to end after the Fed tightens, not when the Fed begins to tighten.

Although business news stations seem pre-occupied with the Fed's timing, it is our belief that the first several increases in interest rates will have little, if any, effect on stock prices. In fact, barring unforeseen geopolitical events, we expect stocks will rise – albeit not in a straight line – throughout most of the Fed hiking cycle.

In the last tightening cycle, the Federal Reserve raised rates for the first time in June 2004 and for the final time in July 2006. The stock market peaked in October 2007, 40 months after the initial bump and 13 months after the conclusion of the program. As shown below, these outcomes were virtually in-line with the historical averages. Similarly, the economy fell into a recession in December 2007, 42 months after the first Fed hike and 17 months after the last, once again tracking the past.

If history were to repeat itself and the Fed were to raise the funds rate in September (as some members have speculated) or in December (as the futures market is currently predicting), then the stock market would not top out until late 2018 or early 2019 and the economy would avoid recession until the spring or summer of 2019.

While stocks should outperform bonds over the next few years, we believe fixed-income investments still have a place in balanced portfolios. Our research continues to uncover shorter-term corporate notes with yields equal to or above those available on the 10-year U.S. Treasury. We contend that the former are much more defensive than the latter with respect to changes in interest rates due to the significant difference in the duration of the investments. A ladder portfolio of such notes provides liquidity via scheduled maturities and calls as well as “bird-in-the-hand” coupon interest for those in need of income.

Bull Markets and Economic Expansions After Fed Tightening

	Average (Months)	Median (Months)
Peak in S&P 500		
After first rate hike	38	40
After last rate hike	11	12
Recession		
After first rate hike	44	35
After last rate hike	17	8

Source: Federal Reserve Board, National Bureau for Economic Research, Haver Analytics, Gluskin Sheff

