



After “liftoff,” US Federal Reserve must weigh next move.

As expected on December 16, the US Federal Reserve raised key interest rates for the first time since June 2006. The move took the Fed funds target rate above zero for the first time since December 2008. The financial media has named the Fed’s move to rates above zero as “liftoff.”

December 18, Disney released *Star Wars Episode VII—The Force Awakens* as the latest installment of the epic franchise. Disney magic worked even in a galaxy far, far away. Grossing \$528M worldwide, the film shattered opening weekend box records.

On December 21, SpaceX succeeded with a mission to launch a rocket into space and return to land the rocket on earth. Launch rockets are among the most costly materials used in space exploration. The ability to safely redeploy them would materially improve the economics of space exploration.

Dual purpose Fed. The Fed has a dual mandate: to provide for stable prices and to provide for full employment. We have viewed the Fed’s seven year quantitative easing and zero rate experiments as exploration in folly that deviated from its mandate. The Fed was probably right to bring reasonable interest rates that usher in normalization.

Unfortunately, “liftoff” could hardly come at a worse time. It coincided with weak domestic and global financial markets. Most stocks and bonds lost value during 2015. The S&P 500 and US Treasuries made small gains, but nearly all other stocks and bonds fell while commodities signal outright deflation.

Previous launch patterns. Since 1990, the Fed raised rates during three periods as shown in the accompanying chart and table. Over each period, the S&P500 rose. Relevantly, the 2004-06 period resembled current conditions. It followed a period of sustained low rates, occurred during frustratingly slow expansion that coupled with underutilized labor. While the Fed undertook the largest set of rate hikes, stocks gained 11.57%.

What follows liftoff? Seeking stable prices and full employment, the Fed should pause along the path to normal, or even attempt to return rates to zero, like a SpaceX mission. The Fed did just that when in the late 1990s another Asian emerging market crisis dictated the Fed’s path. Wherever the Fed takes its mission, may the force be with Ms. Yellen.



Start Date	Rate	End Date	Rate	Rate Hikes	S&P 500 Return
2/1/1991	3.00	2/1/1995	6.00	7	0.13
6/30/1999	4.75	5/16/2000	6.50	6	6.80
6/30/2004	1.00	6/29/2006	5.25	17	11.57
12/16/2015	0.00	?	?	?	?

Fed funds rate changes and S&P 500 Index prices.
 Sources: Federal Reserve, Telemet.

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