Hello Everyone,

The key question for investors is this. *"If the US economy is doing so well, why does the Federal Reserve feel compelled to lower rates?"*

I did not answer that question in today's KKOB broadcast to the general-public; but I will offer a speculation for my intrepid email followers.

The global economy is slowing, and the Fed wants to help. But wait, you say. Why is it our job to boost Europe, India, and Asia? And the answer is…not all Central Banks are created equal. The US Fed has greater discretion than the European Central Bank, Bank of Japan, Bank of England, and even the Bank of China. No one else can do it.

My conjecture (and it is only conjecture) is Fed Chair Jerome Powell's banking buddies have made some phone calls for help. Mr. Powell's rationale may be if the global economy sinks into recession, the US won't be far behind. It's the only thing that makes sense to me.

Signed, Your Just-Because-We-Can-Do-It-Doesn't-Mean-We-Should-Since-There-Are-Always-Unintended-Consequences Financial Advisor,

Greg

KKOB 07.08.2019 Questions For The Fed

Bob: So, Greg, the Loser Nation series is now behind us. So, today we're talking about the Federal Reserve's recent signal to lower interest rates and stimulate the economy. I know this is what President Trump wants as well. And, from everything I'm hearing, this should help stocks heading into the 2020 election, right?

Greg: Right. Over the past 10 years, I think we have proven rather conclusively the "lower-for-longer" interest rate policy has been exceptionally advantageous for stocks. Plus, dropping rates back toward zero while we are engaged in a trade war with China is a logical decision.

Bob: But I know many people have expressed concern about the long- term effects of all this. There are always unintended consequences, right?

Greg: Sure. But so far, those consequences haven't manifested. All is going rather smoothly. Still, there is no perfect policy, and this one has warts.

What we know is this. Policy makers had hoped corporate America would use the low rates (and basically free money) to invest in new plant and equipment---- and bring manufacturing jobs back to America.

Instead, in large measure, corporate America used the stimulus to buy back their shares---and to pay themselves some hefty bonuses.   There was some degree of modernization, reinvestment, and manufacturing--- but the Fed's policy rewarded share-buybacks more.

Bob: So, when a company buys its shares back, that means there are fewer shares on the open market. That means when money flows to Wall Street—-----like it does every month when money goes from people's paychecks to their 401K plans—that money is chasing fewer shares. That helps push the prices of the shares up. But that doesn't necessarily mean the companies are necessarily selling more products…or expanding market share.

Greg: Right. I believe we are making the mistake of thinking the stock market is the driver of the greater economy. At the end of the day, it's the opposite. The economy will ultimately drive the stock market---but, again, that hasn't happened yet.

Still, this is one of the unintended consequences of the "lower-for-longer" policy. The disconnect between the real economy (translation Main Street) and the financial economy (translation Wall Street) has become very pronounced. The Fed knows this. Nonetheless, it signaled last week it's prepared to proceed down this same path.

Bob: So, I've heard you use the term "distortion" before when talking about this. You think "lower-for-longer" distorts both the stock market and the real economy, so investors receive false signals.

Greg: Yes. I understand why the Federal Reserve interceded in 2009 after the Lehman collapse. But, if we have the greatest economy since 1969, why do we need to drop rates again? Technically, you'd want to be raising rates so when the next recession rolls around you have room to lower.

The other concern is how the low rates have encouraged trillions in new debt. And look, I get it. It's crazy not to borrow when rates are 1-2%--- but you're still borrowing, and that money will have to be paid back some day.

Anyway, there are other unintended consequences like the effect on pension funds, wages, and rising income inequality, but as an investor the Fed's goal right now is clear. They are giving a green light to stock investing as we head toward 2020. With that said, every subsequent stimulus package has a diminishing effect. What was fantastic in 2009 won't give you as big a high in 2019. There are limits to everything.

Bob: It sound like an addiction. And, in a way, I guess it kind of is.

So bottom line is…we lower rates and print money and hope it turns into economic growth. The low rates---and money printing---help the real economy in a small way, but the growth in the stock market is disproportionately more. So--- as an investor---be aware there is some artificiality to things right now.

Greg: You just said in two sentences what I rambled on about for 3 minutes. Your vacation served you well!

Bob: And it's nice to be back. How do people reach you?

Greg: My number is 508-5550, 508 triple-5-zero. Or, go to my website at zanettifinancial.com

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