LEADING ECONOMIC INDICATORS SUGGEST IT'S TIME FOR THE FED TO HIKE

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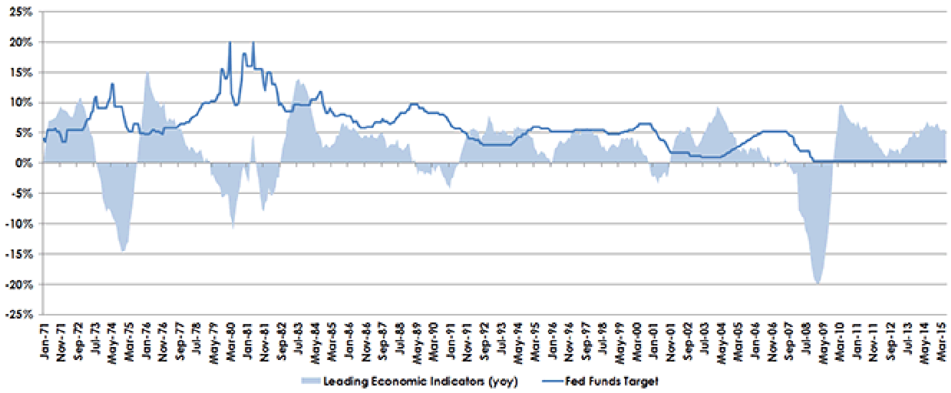
With the underlying improvement in the August employment report, domestic economic strength continues to move the Federal Reserve (Fed) toward liftoff. Leading economic indicators would suggest it is about time: the trend has been above zero for 68 consecutive months. This is the longest period of Fed inactivity on rates amid economic recovery since 1971. While the expansion has been noteworthy for its lack of robustness, it is still a very long time to remain in positive territory without a monetary policy adjustment. The Leading Economic Indicators Indexis a composite of 10 economic and market indicators, whose levels and changes tend to foreshadow changes in the overall economy. Building permits, average weekly hours, new orders and the spread between 10-Year Treasuries and the Federal Funds Rateare just a few of the indicators incorporated into the index. It is published every month by The Conference Board. The trend in leading economic indicators (year over year) has been relatively useful in validating thoughts on the economy and monetary policy. For example, the Fed punctuated both the 1994–1995 and 1999–2000 tightening cycles by hiking rates when the trend in leading economic indicators was decelerating rapidly. Both periods presented tremendous opportunities for bond managers to lengthen duration. **Recent Period of Strength Is Longest by Far** With the trend exceeding 4% since mid-2013, I was curious about how this recent period of strength compared to other periods. As illustrated in the graph and table below, there have been seven periods since 1971 in which the trend in leading economic indicators has remained positive for an extended period of time. The previous six periods have averaged 54 months in length, with average Fed rate movements of +2.33%. Interestingly, the time until the first rate hike in these periods has ranged from 1 month to 36 months, with the average being a little over 15 months. **Trend in Leading Economic Indicators vs. Fed Funds Target**



Monetary Policy Changes in Regimes of Positive Trends in Leading Economic Indicators, January 1971- July 2015

Start	End	Consecutive Months LEI Trend Positive	Month of First Hike	Months to First Hike	Beginning Fed Funds Rate	Ending Fed Funds Rate	Fed Funds Target Change over Period	Max Fed Funds Rate over Period	Fed Funds from Start to Peak
January-71	August-73	32	March-71	2	4.00	11.00	7.00	11.00	7.00
September-75	March-79	43	April-76	6	6.50	10.00	3.50	10.00	3.50
September-82	April-89	80	May-83	8	10.00	9.00	-1.00	11.75	1.75
July-91	December-95	54	February-94	31	5.75	5.50	-0.25	6.00	0.25
February-96	October-00	57	March-97	13	5.25	6.50	1.25	6.50	1.25
December-01	October-06	59	June-04	30	1.75	5.25	3.50	5.25	3.50
December-09	July-15	68	TBD	TBD	0.25	0.25	0.00	0.25	0.00
Average excluding 12/2009-7/2015		54		15			2.33		2.88

Sources: WisdomTree, Bloomberg, The Conference Board.

This recent streak, which started at the end of 2009, is now 68 months old, and still the Fed remains inactive—37 months longer than the second-longest period. The extraordinary monetary policy triggered by the financial crisis has in many ways overwhelmed economic fundamentals and altered incentives for participants in the capital markets. But followers of economic cycles continue to keep nuggets of information like this in their back pockets and wonder whether the Fed's inactivity in recent years could come back to haunt us when cyclical forces return. With the markets still relatively complacent about the upcoming Fed meeting, we could see rates adjust higher and additional volatility in the equity and commodity markets. The August employment reports could give the Federal Reserve the domestic cover to hike rates despite lingering global concerns. The trend in leading economic indicators would argue it's about time.

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Monetary easing policies : Actions undertaken by a central bank with the ultimate desired effect of lowering interest rates and stimulating the economy.

Citi Economic Surprise Index : An indicator of how actual economic data compares to analyst expectations. A downward trend means actual data has been trending below expectations, and an upward trend means actual data has been trending above expectations.

U.S. 10 Year Treasury Note : A debt obligation issued by the United States government that matures in 10 years.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Volatility : A measure of the dispersion of actual returns around a particular average level. .