

Market Outlook:

Who needs the Federal Reserve?

When the Fed announced last week that it was dropping the word "caution" from its future guidance, an anticipated "next shoe to drop", rising interest rates, became momentarily inconsequential. But was the crisis really averted?

Although it was hardly a surprise that they affirmed their bias to let rates rise, it is becoming necessary in this observer's opinion to let it happen sooner rather than later. Perhaps not at this very moment, at this time, but soon, very soon.

As a result of the Fed's pronouncement, stock prices soared immediately afterwards but had been bracing for several weeks prior for the rate changes it knew were coming, bouncing around at the apex of this current bull cycle and causing investors a great deal of heartburn in the process.

Why all the volatility? Because investors have been feeding at the Fed's trough for quite a long time, and have gotten used to a steady, almost linear, upside bull pattern. The main reason for their optimism had been a *no impediments/no holds barred* monetary environment reminiscent of policy in the pre-recession run-up just before the credit crisis. The fact that financial authorities worldwide had given them no reason to be worried about the spigot of largesse being turned off only intensified this imaginary sense of invulnerability.

However, we know that down the line reality will be coming home to roost. It certainly is not the responsibility of the Fed, or any other money agency, to manage our "feelings", but rather their role is to coordinate the money supply and the opportunity curve that leads to and maintains growth. To that extent, we should be mindful of their advisory describing both their comfort with, and concerns about, the current trajectory of financial assets.

In case you haven't noticed, stocks are on pace for the third best bull market recovery ever recorded.

Worse or better?

Besides, if our feelings can be hurt this easily simply by an *indication* of a change in monetary policy, what might occur when rates actually do start going up? **I would like to think that logic and calm would prevail, recognizing that higher interest rates might also provide an alternative investment scenario that would be good for investors in the long run.**

Despite a huge gap in the distribution of wealth between rich and poor, the valuation expansion in financial securities has increased the money supply dramatically. While *the rate of appreciation* might be unsustainable indefinitely, we must be aware that monetary strategists and policymakers are finally prepared to offer some resistance to this never-ending upwards spiral.

I also find it disconcerting that the wealthy seem to be hoarding money rather than spending it on capital projects that could accelerate economic development. There is very little data to suggest that a majority of this recently created capital gain is aggressively making it back into the economy. As a result, we as consumers, and the Fed as well, are caught in a conundrum between disinflation, in which unmet expectations and overproduction is driving prices downward, and insidious inflation in goods and services (e.g. food, commutation, education, healthcare, habitat) that is posing a threat to the sustainability of a recovery. It isn't just the well-to-do, however, who aren't spending, nor should they shoulder all the blame. Instead, our data indicates a widespread confidence gap that causes everyone to sit back and wait. Another reason why the Fed delaying implementation of a tightening policy is just postponing the inevitable.

While inflation factors selectively permeate into our cost of living, they also reverberate into others segments of the economy, such as cyclical (discretionary) spending and materials. **The latest data show that cost increases are having a much more debilitating impact upon consumers than any cost reductions might be benefitting them.**

If these negative effects become too pervasive, the stock markets themselves might be next to suffer. Part necessity, part casino, Wall Street is already largely inconsequential in the lives of the average citizen just trying to get by.

By contributing to the factors which have allowed for this prolonged period of linear upside mania, the Fed has already contributed to its share of the damage. "Cheap money" sounds like a great idea, doesn't it? Who wouldn't want to borrow money at zero percent interest? The issue, however, is whether that cash circulates into the system or simply applies to paper profits and speculative trading. Let's hope we can discern the difference and do something intelligent with our answers.

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