AR SCHMEIDLER & CO
INVESTMENT ADVISORS
A Pine Street Asset Management Company

THE OUTLOOK

The Federal Reserve's Asymmetric Monetary Policy

Definition of asymmetry: Uneven or lacking balance. In an asymmetrical situation, a portion of something does not have the same exact form as another portion.

"Given the risks to the outlook, I consider it appropriate for the Committee to proceed cautiously in adjusting policy. This caution is especially warranted because, with the federal funds rate so low, the FOMC's ability to use conventional monetary policy to respond to economic disturbances is asymmetric. If economic conditions were to strengthen considerably more than currently expected, the FOMC could readily raise its target range for the federal funds rate to stabilize the economy. By contrast, if the expansion was to falter or if inflation was to remain stubbornly low, the FOMC would be able to provide only a modest degree of additional stimulus by cutting the federal funds rate back to near zero."

Excerpts from Janet Yellen's speech on 3/29/16

The speech by Ms. Yellen, Chair of the Federal Reserve, at the Economic Club of New York has important implications for investment strategy as it was among the most detailed and succinct statements as to the Federal Open Market Committee's (FOMC) position on its intensions for monetary policy for the coming quarters. Based on Ms. Yellen's speech this week, it was made clear that **the Federal Reserve intends to maintain an accommodative policy stance for as long as domestic and global economic conditions warrant.** The Committee "anticipates that only gradual increases in the federal funds rate are likely to be warranted in coming years" and "monetary policy will, as always, respond to the economic twists and turns so as to promote, as best as we can in an uncertain economic environment, the employment and inflation goals assigned to us by Congress." As the U.S. recovery has progressed following the Great Recession, market participants have been uneasy about any comments from Federal Reserve members with respect to the scope and timing of potential 2016 interest rate increases. **As long as the Federal Reserve feels it cannot return interest rates to a more normal level as had existed in the past, then investors must anticipate that interest rates will remain low for a prolonged period.**

In her speech, Ms. Yellen commented that the U.S. economic outlook was somewhat mixed. Among the many positives are solid job growth, increasing consumer spending, income gains, and improving residential and non-residential construction. These positives have been offset by weakness in manufacturing and exports, a stronger U.S. dollar and lower business investment. The strength of the dollar has had the effect of putting downward pressure on the U.S. economy as lower-priced imports increase competitive pressures for U.S. companies. A stronger dollar also has provided a headwind for the earnings of U.S. multinationals when they translate their foreign earnings into U.S. dollars. Additionally, Federal Reserve Vice Chairman Stanley Fisher's comments in January discussing the potential for four interest rate increases in 2016 further exacerbated the divergences among major central banks which were moving in opposite directions to the Federal Reserve. In fact, Europe and Japan were shifting to negative interest rates, while China was taking steps to depreciate its currency. The combination of these factors had the effect of increasing global economic disequilibrium.

In our view, this speech represented a sea change as Ms. Yellen expressed for the first time the asymmetric risks of conventional monetary policy. This has reduced the divergences in monetary policy among the major central banks and should benefit many U.S. multi-national corporations and result in improving corporate earnings for the second half of this year. In our view, the Federal Reserve did not make a mistake in its initial rate increase of 0.25% in December; however it seems clear to us that it miscalculated the fragility of the global economic system in communicating four possible rate hikes for 2016. In the future, the most important expressions of Federal Reserve policy will be those from Ms. Yellen. The beneficiaries of this environment remain the same as those expressed in our recent Outlook Note dated March 23, 2016.