

The Investment House Quarterly: Dec. 31, 2017

Index %	YTD '17	2016	2015
S&P 500	+21.83	+ 11.96	+1.38
Barclays US 20+ Yr Treasury	+8.98	+1.43	-1.59

Source: Morningstar

Tax Cuts and Interest Rate Increases: Do They Matter?

As we bid farewell to 2017, we do so with equity prices broadly higher than at the year's beginning, and long term interest rates lower. This occurred even as the Federal Reserve raised short term interest rates 3 times last year, to a recent range of 1.25% - 1.5%.

Many have speculated that the Fed's 3 additional expected rate rises in 2018 will provide a stiff wind against which stock prices might struggle, but recent history suggests that might not be so. As the graph of the 2 Year Treasury Rate below shows, short term *market rates* – i.e. interest rates set by buyers and sellers, not by the government – have actually been rising steadily over the past 4 years, from a low in 2013 of .2% to a recent level of 1.95%. In fact, the steepest increase has occurred in the last 18 months, since June 2016 when rates were roughly .8%, having risen recently to a level nearly .75% *above* the Fed Funds rate. In other words, the Federal Reserve appears to have been following, not leading, rates higher.



The result? Not only have corporate earnings and stock prices continued their steady climb, but, as can be seen in the chart below, long term rates have actually *declined* both during the recent period of short term rate increases, *and* overall, since 2013 – in spite of the increasing strength of the economy and record low unemployment rates.

# The *Investment* House LLC



The lesson for us, as for other investors and Fed Watchers alike, is that there is no easy, formulaic relation between the policy pronouncements of the Federal Reserve and *either* market interest rates *or* the reaction to them in equity markets and corporate earnings. For that the talking heads just won't do. We actually have to do some serious thinking about economic and financial reality on a company by company basis - which is exactly what we will continue to do in 2018.

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