

Il Sole 24 Ore  
08 November 2015

## **Global markets**

WAITING FOR THE CHANGE OF DIRECTION ON RATES

### **The winners**

Banks and companies linked to the cycle benefit most from dearer money

### **The losers**

Utilities and telecommunications groups are usually the hardest hit

### **Stock markets: who's raising a glass to the rise in US rates**

*In the last 6 "restrictive" cycles, Wall Street has always gained – for the time being the wait is no cause for concern*

#### **Maximilian Cellino**

Who's afraid of a rate rise by the Federal Reserve? To judge from the markets' response last Friday, when the higher-than-expected figure for US employment increased the possibility of an intervention as early as December, not many. Wall Street reacted with a shrug of the shoulders, on a day when the dollar also strengthened markedly and returns on US Treasury bills increased according to script.

Past examples don't disturb investors' sleep: in the six upwards cycles of the last 30 years Wall Street has always benefited and, except for 1994, when the movement and its extent took the markets by surprise, it did so almost immediately. The most obvious reason for this only apparent anomaly is that when a central bank increases rates the economic recovery is well under way: so the tailwind from growth is enough to overcome any obstacles caused by the higher cost of money

It certainly can't be denied that each economic and monetary cycle has its own story and nothing, ultimately, is repeatable. Indeed, the current scenario has no shortage of its own peculiarities, starting with the minimum level from which the Fed's rates are starting (practically zero) and the by no means cheap prices seen on Wall Street (close to their historic highs). There are, therefore, well-founded reasons to stay confident. "The process leading towards the normalisation of monetary policy will be gradual", explains Richard Gillham, Head of Product Specialists at Legg Mason, "and in the transition between an extremely accommodative rate and a more normal one the stock markets can continue to behave".

When you look at the companies that benefit most if rates rise, the banks generally top the lists. That's because their margins, or the differential between the interest generated by what is their typical business (i.e. lending) and that paid to the people supplying them with money (i.e. deposits), generally increase proportionately with the level of interest rates set by the central banks.

But the financial sector is certainly not the only beneficiary: we need to bear in mind that when the Fed raises rates the US economy is moving at a strong pace or at any rate is nearing its potential. All the sectors linked to growth will therefore tend to perform better than the classic defensive sectors. "The improvement in the employment climate, together with a more stable situation on the real estate market", continues Gillham, "make consumers more likely to spend, and not just for their day-to-day needs. So this situation could benefit all those companies that produce discretionary consumer goods".

There's scope, therefore, for those who traditionally benefit from a recovery, while penalised sectors could include utilities and telecommunications. "The relatively stable value and the reliability of the dividends", underscores Gillham, "mean that the shares of these companies are less closely linked to the economic cycle and more similar in their behaviour to bonds, which tend to suffer in a situation of rising rates".

Recent decades tell us that in times of restrictive policies in the United States the markets of the rest of the world benefit. The concerns, from this perspective, are mainly concentrated in the emerging economies, which suffer when liquidity is reduced and the dollar strengthens. And which have already taken a hit, both when talk began of a reduction in the USA's monetary stimulus (tapering) in spring last year, and more recently as a result of the collapse in commodities and the Chinese turbulence.

Here too, however, the reaction is not necessarily automatic. "The slowdown in China seems to be settling out, like the commodities crisis", observes Luca Riboldi, Chief Investment Officer at Banor. "If to this we add the fact that in the last few days the dollar has gained ground, especially against the euro, and to a lesser extent with respect to currencies like the Brazilian real, there is good reason to once again take a constructive view of the emerging markets, whose evaluations have returned to acceptable levels".

The rise in US rates and the resulting strengthening of the dollar can only benefit Europe, especially "peripheral" Europe, whose companies can exploit both a more competitive exchange rate and the American recovery. The factor that could derail a scenario that seems almost idyllic is perhaps paradoxical: "There's a risk that the Fed acted too late on rates and that the situation could slip its control and cause long-term US rates to rise excessively", ventures Riboldi. In that case, investors would have to reconsider their risk premiums. And Wall Street would be the first to suffer.

## Winners and losers with US rate rises

Wall Street sectors in the last two periods of rate rises.  
June 1999–May 2000 and June 2004–June 2006

### Chi vince e chi perde con i rialzi dei tassi Usa

I settori di Wall Street nelle ultime due fasi rialziste dei tassi.  
Periodi giugno 1999 - maggio 2000 e giugno 2004 - giugno 2006



Fonte: Thomson Reuters

## Market reactions to a squeeze by the Fed

CONFRONTO STORICO = HISTORIC COMPARISON

Indice di Wall Street e tassi Fed = Wall Street index and Fed rates

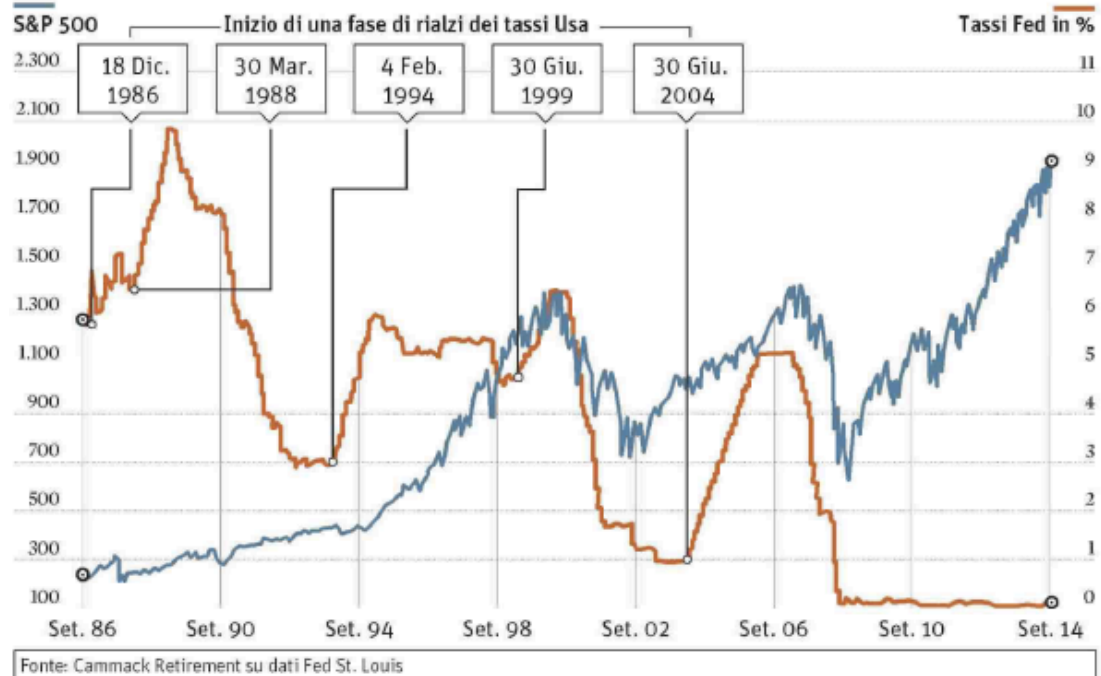
Inizio di una fase di rialzi dei tassi Usa = Beginning of a period of US rate rises

Tassi Fed in % = Fed rates in %

### La reazione dei mercati quando la Fed "stringe"

#### CONFRONTO STORICO

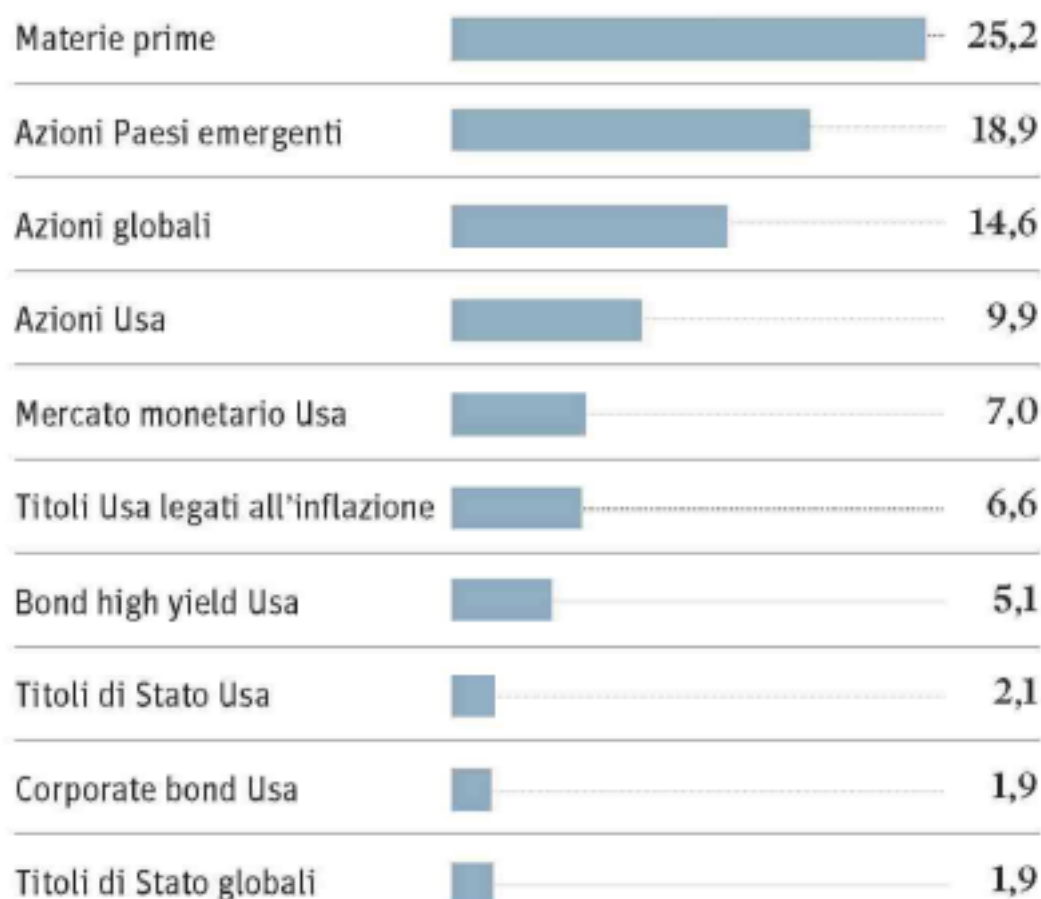
Indice di Wall Street e tassi Fed



Source: Cammack Retirement from Fed St. Louis data

## LA CLASSIFICA

Performance media durante le fasi restrittive della Fed. In %



Fonte: Allianz Global Investors

<b>Average performance during the Fed's restrictive periods. In %.</b>	
Commodities	25.2
Emerging countries' stocks	18.9
Global stocks	14.6
US stocks	9.9
US monetary market	7.0
Inflation-linked US stocks	6.6
High-yield US bonds	5.1
US government securities	2.1
US Corporate bonds	1.9
Global government bonds	1.9

Source: Allianz Global Investors