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Fed Willing to Run it Hotter

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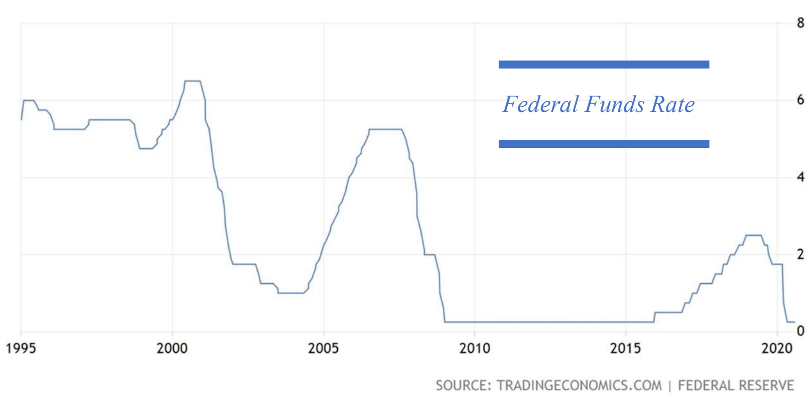
Thursday's stock market sessions was mixed. The S&P 500 gained 6 points, or 0.17% closing at 3,485. The Dow Jones Industrial Average rose 160 points, or 0.57% to close at 28,492. The Nasdaq Composite was the laggard, falling 40 points, or -0.34%, and closing at 11,625. Finally, the Russell 2000 increased 4 points, or 0.28% to close at 1,565.

After some whispers that the Fed might make a significant policy change, Fed Chair Powell made it official by announcing a robust updating of the Fed's monetary policy framework relative to inflation. The Fed's new policy will allow inflation to run moderately above or below the Fed's 2% target for an extended time. The Federal Reserve has not been able to raise inflation to its 2% target since 2012, despite significant efforts. The unsaid part of the message is that the Federal Reserve will leave interest rates lower for a longer period even if there is a rise in inflation.

The Federal Reserve has two main goals: price stability and employment maximization. With today's announce ment the clear priority of the Fed is to maximize employment even if they have to allow inflation to run hotter than they would like. Regarding employment, Chariman Powell's speech implied that a robust job market can be sustained without causing an outbreak of inflation. He also alluded to the fact that the maximum level of employment is a broad-based and inclusive goal. Chairman Powell left the target for the federal funds rate unchanged but suggested that there may be more monetary easing in the future.



Chairman Powell's comments were not lost on the capital markets. A federal reserve that is willing to juice the economy longer than anticipated is a significant signal to the market. Longer dated U.S. Treasuries fell which had the effect of increaseing their yield. Stocks indexes were mixed, but the economically sensitive stocks did best.

It is rare to hear a Federal Reserve Chairman suggest that they are willing to run the economy hotter with respect to inflation so as to increase job creation. That is good news for a pandemic ravaged economy; however, it will require adept skill to know when hotter becomes too hot. <u>The Fed's comments are not just a reflection of the current economic impact of the pandemic alone, but also a recognition of the longer-term changes in the underlying economy accelerated by the pandemic.</u>