



CHARTER OAK  
CAPITAL MANAGEMENT  
*Registered Investment Advisors*

## The Acorn

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### What Rising Rates May Mean for You



After years of keeping the benchmark federal funds rate at historic lows, the Federal Reserve has been raising it gradually. This leaves some people asking how rising rates can affect you as an investor.

#### **What is the Federal Funds Rate?**

All big banks and community banks in Maine and New Hampshire and throughout the United States are required to maintain a certain amount of reserves so they can meet their obligations.

Sometimes banks need to borrow funds to meet their reserve requirements. The name for the rate at which they borrow is called the "**Federal Funds Rate**". When you hear about "*rates rising*" in headlines they are simply referring to the federal funds rate.

The Federal Reserve System, through its Federal Open Market Committee (FOMC), sets a target range for the funds rate.

Although the federal funds rate is an internal rate within the Federal Reserve System, it serves as a benchmark for many short-term rates set by banks and can influence longer-term rates as well.

### Why does the Fed adjust the Federal Funds Rate?

The Federal Reserve has two main responsibilities: conducting monetary policies that foster maximum employment and price stability. Simply stated, making sure folks have jobs and also that prices of goods sold don't go haywire. Adjusting the federal funds rate is one way the central bank can influence economic growth and inflation.

### Higher rates are good news for savers. What about stock investors?

The data may surprise you.

Many investors believe that rising interest rates lead to poor stock returns. They believe higher rates make bonds relatively more attractive versus stocks; that higher rates may slow economic growth, which weighs on corporate profits and stock prices.

However, historical research conducted by Vanguard doesn't show a pattern of falling stock prices during rate-hiking cycles. In fact, rising rates often take place when the economy is performing strongly and earnings growth is robust. As a result, stocks tend to perform respectably during those periods.

As the graphic below illustrates, in the 11 periods of rising rates over the past 50 years, stock market returns were positive in all but one of them.

### Rising interest rates do not equal poor equity performance.

The graphic below illustrates **11 periods of rising rates** that have occurred over the past 50 years with **annualized total returns** broadly positive and in line with historical averages.



## **For bond investors, the picture is more mixed.**

Short term rates are rising (as forecasted) after being at or near historic lows for almost a decade. Longer-term rates have remained more unchanged because they are influenced less by Fed action than by investors' long-term expectations for growth.

We believe price fluctuations in the short term will be offset by an opportunity to invest at higher rates in the future and that should be viewed as a positive.

## **The bottom line is to stay the course.**

The broader perspective is that rates are rising in the U.S. because the Federal Reserve believes the economy to be on solid ground.

Rising rates do not necessarily argue (at this point) for a sweeping change in portfolios. And in any event, we feel large changes based on headline news would amount to trying to time the markets which research has shown time and again is a strategy that most often does not work out well.

We thank you for the opportunity to be your trusted advisor. As always, we strive to be a resource that provides clarity and perspective to your long-term financial plans. Please contact us with any questions or requests for additional feedback. It is always a pleasure to help.

*Charter Oak Capital Management is a registered investment advisor that provides retirement planning, financial planning and fee-based investment portfolio management to individuals and non-profit organizations. Our offices are located in Portland and Kennebunk, Maine and Portsmouth, New Hampshire.*

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