

With global monetary policies tight or loose, what's appropriate for investors?

Asset Management Services Research Analyst **Sandrina Riddell** explains what opposing interest rates across the globe could mean moving forward.

Since 2010, there has been a global trend of more accommodative monetary policies with several major central banks overseas. However, both the Federal Reserve (Fed) and the Bank of England (BOE) are expected to tighten monetary policies this year. With this movement in opposite directions, you are left to wonder what that could mean for your investments.

WHAT'S HAPPENING?

In a much anticipated and well-telegraphed rate hike in December 2015, the Federal Open Market Committee (FOMC) increased the federal funds rate by 25 basis points. However at the March meeting, the Fed kept the rate unchanged, citing global economic and financial developments. Other major central banks (European Central Bank, Bank of Japan, and the Swiss National Bank) have continued their monetary easing policies and slashed interest rates into the negative territory – known as negative interest rate policies (NIRP).

Negative short-term interest rates abroad combined with a weaker dollar may have boosted international fixed income returns in the first quarter of 2016, with the Barclays Global Aggregate Ex-USD index gaining 8.26%. Such monetary policy divergence may continue even if the Fed keeps the federal funds rate unchanged for longer since other major central banks keep lowering their rates.

POTENTIAL IMPLICATIONS

Monetary policies and their effects on financial markets are strongly related with currency market movement. The prospect of higher interest rates tends to strengthen a currency, which in turn affects international returns for domestic investors.

In 2015, a strong U.S. dollar had a negative impact on international fixed income holdings owned by U.S. investors. To illustrate, last year emerging market debt returned 3.3% in local currency but lost 14.9% in U.S. dollars, as per the JPM GBI-EM Global Diversified index.

One-year return, post first rate increase

Rate hike dates	U.S. equity	European equity
July 1971	14.3	26.3
August 1977	-7.2	21.9
September 1987	5.2	3.7
May 1994	1.3	2.3
August 1999	21.0	15.9
June 2004	10.9	20.9

Source: Morningstar & Newyorkfed.org, as of 1/31/2016. Ibbotson SBBI US Large Stock & MSCI Europe



Additionally, investment grade fixed income tends to have lower volatility than equities as well as having low correlation with equities. Even though the Fed raised the federal funds rate last year, the raise had a subdued effect on the fixed income market relative to expectations, with yields coming down instead of increasing. Core fixed income, represented by the Barclays U.S. Aggregate Bond Index, gained 3.03% in the first quarter, which demonstrates that bonds continue to mitigate risk during times of equity market weakness.

Another implication of central banks' actions relates to equity returns. Historically, within 12 months from the Fed's first rate hike, European stocks outperformed U.S. equities

with the exceptions of 1987 and 1999. Even so, U.S. stocks posted negative 12-month returns in only one instance. In the coming years, eurozone and Japanese equities are anticipated to potentially have more attractive returns than U.S. equities based on their valuations, earnings growth projections and accommodative monetary policies. ■

As always, well-diversified portfolios have the potential to provide investors with optimal risk-adjusted returns. Contact your financial advisor if you'd like to discuss investment selection strategies for your portfolio.



Mutual funds are sold by prospectus only. Investors should consider the investment objectives, risks, charges and expenses of an investment company carefully before investing. The prospectus contains this and other information about an investment company and is available from your financial advisor. The prospectus should be read carefully before investing.

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Please note that all indices are unmanaged and investors cannot invest directly in an index. An investor who purchases an investment product which attempts to mimic the performance of an index will incur expenses that would reduce returns.

Definitions:

Barclay's US Ag Bond Index: This index includes investment grade U.S. Government bonds, corporate bonds, mortgage pass-through securities and asset-backed securities that are publicly offered for sale in the United States. The securities in the index must have at least one year remaining to maturity.

Barclays Global Aggregate ex U.S.: Measures changes in global investment-grade, fixed-rate debt markets. It combines non-U.S. dollar-denominated versions of the (an-European Index and the Japanese, Canadian, Australian and New Zealand components of the Global Treasury Index.

MSCI Europe Index: A free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe. As of June 2, 2014, the index consists of the following 15 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

JPM EMBI Global Diversified index: The J.P. Morgan Emerging Markets Bond Index Global ("EMBI Global") tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the EMBI+. The EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least \$500 million.

The Federal Open Market Committee (FOMC) is the branch of the Federal Reserve Board that determines the direction of monetary policy. The FOMC is composed of the board of governors, which has seven members, and five reserve bank presidents.

It is important to review the investment objectives, risk tolerance, tax objectives and liquidity needs before choosing an investment style or manager. All investments carry a certain degree of risk and no one particular investment style or manager is suitable for all types of investors.

- High-yield (below investment grade) bonds are not suitable for all investors.
- There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise.
- International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility.
- Investing in emerging markets can be riskier than investing in well-established foreign markets. Investing involves risk and investors may incur a profit or a loss, including the loss of all principal.
- Investing in small-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.
- Commodities trading is generally considered speculative because of the significant potential for investment loss. Commodities are volatile investments and should only form a small part of a diversified portfolio. Among the factors that could affect the value of the fund's investments in commodities are cyclical economic conditions, sudden political events, and adverse international monetary policies.
- These portfolios may be subject to international, small-cap and sector-focus exposures as well.
- Markets for precious metals and other commodities are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.
- Specific sector investing such as real estate can be subject to different and greater risks than more diversified investments. Declines in the value of real estate, economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.
- Accounts may have over weighted sector and issuer positions, and may result in greater volatility and risk.
- Diversification does not ensure a profit or protect against a loss.
- Some accounts may invest in Master Limited Partnership ("MLP") units, which may result in unique tax treatment. MLPs may not be appropriate for ERISA or IRA accounts, and cause K-1 tax treatment. Please consult your tax adviser for additional information regarding the tax implications associated with MLP investments.
- Alternative investments are generally considered speculative in nature and may involve a high degree of risk, particularly if concentrating investments in one or few alternative investments. These risks are potentially greater and substantially different than those associated with traditional equity or fixed income investments. The investment strategies used by certain Funds require a substantial use of leverage. The investment strategies employed and associated risks are more fully disclosed in each Fund's prospectus, which is available from your financial advisor.

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