CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 21, 2018

Volatility Subsides

Stock markers have become calmer since the turmoil of late January and early February. And, despite political upheaval in Washington, the economy grows apace.

In our nation's capital, turmoil reigns as Mr. Trump fires his Secretary of State, threatens to fire other high-ranking officials, impels his Attorney General to fire the second-ranking FBI official, forces from office his chief economic advisor and generally sows chaos. Meanwhile, the American economy moves ahead and the recent turmoil in stock markets subsides. It is striking that White House histrionics have so little effect on the economy or financial markets.

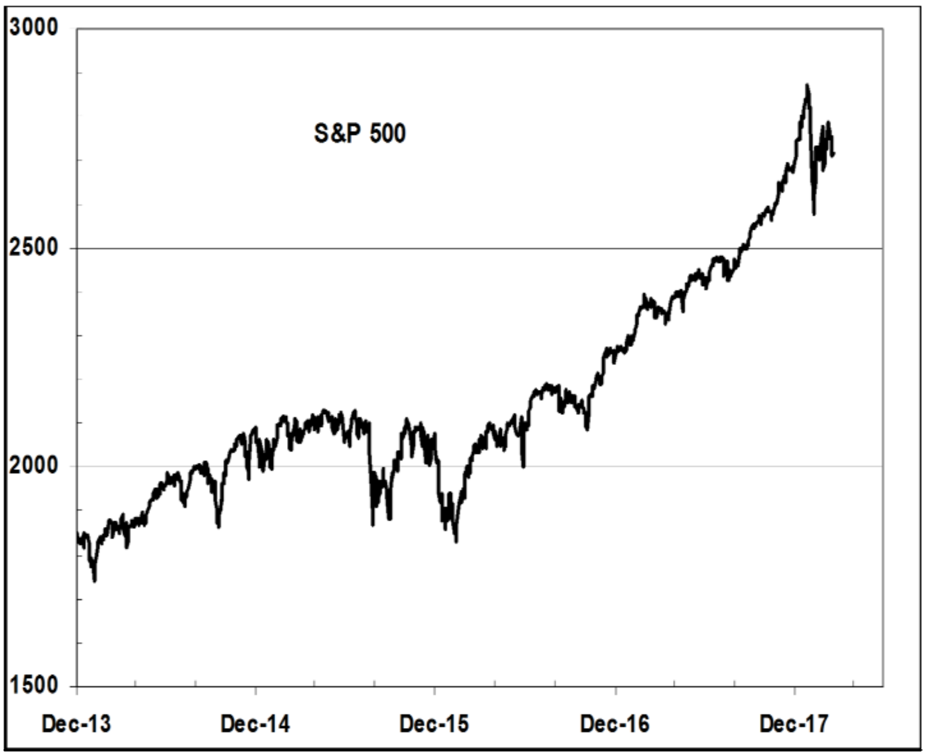
As you will remember, the placid advance in stock markets that characterized 2017 and the opening weeks of this year suddenly gave way to swift and sharp selling that brought the market down by 12 percent in ten trading days. Then, within only five days, the market rallied by 8 percent to recover most of those losses. From there, the market has pushed higher; some stock market indices have surpassed their late January highs. Notwithstanding a sharp sell-off on Monday occasioned by news of ill use of Facebook's information about its users, the stock market turmoil has subsided. Given solid economic growth and robust job creation, it seems likely that the US stock market will advance further, at least for coming months. Core's client portfolios retain substantial positions in stocks and will benefit from advancing prices.

Unusual as the late-January and early-February selling was after the long quiet period of steady stock market gains, it seems likely that we will experience more bouts of selling as things unfold. We have cash in client accounts now and are ready to make further investments at opportune times, especially after further selling squalls. For example, on Monday, we took advantage of weak prices for technology stocks and added to our position in these.

By

Jack Mayberry

Bonds and the Federal Reserve. This week, the Fed is holding its first meeting of the Federal Open Market Committee under Jerome Powell, its new chairman. The uniform expectation is that Fed funds, the short-term interest rate that the Fed directly controls, will be raised by one-quarter percent, to a target range of 1.50 percent to 1.75%. The present view is that this will be the first of three or four such quarter point increases in short-term rates in 2018. After the FOMC meeting, Mr. Powell will hold a press conference today in which he will have the opportunity to express the Fed's plans and the direction of monetary policy. It seems likely that Mr. Powell's remarks will express continuity with the policies the Fed set in motion during Janet Yellen's tenure as Fed Chair. Mr. Powell's recent Congressional testimony, while couched in terms less academic than those of his (academic) predecessors, did not indicate radical changes in direction of Fed policy. Apart from the question of how rapidly and by how much the Fed will raise short-term interest rates is the matter of the pace of decreasing the Fed's enormous balance sheet.



At present, the Fed holds Treasury securities and mortgage-backed assets of some $4 trillion, up from the $800 billion held before the financial crisis. The Fed's actions to reduce the level of these holdings will have real consequences for the prices and yields of all bonds. Given that Congress recently enacted a substantial reduction in taxes and plans significantly greater government spending, the Federal deficit will become much larger and much more government borrowing will be necessary. The combination of greater Treasury borrowing and the reduction in the Fed's Treasury holdings can certainly cause bond yields to rise and bond prices to fall.

For thirty years from the 1980s, bond prices rose and yields fell; we are probably now in early stages of a reversal of that long-term trend. We and many others will carefully attend to Mr. Powell's comments on these matters. For our part, Core has sold its long-term bond positions and replaced them with short-term securities and cash, against this risk of higher yields and lower bond prices.

CORE Comments

CORE ASSET MANAGEMENT
PO Box 1629
108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com