THE FED & MONETARY POLICY

New Frontier

This is probably the most important report that I have written. Those who are of the view that "ignorance is bliss", just ignore this report.

The Federal Reserve System, popularly known as "the Fed", was created in 1913 to perform all roles monetary. It is an independent body. One of their key statutory mandates, however, is "to maintain orderly economic growth and price stability". The most powerful tools at the Fed's disposal to effect monetary policy changes are the basic monetary policy variables; these are the Discount Rate, the Bank Reserve Requirements, and the Margin Requirement. Changes in the Discount Rate are the most frequent. Changes in the Bank Reserve Requirement and the Margin Requirement are infrequent. The last change in the Bank Reserve Requirement was in December, 1990, during the Savings & Loan Crisis. The Margin requirement has been set at 50% since 1974.

The Discount Rate is the interest rates charged to commercial banks and other depository institutions for loans received from the Federal Reserve's discount window. Since December, 2015 because of improving economic conditions, it has been raised eight times.

The Bank Reserve Requirements are the amount of funds that a depository institution must hold in reserve against specified deposit liabilities. Depository institutions must hold reserves in the form of vault cash r deposits with the Federal Reserve Bank. When the Fed raises the Bank Reserve Requirements, it signals monetary tightening and when it is lowered, it signals monetary easing. The single most bullish signal for the stock market is the lowering of the Bank Reserve Requirement.

Margin Requirement is the percentage of marginable securities that an investor must pay for with his/her own cash. The current requirement is 50%. To encourage investment, the Fed will lower the Margin Requirement and to discourage speculation, it will raise the Margin Requirement.

In the past, three consecutive increases in the Basic Monetary Policy Variables indicate Fed tightening.

Also, history shows, the more severe the economic downturn, the more powerful and more sustained is the subsequent bull market. This has been true for more than 100 years. Reasons are simple. Faced with financial Armageddon, the Fed eases much more aggressively and stays accommodative much longer than normal. The current cycle is a good example.

Accordingly, to understand the market's logic, investors must remember the Fed's mandate, i.e., "to maintain orderly economic growth and price stability." Also, always keep in mind that the stock market is a leading economic indicator; the economy does not lead the market.

Once understood, predicting the direction of the economy and the stock market is no rocket science. When the economy slows and particularly when it slides into a recession, the Fed will use all means at their disposal to stoke the economy. If it doesn't work, it will keep doing so until the economy responds as they have done from late 2008 to 2017. The stock market, therefore, always bottoms 6 – 9 months before the recovery begins, not after.

Conversely, when the economy overheats; inflation surges; and speculation is rampant, the Fed will raise the Discount Rate numerous times in succession, by draining liquidity from the system, and invert the Classic Yield Curve (the 13-week T-Bill yield vs. the 30-year T-Bond yield). The stock market will have peaked and start to head south long before the onset of a slowdown or a recession.

Foregoing must be clearly understood. If not, investors will be forever reacting to the headlines and the daily market gyrations, not only losing their money, but their head, too.

I strongly recommend that all investors subscribe to the U.S. Financial Data, released each Thursday evening by the Federal Reserve Bank of St. Louis and it's free. It provides a wealth of information on Fed action such as changes in the monetary aggregates, interest rates, bank loans, etc. It's a must have.

THE NEW FED

Few months ago, Jerome Powell, the Fed Chairman expressed the desire to smooth out past wild swings in the economy by fine-tuning its monetary policy. Those are not mere words, but the Fed is already putting it into practice. Note the statements made by the various Fed members.

In the past, after the election, the Fed would slam the brakes to clean out the excesses. After the Mid-term election, it would start to stimulate the economy. Hence, the "Four-Year Cycle". The Fed has been tapping on the brakes instead of slamming them. Hence, the slowing in the economy. Many, however, are jumping to the conclusion that a recession will take place next year.

The Fed's new goal is not easy to achieve, but if successful, the U.S. will experience a period of unparallel prosperity and the stock market will continue to climb to heights no one ever believe possible.

Despite its importance, few paid attention to Powell's announcement.

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READING MATERIAL

Also, all serious students of the market should read "Money and Stock Prices" by Beryl Wayne Sprinkel. Among other positions, he was the former U.S. Secretary Treasurer. The book is out of print, but is available

On Amazon for $10.00 - $35.00. Investors who understand the content, they will be more informed than 90% of the gumflappers.

Jay Powell says US interest rates are nearing 'neutral'

Economy **Williams backs new Fed approaches to targeting inflation**

Fed's Kashkari says rates should not go up when job creation is strong and inflation is tame