Mitch on the Markets

How the Fed's Interest Rate Hike Affects You

By Mitch Zacks
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The Federal Reserve raised interest rates another quarter basis point on March 15, and signaled that two more rate hikes are on deck for 2017. As the Fed tightens credit in response to an economy on solid footing, it is likely to have an effect on savers, borrowers, and investors. In other words, it can affect *you.* We talk about how below…

For Borrowers:

If you have variable-rate debt somewhere on your balance sheet, you could see an uptick in the interest you pay – and it could increase your monthly payments as a result. The affected could include homeowners with adjustable-rate mortgages, credit card holders, and/or those with a home equity line of credit.

If you have any of those types of loans, you may want to keep a close eye on your interest rate to see if any adjustments are made. As a refresher, the prime rate is what credit companies use as a baseline for what they charge customers—generally prime plus extra depending on your credit history. The prime rate currently sits at 4% and could reasonably be expected to notch up to 5% by the end of the year. Credit companies and lenders are likely to adjust to the new prime rate within 60 days, so you may see a payment impact within that time frame.

For Savers:

Unfortunately for savers, the impact is not nearly as significant as what it could be for borrowers. The safest of instruments for saving (savings accounts, CDs, money market) are likely to hang tight with the fed funds rate, so it is not likely that you will receive much more than 1% or so for your money. Longer-term interest rates may respond over time if inflation ticks up, but there is not necessarily an immediate effect from a Federal Reserve interest rate hike. In short, it is still a pretty dismal environment for savers hoping to make interest in a risk-free or low risk instrument.

For Investors:

Stock performance is more closely tied to corporate earnings and broad economic growth, and both appear to be on track for a positive movement in 2017. There is a lot riding on how the current administration will turn policy proposal into law, and how that will affect the business environment. But regarding just interest rate increases, there is no reason to believe they will impede stock performance this year. In fact, *stocks can still do quite well even during a rising rate environment.* A quick survey of historical stock returns during monetary tightening cycles tells us as much:

Performance of the S&P 500 During Past Tightening Cycles

Date Range of Hikes	**Number of Rate Hikes**	***Annualized* S&P 500 Performance**
1994 – 1995	7	+18%
1999 – 2000	6	+5%
2004 – 2006	17	+16%

Source: JP Morgan

To be sure, the above table does not tell us with any certainty that stocks will do well as the Fed incrementally raises rates from here. What it does tell us is that stocks *can* do well and *have* done well, which means we have good statistical probability of stocks posting positive returns as long as the economy continues to grow. And we think the economy will continue to grow.

Bottom Line for Investors

The market is currently pricing-in three interest rate hikes for 2017, with a March (already happened), June and December bump as the most likely. Savers and borrowers would be wise to keep an eye on these Fed meetings (or just keep reading my column for updates), and be sure to watch your personal finances to see if you are affected in any way or if you can do anything about it. For investors, the interest rates will have an impact but not as much as the financial media would like for us to believe. It's better to focus on policy, fundamentals, and as ever, corporate profits.

-**Mitch**

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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