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# TRANSITIONS

## THE DANGER OF THE FED PUT

**Since 2008, the Federal Reserve Board (Fed) has distorted interest rates by lowering its benchmark interest rate to zero. Then, it agreed to print money to revive the credit markets. They experimented with "quantitative easing" where the Fed purchased Treasury bonds, mortgage backed and US Agency securities in the open market. This buying quadrupled the size of the Fed's balance sheet to over $4 trillion, which is large even by government standards.**

Being a healthy skeptic, one wonders about the real benefit of having the Treasury Department of the U.S. Government busily issuing Treasury bonds, while the Fed, another part of the US. Government, is busily buying Treasury bonds. While many economists viewed this as brilliant, only the history books will have the passage of time to reflect on its wisdom or true impact.

*Income Investors:*

For income investors, those who were fortunate and wise enough to save during their career, found their savings were earning no return for an 8 year period from 2008 to 2016. Rather extraordinary! And rather harmful to the savers, who earned nothing while the Fed focused on what they saw as the bigger good of helping out the banking institutions.

The zero and even a negative interest rate environment was new to many, but not new to the U.S. markets. Early in my career, I was fortunate enough to have been taught about negative interest rates. At that point in time, interest rates were still near 10%, and I was reminded that interest rates could return to the zero returns of the 1930's, and that was exactly what we recently experienced.

*Growth Investors:*

For growth investors, the Fed essentially put a floor under their decisions. Every time a market correction seemed imminent, the Fed came to the rescue as they toyed with the money supply, earning them the nickname "plunge preventers". One could buy a stock, even a highly valued stock, apparently without regard to market risk because the Fed was preventing corrections. This unique period in history was known on Wall Street to some as the "Fed Put". The problem with a Fed Put is

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that it really is artificial. Time over time, we would see the beginning of a correction take place in the markets, and then seemingly the Fed would step in with another round of quantitative easing. Market corrections are a normal part of market movements. Preventing corrections introduces an artificial market environment, where there is a perception by many investors that risk is removed from investment decisions.

There always is a risk versus reward equation to contemplate when investing. A good investment manager investing in a conservative fashion will attempt to reduce risk in an effort to generate returns for their client. Nobody seriously believes risk somehow just disappears... even with a Fed Put.

Interestingly, the current Fed Chairman Powell has a different resumé in that he has actual work experience in business. Although all former Chairpersons have been very smart, his predecessors experience largely were in academia. Academia typically seeks confirmation of large data sets and broad consensus before a decision, which often is near impossible to achieve. By contrast, in the real world, successful business decisions are frequently made without all the facts lined up in place. And with a businessman in charge, the Fed is making decisions that normalize interest rates. What does normalcy provide? Some much needed relief to the long suffering income investor. And a return to normal investment risk for the growth investor. The pain of not having a safety net of a Fed Put will be felt by the younger investors who have only experienced the last eight years, where they could press a button on their phone to make money...which really never was normal, was it?

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