Economic and Market Insights
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Interest Rate Hike Is Right Prescription

While it may be anti-climactic, we've taken our first spoonful of medicine. We think Federal Reserve (Fed) Chair Janet Yellen got it right when she hiked interest rates 0.25% today.

The Federal Reserve's plan to raise interest rates has seemingly been one long drum roll. Speculation about when the hikes would begin, and how big they would be, has been going on for months. Today's increase marks a turning point, with the Fed finally believing the U.S. economy is gathering steam.

With the U.S. economy on more solid ground, the Fed signaled in today's move that it can now begin a slow series of rate increases to head off any future inflation. One of the Fed's key priorities is to rein in inflation, and Yellen has said she expects inflation to rise over the next couple of years to the Fed's target level of about 2%. By raising rates and making it more expensive to borrow, the Fed hopes to dampen spending a tad, making it harder for inflation to get a foothold. As the Fed moves forward, we anticipate it may choose to forgo increases at some meetings as it watches how the economy reacts to each move.

How will a measured pace of rate hikes affect stocks and bonds?

- When the Fed practices moderation with its rate-hiking approach – as we expect it to do now -- stocks on average in the S&P 500 trended upwards one year later.
- In past cycles of rising interest rates, the U.S. dollar remains strong for five to six months after the first rate increase. This suggests that domestic equities may temporarily outperform international stocks as markets sort out the impact.

So while much of the rest of the economies of the world are still applying stimulus, the United States will tap the brakes heading into 2016 to keep its momentum at a steady, manageable speed.

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