Philequity Corner (August 29, 2016)
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Is the waiting game over?

Last Friday, weeks of anticipation came to an end as Fed Chair Janet Yellen made her speech in Jackson Hole. The investment community watched and listened to Yellen's speech entitled "The Federal Reserve's Monetary Policy Toolkit: Past, Present, and Future." Her speech included an assessment of the US economy, the Fed's policy direction and a discussion of the Fed's ability to respond in the case of a potential economic downturn in the future.

Jackson Hole

Every year, the Fed hosts a symposium for central bankers in Jackson Hole lake lodge in Wyoming. Jackson Hole is near the world-famous Yellowstone National Park. Recently, the speeches of Fed leaders in the annual symposium have grown in significance, as they used these speeches to outline the direction of future monetary policy. In Jackson Hole, former Fed Chair Ben Bernanke delivered two speeches in different years to announce the second and third installments of quantitative easing (QE2 and QE3). I was fortunate enough to be in the same lodge as Bernanke when he delivered one of his famed speeches. Last Friday, it was Janet Yellen's turn to hold court in Jackson Hole.

Waiting Game

In our article last week, we talked about the building anticipation regarding Yellen's speech (see *The Waiting Game*, August 22, 2016). Traders, investors and economists were looking at Yellen for clarity on the direction of the Fed's monetary policy and the pace of its rate hiking cycle. The build-up to Yellen's speech also came at a time of divergent monetary policies from global central banks and uneven global growth. Although the US economy is delivering slow but gradual growth, there is persistent weakness in major economies such as Europe, Japan and China, as well as in other emerging economies. Moreover, Fed members such as Fed Vice Chair Stanley Fischer and New York Fed President William Dudley recently made hawkish statements, which only added to investor confusion and market anxiety. Lastly, there have been growing concerns about the Fed's ability to deal with a potential recession given that it has less scope for wider rate cuts due to the prevalence of historically low interest rates.

Stronger Case for Hiking Rates

In her speech, Yellen explained how the Fed's previous and present policy actions have helped the US recover from the Great Recession. Spurred by Bernanke's lead, the Fed exercised patience and determination in pursuing creative policies that addressed various threats to US economic growth. Given this backdrop, Yellen said that the Fed expects moderate growth in the US economy and that inflation will rise to 2% within the next few years. Moreover, she noted the sustained improvement in the labor market, which brings the US economy closer to the Fed's statutory goals of maximum employment and price stability. **Considering these, Yellen believes that "the case for an increase in the federal funds rate has strengthened in recent months." In summary, Yellen explained that the US economy is now better positioned to handle a gradual rate hiking cycle.**

Threats to Growth

Even though Yellen expressed growing confidence in the US economy, she noted that there are still threats to growth that the Fed needs to monitor and the economic outlook is still uncertain. She said that business investment is still soft. Moreover, weak global demand and the appreciation of the US dollar have dampened exports. Yellen assured that these and other global developments will be considered when the Fed makes its future policy decisions.

The Fed's Expanded Toolkit

Before Yellen's speech, there were many concerns regarding the Fed's ability to deal with a potential recession. The main contention from economists and analysts is that the Fed would not have enough room for wide rate cuts considering the historically low level of interest rates. Yellen, however, explained that the Fed now has new tools which proved particularly useful in combating the lingering effects of the Great Recession. These include large-scale asset purchases and explicit forward guidance. These are new tools and insights that the Fed gained over the past eight years from following Bernanke's lead in dealing with the aftermath of the 2008 Global Financial Crisis. Moving forward, these provide the Fed with ample ammunition to combat the threats of a potential recession in the future.

Is the long wait over?

Will there be a rate hike soon? Will it be on September or December? Considering the Fed's repeated pronouncements that monetary policy decisions will be data dependent, the employment numbers coming out this Friday and the ensuing market reaction will be important to watch.

Not one but two?

Following the comments of Fed Vice Chair Stanley Fischer on the statement of Yellen, there is now a concern that there may be two rate hikes for the remainder of 2016. This made the market nervous, causing stocks to pullback and the US dollar to strengthen. During her speech last night, Yellen shared a chart showing the median of individual Fed funds rate projections by the Fed members themselves. Based on the chart, the Fed members, on average, expect interest rates to be at 1% by 1Q17 and 2% by 2Q18. This means that the Fed, as a group, expects about four to five 25-bps rate hikes by end-2017, with one or two possibly coming this year. Despite showing these projections, Yellen stressed that as always, future policy decisions will be based on economic data and not on a preset course.

Will markets correct?

What we have seen so far is that concerns over a potential Fed rate hike had caused many investors to adopt a wait-and-see attitude. What remains to be seen is whether Yellen's statements will cause the market to correct further or if rate hikes have already been priced in. Moreover, the effects of Yellen's statement on the US dollar, other currencies, commodities and EM stocks is something that we will have to monitor in the coming days and weeks.

Fed rate hikes will not derail PH growth story

The market reaction is still not very clear as Yellen's speech only happened last Friday. It is possible that the current correction of our stock market will continue. But as we have said, corrections are very hard to anticipate and predict. We can have a prolonged consolidation, a short and shallow correction or a deeper and longer correction. Nonetheless, we remain confident that these concerns will ultimately not derail the long-term growth trajectory of our country. We believe that the Philippines is an example of a country that has strong fundamentals and growth drivers that are unique to the country. Thus, while we carefully watch Fed talk and its impact on global markets, we have also placed importance on picking stocks which have solid fundamentals, attractive growth prospects and reasonable valuations.

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