



NOVEMBER 12, 2010



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Monetary Sugar Won't Build Muscle

Last week, the Federal Reserve announced it will purchase \$600 billion of US Treasury bonds over the next eight months, pumping a second round of quantitative easing ("QE2") into the markets and ostensibly stimulating a feel-good attitude that could firm into health itself if given a chance. There are a few ways to look at this.

Ben Bernanke's view seems to be that the US economy is a hapless college freshman trying to push through his first all-nighter, and what's needed to make it to daylight is high fructose corn syrup and caffeine in large measure. Gee, thinks Ben, that always kept my head off the desk when I was back on the Quad!

Traders think, "buy, baby, buy" welcoming QE2 as a reaffirmation of the moral hazard that has paid off since the "Greenspan put" redefined the Fed's role as that of enabler, the soft-touch uncle always willing to bail his ne'er-do-well nieces and nephews out of any mischief or misdeed.

Faced with the realization that US dollars appear to be potentially limitless in supply – and moreover, this is no conspiratorial whisper but fully voiced central bank policy – our trading partners have misgivings, no surprise.

The irony here – and perhaps the investment opportunity – is that the Fed's efforts to jerry-rig an open-market stimulus package may turn out to be a non-starter, whether because they'll spur Congress to reassert its constitutional primacy in setting fiscal policy (with Fed foe Ron Paul only emboldened by his newfound status in the majority) or just as likely because our newly alienated foreign creditors may choose a rational path: knowing the details of

a \$600 billion bid, they'll take this as an opportunity to unload their groaning shelves of US Treasuries, neutralizing the Fed's intent while improving their own asset allocation.



The Federal Reserve dispatches its PhDs across America to deliver another round of quantitative easing. (Photo source: addicted-to-fizz.blogspot.com)

Regardless, when one organ of government promises to absorb the liabilities of the whole – and at more than 100% of new issuance at some maturities – it degrades the quality of that government's balance sheet. Has the Fed become America's own SPE, an Enron-like special purpose entity whose long-term survival is less important than its utility today in staving off a final reckoning of accounts?

We don't know, and while we hope the Fed is right in its fond stratagem that a sugar fix can get us through the night and even build muscle, the better long-term bet is diabetes.

Sweet though the stock market's fizz has been, our aim now is tracking down a set of assets more akin to insulin.