**Philequity Corner (November 9, 2015)**
**By Valentino Sy**

## Every Move You Make

With last Friday's US payrolls coming out at 271,000, exceeding even the most bullish forecasts, it looks like a December liftoff is imminent. This left little doubt that the US economy is expanding at a pace that warrants the much-awaited rate hike. From a 38% probability before the payrolls data, Fed fund futures are now pricing in a 70% chance of a rate hike in December. Thus, many pundits believe that Federal Reserve Chairman Janet Yellen will be giving the go signal at the conclusion of the Fed's next meeting on December 16.

### First since 2006

With all the headlines and articles about the US rate hike, many have been wondering why so much attention is being paid to what seems to be a very negligible action. Although this rate hike is expected to be just 0.25%, it is important to remember that the last increase in US interest rates was in June 2006, when it hit 5.25%. Since then, interest rates have fallen 500 bps and have remained unchanged at a record low of 0.25% since December 2008.

### Fed watchers

For many years, traders have been watching the Fed. However, it was only in May 2013 that market participants started watching them with concern for that was the time when then-Fed Chairman Ben Bernanke made an off-the-cuff statement hinting at QE tapering (see *The Big Unwind*, 17 June 2013). This was the first sign that the Fed may begin to tighten after keeping rates at record lows for nearly 7 years (see *Tale of the Taper*, 22 July 2013).

### Every word you say

It is important to remember that the main architect of the current bull market in the US and most other markets, including the Philippines, is the Fed and Bernanke himself. In Chapter 4 of "Opportunity of a Lifetime", we discussed how the Fed's policies created an opportunity of a generation (see Chapter 4, Don't Fight the Fed, pages 82-109). Since then, every word that the Fed has been saying has moved markets. Traders and economists alike have been watching every step that they make. The uncertainty over the Fed's next move after 2013 has resulted in heightened market volatility. This is why everyone waits with bated breath before every Fed meeting.

### Liftoff at its next meeting

Before the US payrolls numbers came out though, there were already indications that the Fed was poised to raise rates within the year. In its October 28 policy statement, they said that data is being assessed with the goal of "determining whether it will be appropriate to raise the target range at its next meeting." This one phrase - "at its next meeting" - sent chills down the spine of traders who were banking on a dovish Fed.

### A Live Possibility

Then, on November 4, Yellen was summoned before the US House Financial Services Committee. In her testimony, she said that last month, "the committee has judged that some of the downside risks, relating to global and financial developments, have diminished." She then said that if incoming data supports her expectation that the US economy is improving, then "**December is a live possibility**." This sent stocks broadly lower as financials rallied on the expectation of higher interest rates.

**Path more important than timing**

However, Yellen has continued to emphasize that the Fed is not on a preset course and that any action will be **data dependent**. In addition, she said that the **path of interest rate hikes is more important than the timing**. Yellen said that policy tightening would **be gradual and based on the economic conditions at that time** as to ensure its dual mandate of maximum employment and price stability. We expect the Fed to be very careful in raising interest rates so as not to derail the economic gains it has achieved in the previous years.

**Divergent**

Given the profound impact of the Fed's interest rate policies, many have been asking why investors are so concerned about the prospect of higher interest rates. Some have been wondering how, at times, even a single word from the Fed could send markets higher or lower. The reason behind this is the divergent monetary policy of the US versus other countries. While others are lowering rates, like the EU, China, Japan and many emerging countries, the US is on the verge of increasing interest rates. This will have a significant impact on the economy, currency and equities of countries around the world.

**Dollar strengthens**

The imminent December liftoff sent the dollar sharply higher, rising more than 1% against the Euro and the Japanese yen on Friday alone. This may also cause emerging market currencies, including the Philippine peso, to weaken. In Chapter 7, Peso Tops Out, of the book "Opportunity of a Lifetime", we said that the peso had reached its peak against the dollar. On pages 148-150, we explained that the peso is weakening precisely because of dollar strength (see *It's the Strong Dollar, Stupid*, 24 June 2013).

**Markets will rise if accompanied by growth**

Though we are entering a seasonally strong period for stocks (see *Opportunity of a Lifetime, Chapter 10 on Investor Education, Seasons in the Stock Market, page 198*), this may be partially offset by concerns over the impending rate hike on December 16. Thus, traders should brace for more volatility. However, we have to remember that higher interest rates do not undo a bull market. In fact, history has shown that if growth endures despite policy tightening, the stock market will continue higher.

**Every Breath You Take**

To end this article, we leave our readers, investors and all you Fed watchers with lyrics from the song "Every Breath You Take" by Sting and The Police:

Every breath you take
Every move you make
Every bond you break

Every step you take
I'll be watching you

Every single day
Every word you say
Every game you play
Every night you stay
I'll be watching you

O can't you see
You belong to me
How my poor heart aches with every step you take

Every move you make
Every vow you break
Every smile you fake
Every claim you stake
I'll be watching you.

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