Weekly Commentary **December 11, 2015**

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Despite Market Downdraft, Fed to Hike Next Week

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The market is clearly telling the Fed not to raise rates, but if you do so, do it *very, very* slowly. Given the collapse of commodities and the turmoil in the junk market, Treasury bill rates should be zero now. But given the widely-expected Fed hike next Thursday, traders are keeping them some 22 bps higher. Today's early market equity sell-off is related to the increasingly threatened position of debt floated on commodity-based assets. The 75% cut in the dividend of Kinder-Morgan and other energy-related MLPs, once the darling of yield oriented investors, is an ominous sign. Another is the suspension of withdrawals from the Third Avenue Focused Credit Fund, which invested heavily in energy credits. Many are asking: Is this beginning of a more general credit crisis, such as we saw in 2007-08? Ae Third Avenue's problems similar to the Reserve Fund, a $40 billion money market fund that suspended convertibility days following the Lehman collapse?

The answer is definitely no. What is so remarkable about the energy boom over the past 5 years is that it was financed almost completely outside the banking system. This is in stark contrast to the energy boom of the 1970s and early 1980s and the subprime mortgage boom of the last decade. Only those of us with a few grey hairs remember the saga of Continental Illinois National Bank, the seventh largest bank in the US at the time, that went belly up in 1984 after extending huge amounts of credit for oil exploration in Oklahoma and Texas.

This time around is much different. Banks are gun shy following the mortgage blow-up of 2008 and the piles of new regulations curtail such risky bank lending. More importantly, in recent years there were tons of money on the sidelines crying out "give me yield" and there was no problem finding investors. I am not saying there is no further downside to the market. What I am saying is this is not the start of another general credit crisis.

Today's economic news further supports Yellen's increase next Thursday. Retail Sales in November were almost exactly on target and PPI came in well above expectations. Although both headline and core PPI beat expectations by two tenths, this didn't offset the much larger shortfall we saw in these data in October. Tuesday we will get the CPI data, but that is extremely unlikely to impact the FOMC next week. If Yellen wants to postpone an increase she has to hit the airwaves very soon. And barring a thousand point swoon in the Dow, I don't see that happening.
