# THE AUSTIN ADVISOR

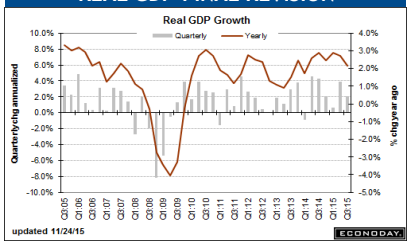
December 21, 2015

| Markets | 14-Dec | 15-Dec | 16-Dec | 17-Dec | 18-Dec | YTD% | 31-Dec-14 |
|---|---|---|---|---|---|---|---|
| DJIA | 17,368.50 | 17,524.91 | 17,749.09 | 17,495.84 | 17,128.55 | -3.90% | 17,823.07 |
| S&P 500 | 2,021.94 | 2,043.41 | 2,073.07 | 2,041.89 | 2,005.55 | -2.59% | 2,058.90 |
| NASDAQ | 4,952.23 | 4,995.36 | 5,071.13 | 5,002.55 | 4,923.08 | 3.95% | 4,736.05 |
| SNL Bank Index | 424.93 | 437.49 | 445.11 | 437.61 | 425.73 | -1.62% | 432.75 |
| Fed Funds Rate | 0.14% | 0.15% | 0.15% | 0.37% | 0.37% | | 0.06% |
| 1 Month LIBOR | 0.34% | 0.35% | 0.36% | 0.40% | 0.41% | | 0.17% |
| 3 Month LIBOR | 0.52% | 0.53% | 0.53% | 0.57% | 0.59% | | 0.26% |
| 3 Month T-Bill | 0.26% | 0.25% | 0.27% | 0.23% | 0.19% | | 0.04% |
| 1 Year Treasury | 0.68% | 0.69% | 0.70% | 0.69% | 0.67% | | 0.25% |
| 2 Year Treasury | 0.97% | 0.98% | 1.02% | 1.00% | 0.97% | | 0.67% |
| 3 Year Treasury | 1.25% | 1.29% | 1.35% | 1.33% | 1.27% | | 1.10% |
| 5 Year Treasury | 1.66% | 1.71% | 1.75% | 1.73% | 1.67% | | 1.65% |
| 10 Year Treasury | 2.23% | 2.28% | 2.30% | 2.24% | 2.19% | | 2.17% |
| 30 Year Treasury | 2.96% | 3.00% | 3.02% | 2.94% | 2.90% | | 2.75% |

## WEEKLY HIGHLIGHT

The Fed did as expected and moved managed rates up for the first time in almost ten years

## REAL GDP-FINAL REVISION




| Economy | Week of December 14, 2015 | |
|---|---|---|
| Consumer Price Index | 0.0% | Headline number was unchanged and below expectations, while the core rate was up 0.2% for the month and 2.0% YOY |
| Housing Starts | 1.73 Million | Starts were up 11% for the month, well above forecasts; multi-family up 27% and permits up 2% for a very strong report |
| Industrial Production | -0.6% | Manufacturing continues to contract and utility output was down, with a warm fall and a strong dollar the biggest factors |
| Capacity Utilization | 77.0% | This weak manufacturing activity has driven the operating rate down from above 80% a year ago |
| Leading Indicators | 0.4% | The strong housing data is driving this index higher, with the second consecutive strong month reported |

## MONDAY MUSING

We were invited to dinner last week by a couple who had just moved to Toledo from southern Ohio. We asked what we could bring. They said five quarts of Cool Whip. We could not think of a reason for that but we brought them. Turns out they needed them to have a matched set of salad bowls. I did not know Ohio went that far south. We hope you all have a Christmas filled with love and sharing. I also thank you for putting up with my forecasts and stories for the past year.

| Calendar | Release | Covering | Week of December 21, 2015 |
|---|---|---|---|
| Real GDP-Final Revision | Tuesday | 3rd Qtr | Little change from the 2.1% growth last reported is expected |
| Existing Home Sales | Tuesday | November | Sales are expected to remain at 5.32 million, which is even with October and reflects solid demand |
| Durable Goods Orders | Wednesday | November | Monthly orders are highly volatile and affected by the aircraft sector, with no growth expected when excluding transportation |
| Personal Income | Wednesday | November | An increase of 0.2% would be less than the 0.4% reported for October, but still represents a better result than the last year |
| Personal Spending | Wednesday | November | Spending is forecast to increase by 0.3%, reflecting solid growth in consumer final demand |
| Core PCE Price Index | Wednesday | November | A small increase of 0.1% is expected, which does not get inflation up to the Federal Reserve's target of 2% |
| Christmas Day | Friday | | All Markets Closed |

# THE AUSTIN ADVISOR

## Commentary

In the most telegraphed change in **monetary policy** in the history of **the Fed**, **the FOMC** increased the target range for **Fed Funds** from 0-.25% to .25%-.50% at their meeting last Wednesday. This is the first increase by the Fed since June 2006, and the first change in policy since December 2008. During the press conference which followed the meeting, **Chairwoman Yellen** said the FOMC made this move for three reasons. First, she cited the long lag time between changes in **monetary policy** and the impact to economic conditions. While there are no **inflation** pressures in the current environment, the Fed expects rising inflation data during the coming year. She indicated waiting for the inflation pressures to rise would mean more aggressive monetary policy changes. The Fed wants to move gradually before inflation increases and avoid larger, faster changes later. Secondly, she said **business expansions** do not "die of old age". The Fed does not see the end of the expansion as of yet. While this expansion has been much more moderate than past expansions, it is not sending signals it is about to slow. In fact, the Fed's own forecast calls for four increases in managed rates, including the one executed last week, while economic growth accelerates during this change. Finally, Chairwoman Yellen said the Fed wants to create greater room to move in the future should economic conditions change.

The Fed needs room to stimulate, should growth slow due to global economic weakness. Higher managed rates now gives them time to move rates down should we slip into recession in the future. The Fed's new forecast calls for the Funds rate to reach 1% by year-end 2016, the core rate for the **PCE price index** to reach 1.6% in 2016, and **Real GDP growth** to be 2.7% YOY in 2016. Our forecast calls for a funds rate of 1.25% by December 2016, inflation to be running at 2.3% and Real GDP growth above 3% for next year. We are not expecting a huge rebound in commodity prices to cause inflation to rise. We are expecting income growth to accelerate from a tight **labor market** and **consumer final demand** to continue to grow at better than 3% next year.

As the Chairwoman noted, **commodity prices** just need to stabilize and not be a drag on inflation as they have been this year. Market interest rates peaked just after the Fed announcement, with the **two-year treasury** yielding 1.01% and the **three month bill** at .30%. The **five and ten-year treasuries** increased, but did not reach new highs for the year. The equity market drop on Friday did cause capital to flow into the bond market and these yields did drop back on Friday. The curve is flattening with long term rates not moving while short term rates rise with the change in direction for monetary policy. We are forecasting this will continue until investors begin to price in rising inflation pressures in the second half of next year.

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