Hello Everyone,

It was exactly (!) 11 years ago, March 9, 2009 the stock markets bottomed after the Lehman Brothers/subprime crash of September 2008. The inter-day low that day (for the S & P 500) was 666. Yup. 6-6-6. You can't make this stuff up.

By February 19, 2020, the S & P 500 had risen by over 2700 points to 3390.

Since then, (as I type) that index has given back 640 of those points….or, about 19%.

Is this the start of the great correction? Is this a head fake and the markets will soon 'V' higher?

I don't pretend to know.

I do know, however, that Central Banks and Governments are already fighting the virus (and the markets' convulsions) with lower interest rates and printed money. We predicted this.

Today's missive focuses on what the Federal Reserve will do next…and the box they are in. I hope it helps make you a better investor.

Signed, Your Sometimes-Just-Stares-At-The-Screen-And-Shakes-His-Head Financial Advisor,

Greg

KKOB 03.09.2020 The Fed Is In A Box

Bob: So, Greg, after the last few weeks, I believe most of our listeners are a little shell shocked….and this morning's open isn't helping. I think most of just want to know----- what's next?

Greg: Well, let's start with the obvious. Covid19 is going to lead to an economic slowdown…and perhaps even a global recession.

And, Bob, we also know, governments and central banks typically do certain things to cushion recessionary blows.

Bob: Right. I know what they do. Governments stimulate by increasing spending. And central banks (like the Federal Reserve) lower interest rates and print money.

Greg: Exactly. In prior recessions, the standard government response was to create a jobs program to help the unemployed. Plus, you'd see increases in social service or welfare programs.

Simultaneously, on the banking side, you'd see the Federal Reserve print money and drop interest rates. On average, rates would fall 5%. So, rates would go from say 7% to 2%.

But, here are our issues:

- Back then, the US did not have a $23 trillion debt ---and trillion dollar annual deficits.
- Also, in recessions past, interest rates were in the 5%-8% range. Today, we are hovering just above 1%.

Nevertheless, in the name of "doing something", it's easy to predict politicians will add accelerant to already out of control budget. The markets are already anticipating this. Thus, we are seeing the dollar fall and gold rise.

Bob: I've noticed that. It goes back to what you and I have talked about many times. Wealth isn't normally destroyed. It moves. So, as money leaves mainstream stocks, it doesn't evaporate. It goes somewhere. And, it looks like it's going to cash, bonds, and precious metals.

Greg: Right. And all of those are considered safe-haven investments. So, let's dig a little deeper.

Right now, we have a Federal Reserve that's in a box. Remember, last year----- as they insisted the US economy was doing great---- they still cut rates .75%. Then, last week, in an emergency meeting, they cut rates another half a percent. That put the Fed Funds rate at 1.25%.

And even with that, the markets swan dived.

Therefore, there are howls for the Fed to cut even more.

Bob: But wait. I can do the math on this. If we need to drop rates 5%---but we are starting at 1.25%----- that means we would end up at negative interest rates. That would make us just like Japan and parts of Europe.

Greg: Right….and it would put the globe in uncharted territory. You see, as long as the US had positive rates, there was a place for international money to go for a real (if small) return. If the US goes negative, however, there is no port in the storm.

Now I believe Chairman Powell knows how dangerous this would be. So, the alternative would be for him to turn on the money-printing machine instead.

That leads to…how will he do it?

With the QE programs of a decade ago, the money went directly to the banks. That wasn't particularly popular with middle class voters. They believed the banks helped create the Lehman mess…and now the banks were getting rewarded.

Therefore, I believe, if the Fed were to try that again, there would massive political push back.

So, here are some other options:

- Former Fed Chair, Janet Yellin, recently suggested the Federal Reserve print money and buy stocks. This is what the Bank of Japan does routinely to support the Japanese stock market.
- Or, Bob, the Fed could follow the Hong Kong model. Last week, they gave every adult $10,000 Hong Kong dollars.

Bob: So, I can see the tug-of-war. Recessions are typically deflationary since economies are slowing down. Thus, governments create "make-work" jobs which adds to the debt.

But then, you have Central Banks printing money like crazy----which should be inflationary. What a world.

Greg: Right. So, as an investor, your job is to look for the opportunity in this environment. Like you said, wealth isn't destroyed, wealth moves. And, you know where I think it's moving. Go low tech.

Bob: Great report as usual. Talk to you on Friday. How do people reach you?

Greg: My number is 250-3754. Or, go to my website at zanettifinancial.com.