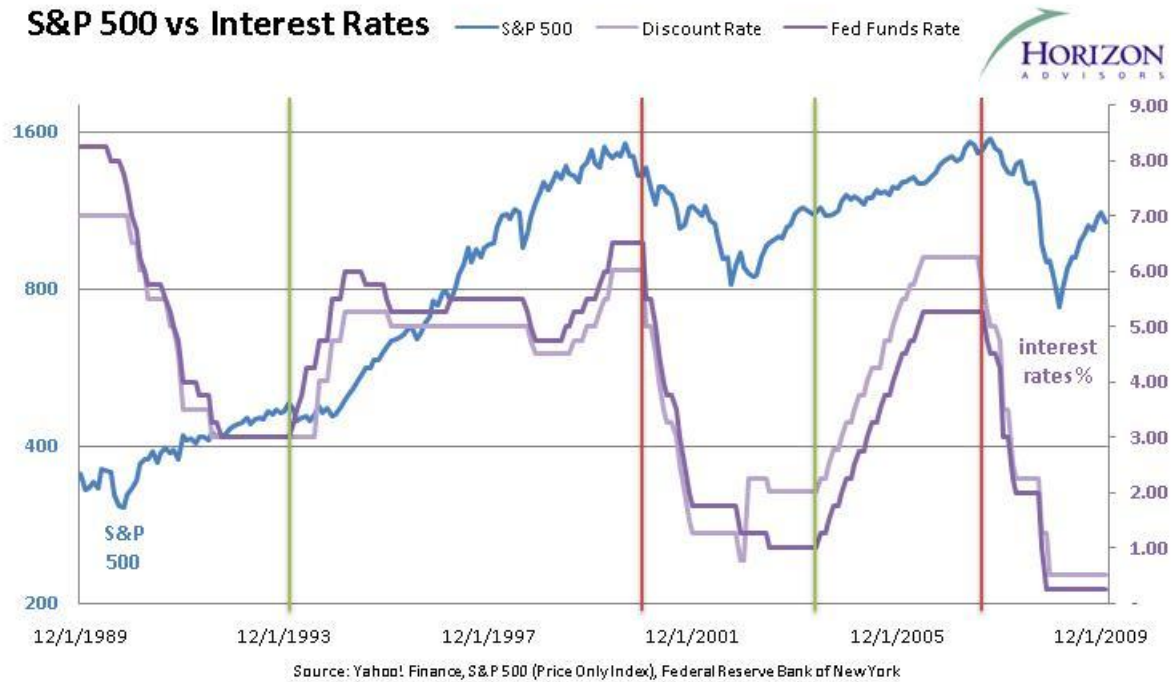




Fed Rate Hike Signals Confidence in Economic Recovery

The Federal Reserve announced yesterday that it has raised the interest rate (discount rate) it charges to banks for emergency loans to 0.75% from 0.50%. While this may seem inconsequential, we believe this action signals a meaningful shift in policy by Federal Reserve.



Since the beginning of the recession in late 2007, the Fed has been lowering (easing) interest rates in an attempt to stimulate financial and economic activity. These efforts accelerated to historic levels in the wake of the credit crisis in late-2008. We believe that yesterday's action represents the first step in a long campaign to reign in (tighten) the massive amounts of monetary stimulus that was pumped into the financial system over the last two and a half years.

In addition to yesterday's action, the Fed has also hinted at other tightening measures such as selling U.S. Government securities from its balance sheet to further reduce the monetary stimulus. We expect that a rise in the Fed Funds Rate, the most widely recognized monetary policy tool, will follow later this year.

Some worry that raising (tightening) interest rates is bad for the economy. The logic being that higher interest rates make it harder for businesses and individuals to borrow the money they need to make purchases that drive the economy.

We, however, view this rate hike by the Fed as a positive development. This move signals a vote of confidence by the Fed in the economy and the financial system. In fact, shifts in monetary policy by the Federal Reserve toward raising interest rates are often followed by a long period of positive results in the stock market (see green bars in chart above). Conversely, interest rate decreases have often been followed by steep declines in the stock market (see red bars in chart above). This is not to say that

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higher interest rates cause stocks to go up. Rather, it is a stronger economy that leads both stocks and interest rates to rise.

About Horizon Advisors

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