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Greetings,

The past year was truly a remarkable one for the stock market. I have heard the term "don't fight the FED" numerous times since I began as an investment advisor 25 years ago. Never has the influence of the Federal Reserve impacted the stock market as it has the past two years. The year before last, the economy was humming along with GDP growth of 3%. Job creation was strong and the unemployment rate was at 50 year lows. However, the stock market returns did not reflect the strong economy. Strong corporate profits were pretty much ignored. Last year, the market had its worst Christmas Eve ever, some people referred to it as the Christmas Eve massacre. The markets suffered because of a severe growth scare. The reasons included escalating trade tensions with China and a loss of confidence in the Federal Reserve, partly because they raised rates four times last year. The fact that the economy and corporate profits weren't adversely affected by higher rates was not relevant to the short sighted people in the market, who scare easily. There was uncertainty of what could happen to the economy going forward, as a result of continued rate hikes and the fact that previous Fed's went too far and caused recessions.

A reason I wasn't concerned at the time about the Federal Reserve and the possibility of a recession is because this isn't the same Fed as the others that screwed up in the past. Also, there were never any signs that the economy was taking a significant turn for the worse. True, the yield on the 10 year Treasury bond sank and for a very brief period of time, there was an inverted yield curve. Historically, this has been a good predictor of recessions. The yield curve, however needs to be inverted for at least 3-6 months for it to be an accurate predictor of a recession. It was inverted for just a day. It was flat for a while but now the 10 year Treasury bond yield is up to 1.92%. At the beginning of the year it was down to just below 1.5%.

In the meantime, the Federal Reserve did a complete about face (some people call this a "pivot") as it lowered short term rates three times last year. What this did was have a huge positive psychological impact on the markets. It was made very clear that this FED is unlike other FED's as others in the past were pretty much on auto-pilot and went too far. In the past, FED's feared inflation so much that they preferred to take a chance on the economy falling into a recession rather than have inflation (which hasn't been a threat to the economy since the late 1980's, and that was mostly because of the ballooning Federal Deficit) rear its ugly head. Today's Federal Reserve has made it clear that while no rate cuts are on the horizon, they will not be raising rates in the foreseeable future. More importantly, they have made it clear that they will let the economy "run hot" and if there is some inflation, they will take a wait and see approach before raising rates. With the global economy not doing well, I don't see there being much of a chance of the domestic economy heating up in the near future. There is a big difference between an improving economy (which I can see happening) and a "hot" economy. This approach is unprecedented and music to the stock markets ears. The FED's revised approach is the primary reason why the market had a great year as opposed to simply a very good year. The recent easing of the China trade tensions has also helped.

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When the Federal Reserve lowered short term rates for the third time last year, Jim Cramer of CNBC in his entertaining way declared that President Trump "has killed" the Phillips curve. I have never brought up the Phillips curve before because I didn't think it was relevant, never mind that my letters are generally long enough. The Phillips curve is an antiquated model that the Federal Reserve uses to predict inflation trends. They have relied on this model for over 40 years. The model basically says that growth in the economy causes inflation. This was true in the 1970's and 1980's, hence why it is antiquated. You can perhaps make a case that it was true in the 1990's. This is 2020 and the Phillips curve has as much use as my combo VCR/DVD player that I still have and use once or twice a year. The reason why growth doesn't cause inflation anymore are twofold. Technology and outsourcing. Under the heading better late than never, while the FED's approach could be heresy to former FED chairmen Alan Greenspan and Ben Bernanke (not so much to Janet Yelen), I am happy that the current FED chairmen Jerome Powell clearly gets it. Interesting that with the stock market at record highs, I don't hear President Trump frequently insulting him with his tweets anymore.

A year ago, a handful of talking heads on CNBC continually were calling for an end to the bull market. Morgan Stanley was especially negative and continues to be. I suppose that these people figure that no one will pay attention to all the times they are wrong and then when the bull market does end, they can take a bow by saying how they made the call. Bull markets don't simply end because of old age. Something has to happen to cause a bear market. Historically, bull markets begin in despair and end in euphoria. Do you see any euphoria in this market?? I certainly don't. If anything I continue to see much negativity in chatting with people (as little as possible) and many that I speak to are waiting for the next market crash. Both individual investors and institutional money managers are under invested in equities. Even at close to record low interest rates, people continue to be addicted to bonds. Individual investors still carry the scars of the financial crises which caused the market crash in late 2008. 95% of Institutional money managers "play not to lose" to avoid losing their jobs. They re balance their portfolios each year so as not to have too much market exposure to be in conformity with their asset allocation model. My preference is to play to win. I find no shame in being different from those who underperform. This Federal Reserve's accommodative policy should extend the life of this bull market. I just don't know by how many years.