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## Was Wednesday a Bottom? Fed Statement will Impact markets next week

**Saturday, 10:30p PST**

I have been in San Francisco on business and hope to get back to blizzard-hit Philadelphia tomorrow. It is hard to believe that a month ago I was walking around in shorts and t-shirts enjoying record breaking December temperatures.

On the stock front, many traders are asking: Was Wednesday a bottom? Personally, I would have preferred to see heavier selling with the VIX moving up to the upper 30s. So the decline might not be over yet and I wouldn't be surprised to at least see a test of Wednesday's lows. On the economic front, jobless claims jumped unexpectedly and I want to see what next Thursday's claims reveal. More importantly, the Fed is meeting next week. Of course, they are not going to raise rates, but their statement will be important. Will the volatility in the markets weigh on their decision whether to raise rates? Recall that the volatility in international markets in late August prompted them to defer a widely-expected rate hike in September. What is happening in China and other markets today is at least as serious as it was back then. But in December the Fed thought that the deflationary pressures had subsided sufficiently to warrant an increase in December. Do they still feel so? We will not get a definitive "yes" or "no" next week, but the language will offer some strong signals. If equity markets recover over the next two months and the unemployment rate continues to fall, a rate increase is a very good bet. But if employment drops off and markets stay weak, the bet is a deferral of further increases.

By the way, the Fed is not "out of bullets", as many claim. If the economy does turn soft, they can take back their rate increase last month, and may set the interest rate they pay on reserves not only back to 25 bps, but even to zero or below zero, as the ECB has done. Speaking about the ECB, Draghi helped turn around the markets by voicing his intention to engage in more QE to spur the European economy. In effect Draghi corrected his error in the last meeting, where a less-than-expected response caused the Euro to surge and was widely criticized by the markets. I personally don't think another round of QE is imminent, as Europe is turning around, even though inflation is falling short of targets. By the way, Yellen can re-institute QE if our economy sharply decelerates, although the data so far certainly do not justify this action. All eyes next week will be on whether oil prices can recover. If so, we may have seen the low in equities.

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