Infomail

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A Return to Normal?

Since 2008 we have been experiencing a global deleveraging process and the pains that go with it: High unemployment, austerity, broke governments, slow or no job growth.

Like Chairman Greenspan before him, Federal Reserve Chair Bernanke seems to be using the same tonic for the cure that created the illness to begin with: low interest rates. Within his endless version of "QE's", is Bernanke making the same mistake his predecessor made in the 1980's by leaving interest rates too low for too long?

Faced with the need to stop a banking crisis, Greenspan began lowering rates in June 1989 eventually taking them all the way down to 3.00% by February 1994 from 9.75%. In all of 1993, the Fed took no action, allowing banks to borrow at 3% and buy long bonds at 7% (what the industry lexicon refers to as "a no brainer"). Finally in February 1994, the Fed raised with a 25 basis point rate hike. The Dow opened at 3,963 that session, closed at 3,871 – and never got higher for the rest of the year. The Fed also raised in March (25bp), April (25bp), May (50bp), Aug (50bp) and November (75bp).

The interest rate hikes by the Fed didn't help the market in 1994, but it didn't crush it either, and once the last 50 basis point hike took place in Feb 1995, the market took off like a rocket. What did get crushed were bonds, preferred shares, etc…all fixed income holdings. Important to note is while Greenspan was raising rates in 1994 to 1995, the US economy added almost 5 million jobs. We are no where near that scenario today, we'd be lucky to get one third of that figure over a 12 month span. Also at that time there was a new phenomenon taking place called the "internet" which was a game changer.

Things got so hot in markets back then that Maestro Greenspan found them to be as he described as "irrationally exuberant," not realizing they would go on for a few more years. The fact of the matter is Greenspan kept rates too low for too long to save the banks after the Savings and Loans Crisis, but he aggressively removed the "punch bowl" in an environment of strong job growth.

The latest jobs numbers out of the USA are showing anything but a period of strong job growth, so unless there's going to be a strong US GDP surge or job growth, one cannot foresee Fed accommodation stopping for another year or two. Bernanke's recent comments with respect to "tapering" have spooked the markets, but in my opinion, there would be little difference whether the Fed bought only $35 billion a month in assets instead of the current $85 billion per month because I believe neither is going to work in the economy against a backdrop of the war on success, higher taxes and unlimited spending by the current Administration.

So the question is, is "QE" really that important? The pundits will claim anything good happening is simply a "sugar high" based on QE and central bank stimulus. So now the latest fear is that any good data on the economy is bad, because it means the Fed will wind down its actions and interest rates will rise.

But like the internet in the 1990's, the Fed did not create fracking, or the wireless/cloud revolution, or smartphones or now 3-D printing. Corporate profits, which the Fed doesn't control, have risen along with the markets.

Short term I remain a little cautious, but remain bullish to year end, early 2014, after which I will have to reassess. One thing I know for certain is that having been around in 1994, the true risk investors should worry about is in their fixed income (i.e. bonds), and not their equities.

Stay tuned,

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