The Nation

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Column: BIZ INSIGHT: American stocks brace for a lift amid looming rate hike

BIZ INSIGHT

American stocks brace for a lift amid looming rate hike

SPECIAL TO THE NATION

THE SPEECH of the US Fed chairperson and the minutes of the April Federal Open Market Committee (FOMC) meeting show an increasing intention to hike the interest rate in the next 2-3 months. The Fed's consideration is backed by positive development data in the US economy. These include the first-quarter GDP being adjusted from 0.5 per cent to 0.8 per cent, the new consumer price index (CPI) being the highest in three years, signalling a revival of American purchasing power, and the retail sales volume being raised by 1.3 per cent, beating a year's record. Additionally, second-hand home sales have exceeded market estimates, and unemployment rates are also diminishing. These factors have heightened the possibility for the Fed's rate hike. According to the polls conducted by economists, the probability that Fed will raise interest rates in June is 30 per cent. This is a dramatic increase from the previous assessment, which had it at 4 per cent. The probability for the rate hike in July is even higher, at 54 per cent (Source: *Bloomberg*, as of May 27).

In any case, there are three main indicators that will determine the Fed's decision to raise interest rates, or, broadly speaking, to shift to a tightening of monetary policy. The first indicator is the US second-quarter GDP. The second indicator is inflation rates, for which the Fed has drawn the line at 2 per cent. The third indicator is the strength of the labour market. If the US economy shows strong signs of improvement in these areas, it could be certain that the US interest rate will go up. Many analysts have speculated that, following the first-time-in-nine-years rate hike in December 2015, the Fed is likely to raise the interest rates at least two times this year.

In the money and capital markets, the probability of the rate hike has caused turbulence for many asset prices. Most imminently, the price of gold has sharply fallen from around US$1,300 per ounce to $1,213 an ounce, the lowest in three months. In the opposite direction, stock market prices have reached new highs for the first time in two months, in response to signs of real economic improvement. In the final week of May, both Dow Jones and S&P indices have been lifted by over 2 per cent.

While speculation for a rate hike may cause volatility in financial markets, it also clearly indicates that the US business cycle is moving away from a depression period to a recovery period. To investors, this means an opportunity to invest in American stocks as a prospect for appreciated returns.

According to various studies, the average rate of return for stocks purchased within a year following an increase in interest rates is 7.48 per cent. So, investors with high-risk appetite can, at a good momentum, buy stocks and anticipate stable returns promised by an overall growth in US stocks. It is estimated that, backed by economic growth, the US stock market will be moving between 2,020 and 2,200. Due to ongoing uncertainties in the markets, investors are strongly advised to keep up with latest developments to ensure the most appropriate timing.

Investment contains risk. Investors should thoroughly study prospectuses, product features, return conditions and risk before investing.

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