QMα Insights

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# The Fed Decision: Is A High-Pressure Economy In Our Future?

**President-elect Donald Trump criticized US Federal Reserve (Fed) Chair Janet Yellen during the hard-fought election campaign, but as President he may come to view Yellen as uniquely qualified to support the Trump agenda.**

Not only is Janet Yellen a well-regarded economist, she shares the new President's expressed concern for those struggling in the current economic environment. In a recent speech in Boston, Yellen discussed the possibility of creating a "high-pressure economy," one where unemployment is forced to very low levels to raise wages and pull more people back into the labor force, even if that means that inflation temporarily runs above the Fed's 2% target. Although they may come at the issue from different perspectives, the President-elect and the Fed Chair share a common stated objective: to improve the economic prospects of Americans and maximize the long-term growth potential of the US economy despite our aging demographics.

Of course, no specific fiscal policy agenda is yet in place. The new economics team has not yet been assembled. But based on his public statements about infrastructure spending, tax cuts, and other issues, it seems as though a basic thrust of the Trump administration will be to increase nominal GDP growth with what amount to stimulative fiscal policies.

The traditional Republican position on the Fed's role would take a "hard-money" approach to monetary policy designed to contain inflation and strengthen the dollar. In recent years some Republicans have supported a formulaic version of such an approach, where rates would rise automatically in response to rising inflation. Yet, as much as Trump campaigned against loose monetary policy, as president, he may find that a hard-money, formulaic policy that quickly raises rates to stay ahead of higher prices might take the air out of his economic agenda before it gets rolling. The "high-pressure economy" suggested by Yellen may suit a vigorous growth program much better.

A side benefit of keeping Yellen at the Fed is that it would help lay to rest concerns about the fate of Fed independence. Janet Yellen does not need to be pressured into maintaining a monetary policy consistent with the Trump agenda; she sincerely believes it is the best policy under current conditions.

Other tactics floated during the campaign, such as re-negotiating trade deals, imposing tariffs, reducing or reversing immigration etc., will either take much longer to implement, have a small positive impact, or potentially be counter-productive. A high-pressure economy might help many folks before the end of 2017. That does not mean the Fed Funds rate cannot move higher; we suspect the Fed will hike 25 bps at the December meeting. But further rises, we think, will be cautious and deliberate, giving the economy a chance to heat up significantly more.

In contrast to his campaign rhetoric, we expect President-elect Trump will make little effort to force Yellen out before her current term expires in January 2018, and may even find reason to renew her appointment to a second four-year term. The President-elect's agenda and appointments are still very much in flux, so positions can change.

But if we're right, a high-pressure economy is in our future, ***driven by both increased fiscal stimulus and continued accommodative monetary policy.*** This implies the inflation rate might rise, the yield curve continue to steepen and the dollar continue to rally. The broad equity market will be both helped and hurt: faster growth will help profits, but higher wages and a stronger dollar will damage them. The financial sector should continue to do well, if our views are correct; the sector looked cheap before the election, and most financials benefit from a steeper yield curve and possibly lighter regulation. In QMA's multi-asset allocation portfolios, we have been reducing bond positions and adding to stocks and cash. For portfolios with sufficient flexibility to do so, we have been overweighting the financial sector.

In an election aftermath that has been full of surprises, one of the biggest might be that President-elect Trump and Fed Chair Janet Yellen find themselves working together towards a common goal.

*"The President-elect and the Fed Chair share a common stated objective: to improve the economic prospects of Americans and maximize the long-term growth potential of the US economy despite our aging demographics."*

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**For more information**

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*As of 9/30/2016.



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