



Weekly Market Commentary



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The Great American Race

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Highlights

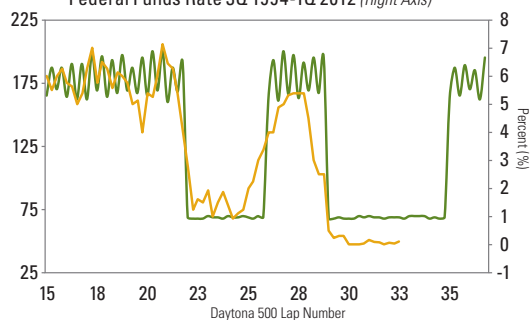
Today at “The Great American Race,” NASCAR’s Daytona 500, a contestant in another great American race, Rick Santorum, will have his logo on the hood of the number 26 car.

Following the “crash” of 2008, the Federal Reserve (Fed) has the yellow flag out and is playing it safe with the Federal funds rate at a very low level in an attempt to keep the economy on track.

Each of the GOP candidates has indicated that if elected he would pursue making changes either to the mandate or the chairman of the Fed. Leadership of the Fed will be important for investors to assess when not to “fight the Fed.”

1 Yellow Flag: Fed Keeping Rates Low and Economy on Track after “Crash” of 2008

2011 Daytona 500 Average Car Speeds and the Federal Funds Rate
 — Daytona 500 Average Car Speed Laps 15-36 (Left Axis)
 — Federal Funds Rate 3Q 1994-1Q 2012 (Right Axis)



Source: LPL Financial, NASCAR.com, Bloomberg data 02/27/12

Today, forty-three of the top drivers in the world will compete in “The Great American Race,” NASCAR’s biggest, richest and most prestigious motorsports event. Another great American race will be evident at Monday’s showdown: Republican presidential candidate Rick Santorum’s logo will cover the hood of the number 26 car. While the winner of the Daytona 500 will soon be in the books, it will likely take at least until the so-called “Super Tuesday” in the second week of March—or longer—for the likely winner of the GOP presidential nomination to become clear.

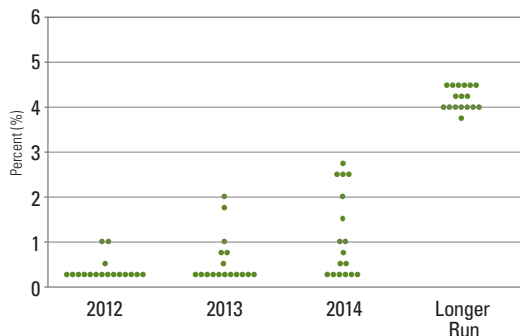
Over the coming weeks, the shift in focus from the differences among the candidates to differences between the likely nominee and President Obama may become a renewed focus for investors. Of course, there are many differences that are well known to investors, such as those surrounding taxes and spending priorities, health care and energy policy, and foreign affairs. However, some differences may be less generally known but are also impactful for the financial markets. One such area is the Fed, or more specifically, the Federal Open Market Committee (FOMC). Led by Chairman Ben Bernanke, this independent group of 17 members of the Federal Reserve system determines U.S. monetary policy including setting interest rates, quantitative easing, and other influential factors. Each of the candidates, including frontrunner Mitt Romney, has indicated that if elected he would pursue making changes either to the mandate or the chairman of the FOMC.

Ben Bernanke was appointed to head the FOMC in 2006 by Republican President George W. Bush, and he was confirmed for a second term after being re-nominated by Democratic President Barack Obama. While his second term ends in 2014, it is possible that pressure from the President could cause Bernanke to step down as chairman prior to the end of his term. While the Fed is structured to remove the influence of politics from monetary policy by granting the governors such as Bernanke 14-year terms, it is challenging for a Fed chairman to operate without the support of the President.

As you can see in [Chart 1](#), Fed policy is—in NASCAR terms—running under a yellow flag. While cars at the Daytona 500 typically vary around 175-200 mph as they go around the oval track, after a crash, officials send out a safety car to slow the cars down until the race is safe to resume. The Federal funds rate is normally much higher than it is today when the economy is operating around full speed. But following the “crash” of 2008, the Fed is



2 FOMC Individual Member's Views of Where Rates Should Be by Year



Source: Federal Open Market Committee 01/25/12

Each shaded circle indicates the value (rounded to the nearest ¼ percent) of an individual FOMC member's judgment of the appropriate level of the target federal funds rate at the end of the specified calendar year or over the longer run.

playing it safe with the Federal funds rate at a very low level in an attempt to keep the economy on track.

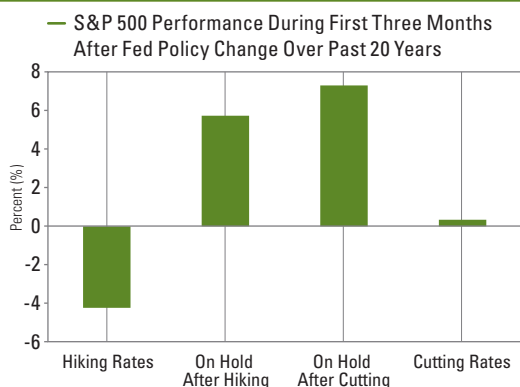
Over the last 15–20 years, the FOMC has pushed the Federal funds rate back up to around 5.5–6.5% during periods of economic growth. With the rate currently a mere 0.1%, there may be a rapid acceleration in the rate when the time comes to begin to raise the rate. When will the race restart and the Fed put away the caution flag? That may depend on who the Fed chairman is going to be.

The members of the FOMC are not of one mind on when rates should be hiked. In fact, the members have opinions ranging across the board in their view of when rates should next be raised. Three members of the FOMC believe that rates should be hiked for the first time this year, while another three believe next year should be the start. Of the other 11 members of the FOMC, five believe rates should be hiked in 2014, four in 2015 and two in 2016. [Chart 2](#) shows where the 17 individual FOMC members believe the Federal funds rates should be by the end of the specified year and over the longer run. Leadership of the Fed will be important to assessing the Fed's likely course of action and when to not "fight the Fed."

In general, based on their statements, the Republican presidential candidates indicate that they would favor a less cautious Fed and an earlier start to getting interest rates back up to more normal levels. This is favored in order to avoid an inflation problem that could be caused by keeping monetary policy too easy for too long.

For investors, the potential for a change in Fed leadership or mandate that would prompt an earlier series of rate hikes than the market currently anticipates could be a negative for stocks. The old adage "don't fight the Fed" refers to the relatively poor performance of the S&P 500 when the Fed is hiking interest rates, as you can see in [Chart 3](#). While that action by the Fed may still be more than a year away no matter what happens, markets could begin to price in the possibility of more rapid and larger rate hikes as the leaders emerge in the great American race. ■

3 Don't Fight the Fed



Source: LPL Financial, Bloomberg Data 02/27/12



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The Standard & Poor's 500 Index is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

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