



Education Center

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There are many factors which influence the movement of the stock market. Some cause a direct effect and others take some longer time to see the significance. Economic numbers fall into both of those categories.

From the amount of people working or not working, to the interest rates business owners have to pay on the money necessary to borrow to run their business to the cost of goods and how that factor affects the bottom line.

Also in the mix now more than ever is foreign currency as the worlds markets are being monitored and even traded for the better part of 24 hours a day. The perceived value of the U.S. dollar represents the strength of the U.S economy. When economic numbers are positive lower bond prices will create higher interest rates which should rally the U.S. dollar against other currencies.

A strong economy with increasing growth has a history of causing the stock market to react with a bullish sentiment when growth is stimulated and negatively when economic growth is slowed. An increase in interest rates slows growth and generally causes stocks and bonds to fall.

Lowering of interest rates increases money supply, stimulating growth and more often than not causes stocks and bonds to rally. A strong economy in sync with inflationary pressures creates a bias for higher interest rates and lower stock prices. Bearish economic news includes a slowdown in production and slower demand. We will comment on these factors individually and their affect on the market.

CPI: Consumer Price Index- Announced once a month and measures the change in the “standard” basket of products as used by the average consumer; helps to determine the level of inflation for those prices.

A strong or rising trend in CPI typically leads to higher prices and rising inflation which can cause the Fed to raise interest rates. If the number announced exceeds expectations stocks and bonds should fall while interest rates and the dollar should rise.

Housing Starts: Monthly statistics announcing new home construction. It is usually an effect of a strong economy as opposed to a cause.

Index of Leading Indicators: Aggregate of eleven indicators created to forecast broader movement within the economy. Announced monthly; a rising trend from month to month indicates a growth in the economy. If the growth is too strong this may induce the Fed to increase interest rates to slow the growth.

Industrial Production and Capacity Utilization: Measures the production of the manufacturing, mining and utilities industries. Rising production trends in manufacturing suggests a growth in the economy. Depending on the speed of the growth the Fed may chose to increases interest rates to temper the growth.

Real Gross Domestic Product GDP: Measures the aggregate value of goods and services produced in the economy. Steady monthly growth is healthy; a sharply rising number may cause the Fed to react by raising rates. A strong number increases the strength of the U.S. dollar.

Retail sales: Analyzes consumer spending on both durable and non durable goods by measuring retail sales to those consumers. When consumers are spending more on retail items this indicates that demand is high which could create higher prices. Typically when this number exceeds, stocks and bonds will fall and interest rates will rise to stem the growth.

Initial Unemployment claims: Weekly number examines how many workers have filed claims for unemployment benefits. If this number is trending upward this may indicate that the economy is getting weaker because there are fewer jobs available due to the slowdown n growth. If this is indeed the case the fed may lower interest rates to stimulate the economy.

Non Farm Payroll: This monthly economic number **is a KEY economic indicator**. The reading takes into account production across sectors to determine the overall strength of the economy. Strong employment growth suggests a growing economy which is conducive to stronger demand and higher prices. The long term effect will be a strong U.S. dollar and rising interest rates.

Producer Price Index PPI: Determines wholesale inflation on a monthly basis. Measures the change in wholesale prices of goods shipped from manufacturers. If the number is rising the increase will be passed on to the consumer and can be a leading indicator of inflation. If this is the determination from the Fed, increased interest rates are most likely to follow.

Understanding the Fed and interest rates a little better:

The Federal Reserve Board's goal is to foster a strong and steady economy. It does so by adjusting the availability of money and credit with the objective of advancing a sustainable growth in the economy. The fed's monetary policy has a direct effect on economic growth, inflation and employment.

The Fed has three main strategies for instituting its monetary policy:

1. Regulating reserve requirements for banks
2. Adjusting the rate the Fed charges banks for overnight credit; otherwise known as the discount rate.
3. Buying or selling U.S. Treasuries in the open market.

The FOMC sets short term monetary policy for the US central bank. This policy is derived from economic measures as described above; takes into account both domestic and international circumstances.

When the FOMC meets the main focus is whether or not they will change the short term Fed Funds rate. The interest rate banks charge one another for overnight lending.

When the Fed announces it has increased the Fed Funds Rate, this translates that it is instituting a tightening of monetary policy. This occurs during periods of strong economic growth when the concern of the fed would be about inflation. When the Fed id easing monetary policy, economic growth is slow and the Fed is attempting to stimulate the economy.

Numbers that point toward strong economic growth tend to be associated with inflationary pressure which means higher interest rates and lower stock prices.

Economic indicators that point toward strong growth and low inflation are the best of both worlds for the stock market.

Economic numbers that are reported provide insight as to which actions the Fed may take.

This report is by no means a detailed analysis of Fed actions; it is a primer for you as a trader to at least understand the significance of the Fed, interest rates, inflation and key economic numbers and their expected impact on the stock market.