First Trust
Monday Morning OUTLOOK
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Tight Money, Still A Long Way Off

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Going into last month's Fed meeting, most analysts thought that if anyone dissented it would be Dallas Fed President Richard Fisher, the Federal Reserve's most outspoken hawk. After all, Fisher had publicly called out the dovish Fed majority only days before the meeting (in an unusually aggressive Wall Street Journal Op-ed), pointing to the risk of "staying too loose, too long" given a "rapidly improving employment picture."

In the end though, Fisher held fire, deciding to vote with the majority, as he later explained, because the discussion of when to start raising short-term rates is "coming my way," which means earlier in 2015 rather than later.

The idea that the inevitable first rate hike from the Fed might come sooner than previously anticipated probably rattled some nerves in the equity markets, along with Ukraine and Iraq. After all, the Fed's next series of rate hikes, whenever they do arrive, will come in unprecedented monetary territory, with the Fed's balance sheet bloated from several years of quantitative easing. This all raises the question of whether the Fed can properly manage the timing of raising rates and unwinding its balance sheet.

But we think the markets are, once again, paying too much attention to current and future Fed policy and not nearly enough to the underlying economic fundamentals - the real power behind equity gains since 2009.

Quantitative easing, in spite of the conventional wisdom these days, is not the driving force behind the equity rally. Soaring corporate profits are the real reason. This is why the Price-to-Earnings ratio on the S&P 500 sits at 17.5, right about where it was a decade ago.

But even if you believe the Fed's balance sheet expansion was the key behind better equities, you should be satisfied to know that, despite the end of quantitative easing in October, the Fed's not going to actually reduce the size of its balance sheet anytime soon.

And, when the Fed starts raising rates, monetary policy will still be loose and will probably remain that way for a couple of years. Hiking rates from near 0% to 0.5% or 1% won't make the Fed tight, it just makes it less loose. Fed policy won't be tight until short-term rates get to at least 3%, and probably more like 3.5% to 4%.

In other words, even though the Fed is moving toward Fisher and the other hawks, the likelihood that monetary policy will end this bull market anytime soon is extremely low. The Fed is nowhere near getting tight. Corporate profits are poised to keep pushing higher, even if profit margins shrink a little. The driving force of growth - the entrepreneurial spirit - remains alive and well.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-13 / 7:30 am	Retail Sales – Jul	+0.2%	**+0.3%**		+0.2%
7:30 am	Retail Sales Ex-Auto – Jul	+0.4%	**+0.4%**		+0.4%
9:00 am	Business Inventories – Jun	+0.4%	**+0.4%**		+0.5%
8-14 / 7:30 am	Initial Claims – Aug 9	295K	**300K**		289K
7:30 am	Import Prices – Jul	-0.2%	**-0.4%**		+0.1%
7:30 am	Export Prices – Jul	-0.1%	**-0.2%**		-0.4%
8-15 / 7:30 am	Empire State Mfg Survey – Aug	20.0	**21.4**		25.6
7:30 am	PPI – Jul	+0.1%	**+0.2%**		+0.4%
7:30 am	"Core" PPI – Jul	+0.2%	**+0.2%**		+0.2%
8:15 am	Industrial Production – Jul	+0.3%	**+0.3%**		+0.2%
8:15 am	Capacity Utilization – Jul	79.2%	**79.1%**		79.1%
8:55 am	U. Mich Consumer Sentiment- Aug	82.5	**82.3**		81.8