



Capital Preservation & Income

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Key Target Rate Cut in Emergency Fed Meeting

The Federal Reserve slashed its two key interest rates by 75 basis points in a surprise move on January 22nd, and by another 50 basis points at its scheduled January 31st meeting. The Fed Funds Rate, which impacts the rates consumers pay on credit cards, car loans, mortgages and home equity lines, now stands at 3.00%, the lowest level since May 2005. The Discount Rate, the rate banks pay when borrowing directly from the central bank, now stands at 3.5%. Each cut is aimed at the lowering the cost of credit for consumers and at helping banks extend credit to all segments of our economy. The January 22nd surprise move was the largest single reduction of the Fed Funds rate in more than two decades, and it was the first inter-meeting move since the attacks on 9/11.

What the Committee said: “The Committee took this action in view of a weakening of the economic outlook and increasing downside risks to growth. While strains in short-term funding (credit) markets have eased somewhat, broader financial conditions have continued to deteriorate and credit has tightened further for some businesses and households. Moreover, incoming information indicates a deepening of the housing contraction as well as some softening in labor markets.”

What does this mean for the economy and your fixed income portfolios? Basically, it means the Fed is poised to take the action necessary to reinvigorate the economy and support the consumer. With

economic uncertainty on the rise, swings in stock and bond prices persist and will likely continue as markets digest the Fed’s actions, trying to predict what the future holds. Typically, when the Fed lowers rates, market yields decline and the value of bond portfolios increase. This is good for bonds, especially those that mature in 15 years or less; but bonds with longer maturities may not fare as well in the coming months.

Near-term risks for a slowing economy have increased, but this is an election year and that means most politicians would like to avoid a recession. Congress and the President, both of whom have endorsed a plan to provide tax rebates, will do what they can to support tax-paying (voting) citizens.

On the corporate front, exports to our trading partners continue to fair well as dollar-based goods are ‘cheap’ relative to goods produced in economies with stronger currencies. We view this as important support for the manufacturing sector of our domestic economy.

As we start this New Year, there are pluses and minuses for our economy and especially the consumer. We are indeed in a ‘repair’ period working off the excesses of an overextended real estate boom and a consumer population driven by flexible, available credit. Overall, we are constructive on the fiscal, monetary, and corporate finance initiatives underway. In time, we expect a rebound in confidence and economic stability consistent with similar episodes of the past.

Highlights:

- FED CALLS EMERGENCY MEETING; SLASHES FED FUNDS RATE 75 BASIS POINTS
- RATE CUT WAS LARGEST SINGLE REDUCTION SINCE 9/11
- GOVERNMENT INITIATIVES ARE UNDER WAY IN AN EFFORT TO EASE BURDEN ON THE CONSUMER IN THIS ELECTION YEAR

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