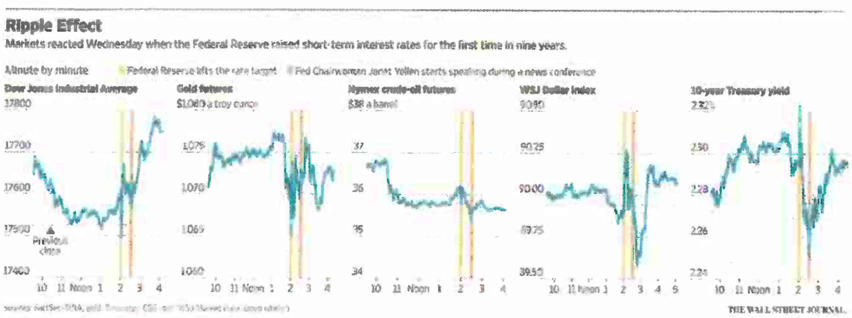
THE WALL STREET JOURNAL.

http://www.wsj.com/articles/investors-turn-focus-to-global-economy-after-fed-rate-move-1450311484

MARKETS

Investors Turn Focus to Global Economy After Fed Rate Move

Many are concerned about how markets will react as U.S. monetary policy diverges from that of other large economies



By **CAROLYN CUI**, **MIN ZENG** and **DAN STRUMPF**
Dec. 16, 2015 7:18 p.m. ET

The Federal Reserve interest-rate increase leaves unaddressed two riddles vexing investors: How healthy is the global economy, and how will markets react as U.S. monetary policy diverges from that of other large economies?

Many traders greeted Wednesday's decision with a sense of relief, as a long promised step toward the normalization of the markets and the U.S. economy. Market action was orderly, with portfolio managers and traders embracing a move for which investors had nearly two months to prepare.

The Fed did a masterful job preparing markets for the announcement, said Jason Ware, chief investment officer at Albion Financial Group. "Looking at most market prices, there's no bloodletting anywhere. It's pretty smooth."

The Dow Jones Industrial Average surged 250 points following the decision to raise the benchmark interest rate, the first since 2006, while Treasury bonds were largely flat and industrial commodity prices continued to slump. U.S. junk-bond prices rallied for a second day, as mutual funds and others continued to hunt for bargains following a two-week-long rout. The Dow industrials ended the day up 224.18 points, or 1.3%, to 17749.09.

The reaction, as well as the muted response to the Fed's rate projections accompanying the announcement, underscores the widely held expectation on Wall Street that the U.S. economy will likely continue to expand next year, while the central bank gradually increases the federal-funds rate following seven years near zero.

Many analysts expect U.S. stock indexes to rise next year after a flat performance in 2015 and bond prices to decline only modestly, sending corporate and consumer borrowing costs somewhat higher as U.S. growth picks up.

Some analysts said they expect the volatility that has swept stocks, bonds and other assets in recent weeks to slow down as many financial firms cut back on trading during the holiday period.

Yet few investors expect any calm to hold long into the new year, given the large swings in financial markets over the past few weeks and the numerous question marks over the global economy.

Energy prices have hit lows not seen in years, the U.S. junk-bond market has suffered its sharpest declines since 2011, and China's currency has posted its largest drop since the summer as the world's most populous nation prepares to move its currency away from a dollar peg that has been in effect for years.

Many developing economies appear vulnerable to a bout of renewed dollar strength, which would increase borrowing costs at a time when growth is already weak. Market turmoil tied to China's currency and Europe's monetary easing highlights the sense that global markets are dependent on stimulus measures.

The European Central Bank has undertaken a €60 billion ($66 billion) a month bond-buying program and cut interest rates to boost the eurozone economy. The Bank of Japan also has implemented monetary-easing measures, as well as structural overhauls, to spur growth. In China, the central bank is instituting easing measures as well.

In the U.S., the developed economy with the strongest growth in recent years, there is concern that weakness from around the globe could spill over at a time when financing

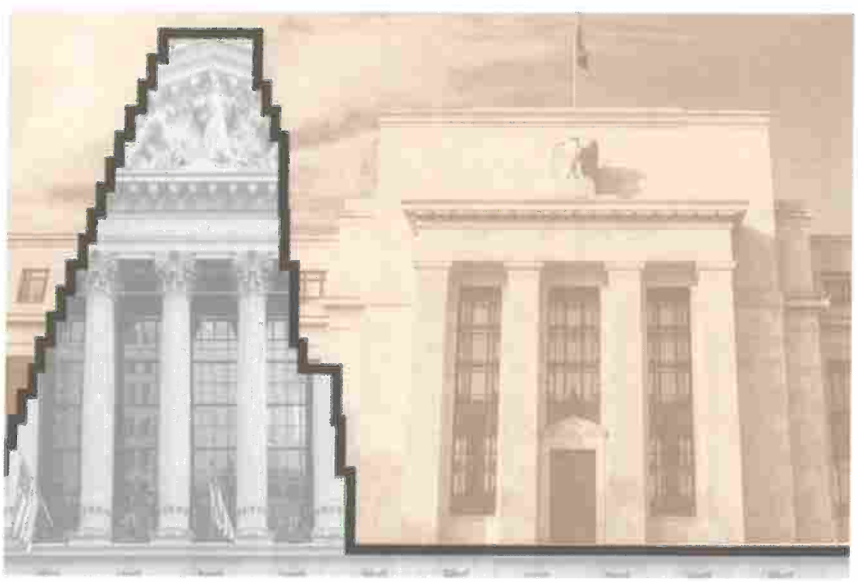
The Dow Jones Industrial Average surged 250 points following the decision to raise the benchmark interest rate, the first since 2006. Above, traders work on the floor of the New York Stock Exchange on Wednesday. *PHOTO: MICHAEL NAGLE/BLOOMBERG NEWS*

is becoming tighter for lower-rated companies.

Fed Chairwoman Janet Yellen emphasized Wednesday that she expected the central bank would raise short-term interest rates gradually in coming months. Many investors said the central bank can't be too judicious.

Reacting to the Fed

How Treasurys, mortgage rates, stocks and the dollar react when the Fed moves rates



"The Fed needs to be careful not to undermine the U.S. growth momentum," said James Camp, head of fixed income at Eagle Asset Management, which had $30.6 billion of assets under management at the end of September. Mr. Camp said he has scooped up long-term Treasury debt in recent weeks, moving cash from riskier corporate debt holdings.

Many investors are keeping an eye on emerging-market investments, which suffered large losses this past summer and still appear vulnerable. Brazil was downgraded by Fitch Ratings on Wednesday, and the South African currency this month hit a low against the dollar.

Among the concerns in emerging markets: retaining foreign capital at a time of slowing growth and substantial debt. Large investor outflows from emerging markets over the past few months have pushed down the monthly flow average to $5.7 billion this year, compared with $22 billion from 2010 to 2014, according to the Institute of International Finance.

Emerging-market currencies as a group are down 18% against the dollar this year through last week. Stocks, which are priced in local currencies, were down 17%. Dollar-denominated bonds have fared better, managing single-digit-percentage gains this year.

The scale of selling this year in emerging markets, U.S. junk bonds and other hard-hit asset classes may help to explain the broadly placid reaction to Wednesday's decision, analysts said. "Given how much [emerging-market] currencies have already fallen this year, we don't expect much turmoil in the near term," said Jorge Mariscal, chief investment officer of emerging markets at UBS Wealth Management, which oversees $1.9 trillion in assets. "What matters is the path of the interest rates in the U.S. going forward," he said.

UBS said it expects four more rate increases next year, which will be problematic for some emerging countries, including Brazil, Turkey, South Africa and Indonesia.

Write to Carolyn Cui at carolyn.cui@wsj.com, Min Zeng at min.zeng@wsj.com and Dan Strumpf at daniel.strumpf@wsj.com