

THE FED AND INTEREST RATES...



*Chairmann of the Board of Governors
of the U.S. Federal Reserve,
Ben Bernanke*

Why is the Fed So Important?

By Roger Ward

**If the Federal Reserve changes its mind a quarter of a percent, it can affect the whole economy.
Why is the Fed so important?**

If you watch any kind of national news broadcast or business program, sooner or later you'll hear some talk about the "interest rate" and the Federal Reserve.

Mysterious to many Americans, the Federal Reserve has an enormous impact on the economy.

How enormous? If you have a mortgage, a credit card, or just worry about prices rising where you shop, the Fed and its decisions directly affect you.

The Fed's Purpose

Basically, the Fed's job is to keep the economy running smoothly. It watches economic data to see if the economy is growing too slow or too fast. When necessary, it responds by a) controlling the supply of money and b) adjusting the federal funds rate. This is the rate at which America's major banks loan money to each other. Most short-term interest rates on loans and mortgages are priced relative to this rate.

When the Fed Adjusts Interest Rates Down

When economic growth seems to be slowing down and the risk of recession appears, the Fed often makes it easier for banks to borrow money by loosening credit and reducing short-term interest rates. The lower interest rates encourage people to spend more money, and this spending boosts demand for goods and services. As a result, big businesses borrow money to hire new employees, expand and increase production, and stock prices of these businesses often rise as well – all from one seemingly small mathematical decision.

Who Makes These Decisions?

Since February, Ben Bernanke has been the world's most powerful banker – the Chairman of the Federal Reserve. A former Princeton University professor and presidential economic adviser, he replaced Alan Greenspan, who was Chairman for a remarkable 19 years (1987-2006). The heralded Greenspan adjusted interest rates to historic lows, which proved great for the real estate market and resulted in higher home

values. He also supported the controversial idea to replace Social Security with private retirement accounts. Bernanke is considered more financially and politically moderate than Greenspan.

Why Fed-Watching is Such a Spectator Sport?

Whole industries watch the Fed's decisions, as well as foreign governments and corporations that depend on the pocketbooks of American consumers. Chairman Bernanke and other members of the Federal Reserve Open Market committee meet about every six weeks to go over economic data and consider raising or lowering interest rates. For the last two months, the Fed has left interest rates alone at 5.25%, after 17 consecutive quarter-percentage-point hikes. The Fed has seemed cautious about making moves in recent weeks, as the jury is still out on whether the economy is edging into recession or growing.

What Impact Does Fed Changes Have on Client Investment Allocations?

While much effort is expended in reading the "tea leaves" of Fed actions, its impact at the implementation level at Tarpley & Underwood Financial Advisors is muted by the other fundamental factors that effect market returns. No individual Fed action causes a shift in investment policy but it does become another piece of the equation that feeds into our analysis process.

If you have a question about what the current Fed actions means to the Tarpley& Underwood portfolios, please contact us at rward@t-u.com.