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Model for the Day

As with every Federal Open Market Committee (FOMC) statement day, there is a model for the stock market to follow pre and post announcement. Certain environments have very strong tendencies while others do not. Two meetings ago was one of the rare times where the models strongly called for a rally on statement which was correct as well as a decline a few days later which was also correct. Today, the upside edge is just outside a coin flip and certainly not worth playing based solely on this.

While it's also December option expiration week which has historically added a nice tailwind to stocks, that edge has also been a bit muted by the strength seen on Monday and Tuesday. On the bright side, there could be a strong and playable short-term trend to the downside starting by the end of the week, but we will have to see how the next few days play out.

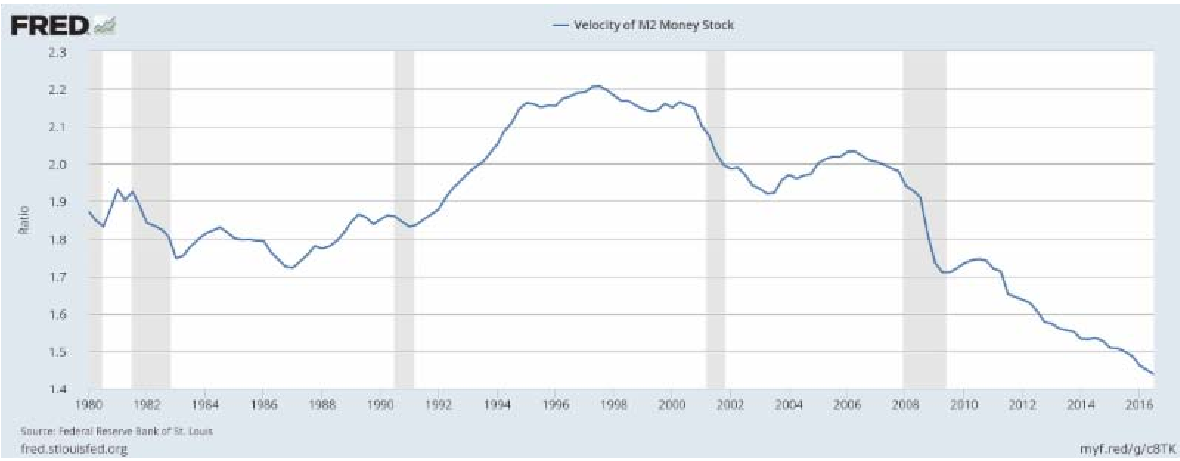
1/4% Hike Against Mixed Economic Picture

Janey Yellen and her friends at the Fed have done an excellent job of preparing the markets for a rate hike today. I would say that it's a 95% certainty. The Fed is going to raise the Federal Funds Rate today by .25%. Whether you want to attribute it to the Fed making an independent decision based on the economic data at hand or that Donald Trump's agenda is assumed to be very pro-growth or that Paul Ryan will be running tax policy or even that stocks have become a bit frothy, short-term rates are going up today and next year.

Looking at what the Fed is supposed to be basing their decision, the economy, we see a mixed bag. Over the past three months, we have created 156,000, 161,000 and 178,000 jobs in the U.S which seems pretty good on the surface. However, that's 200,000 less jobs than 12 months earlier. The manipulated unemployment rate is down to 4.6% with the real or U6 rate at 9.7%. And while the consumer price index (CPI) has finally started to uptick after percolating for years, it's hardly hot and worrisome. Our economic output, GDP, is improving and now stands at just over 3% which is also finally good news. I fully expect that to click between 3% and 4% in 2017.

Velocity of Money Still Collapsing

Turning to an oldie but a goodie, below is very long-term chart of the velocity of money (M2V) produced by the St. Louis Fed. In the easiest terms, M2V measures how many times one unit of currency is turned over a period of time in the economy. As you can see, it's been in a bear market since 1998 which just so happens to be the year where the Internet starting becoming a real force in the economy. Although it did uptick during the housing boom as rates went up, it turned out to be just a bounce before the collapse continued right to the present.



This single chart definitely speaks to some structural problems in the financial system. Money is not getting turned over and desperately needs to. It would be interesting to see the impact if the Fed stopped paying banks for keeping reserves with the Fed. That could presumably force money out from the Fed and into loans or other performing assets.

The Secret Behind Low Rates

Continuing to raise rates, as I have written about over and over, also makes our currency a lot more attractive to foreigners. Remember, money flows where it's treated best. Since early 2008 here, in Street$marts and on the various financial channels, I have been a devout secular bull for the dollar, even when trillions were being manufactured by the Fed. For years, I sat alone in my bullish house before having company over the past few years.

As I have written about, I truly believe that one of the main reasons Yellen and her inner circle don't want to raise rates is because they are terrified of massive capital flows into the U.S. as the dollar index breaks out above par (100) which is already did and travels to 110, 120 and possibly higher, somewhat like tech stocks did during the Dotcom boom. Below is a chart I continue to show at each FOMC meeting. 120 is the next long-term target.

A soaring dollar would be great in the short-term for all except those who export goods. Our standard of living would go up. Companies with U.S.-centric businesses would thrive. Foreigners would buy dollars in staggering amounts at a dizzying pace which I argue would make their way into large and mega cap U.S. stocks. Think Dow 23,000, 25,000 and possibly 30,000.

What's so bad about that?

Eventually too much of a good thing becomes problematic. In this case, mass dislocations in the global markets would grow and that would almost certainly lead to a major global financial crisis later this decade. Think many elephants trying to squeeze out of a room at the same time. Think crash of 1987 on steroids. Yellen and the other smart people in the room must know this. You may not agree with their thinking and actions, but some of these people are scary smart.

I understand why the Fed is going to raise rates. I truly do. However, given our current mixed economic picture and the weakness, deflation and accommodative stances of central banks elsewhere, I believe that Yellen and her minions are barking up the wrong tree.

To Your Financial Success,

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