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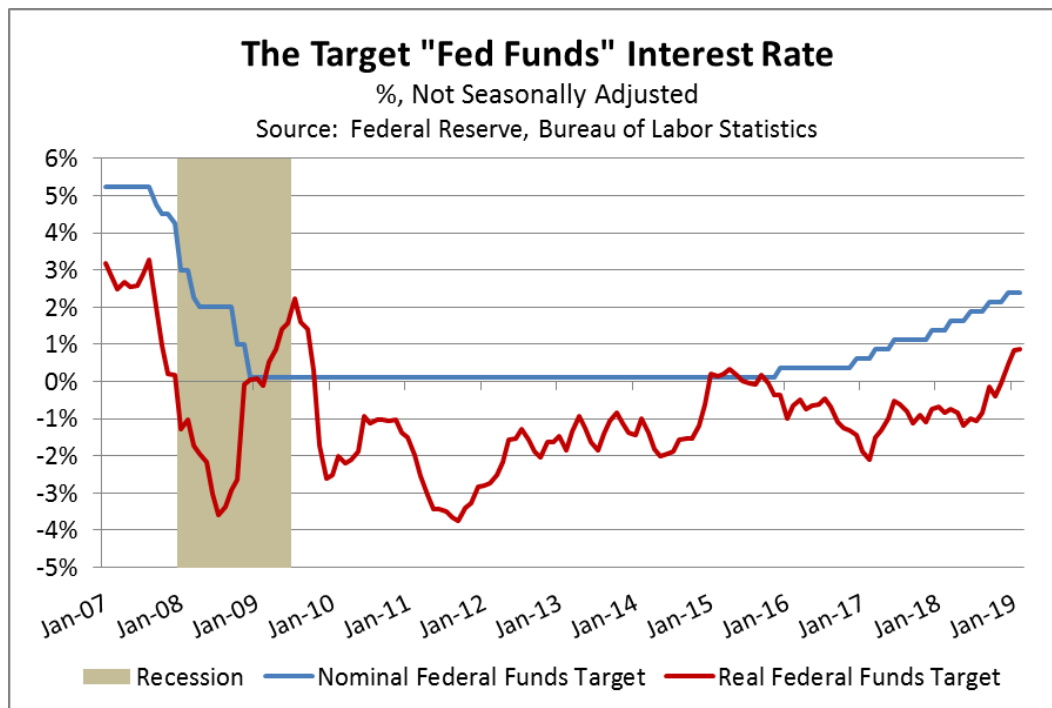
Proactive Investment Management & Financial Planning

Economic Chart of the Week March 20, 2019

At first glance, this week's chart may not seem like a companion to last week's, but I can assure you it is. It's also closely related to the Federal Reserve's decision today to leave its benchmark "fed funds" interest-rate target unchanged at a range of 2.25% to 2.50%.

The blue line in the chart shows the midpoint of the Fed's nominal target range as it's evolved over time. After a one-off rate hike in December 2015, the policymakers boosted their target range gradually but regularly from December 2016 through December 2018. They're now signaling further rate hikes are on hold for the time being. However, the key interest rate for the economy is the inflation-adjusted or "real" fed funds rate, i.e., the nominal rate minus inflation (as measured by the consumer price index). As represented by the red line in the chart, the real fed funds rate has recently been rising much faster than the nominal rate, on account of the falling inflation shown in last week's chart. The real fed funds rate isn't very high historically, but it is at its highest level since right after the Great Recession. Moreover, even if the Fed now holds the nominal fed funds rate steady, any further decline in inflation would mean the real rate would actually go up. With the economy now much less vigorous than in previous decades, we think the real rate is already high enough that it could significantly retard near-term economic growth or even cause a downturn, so any further rise could be a problem. We're happy that the current recovery in the stock market now seems to be getting a second wind, and even though we continue to gradually reduce our exposure to risk, our remaining stock holdings have allowed us to take advantage of the rebound. However, we think high real interest rates and the potential for them to go higher argue against increasing our stock exposure again.

Patrick Fearon, CFA
Lead Portfolio Manager



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