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3rd May 2011

Better dead than Fed

"Traders take heart from Fed comments"

- Headline on the ft.com website.

"Stocks surge, gold at fresh high and dollar falls to lowest since 2008"

- Subheadline on the ft.com website.

So it really depends what sort of traders were listening to Ben Bernanke's inaugural press conference on behalf of the Federal Reserve Open Market Committee. Equity and gold traders evidently took heart; forex traders took flight. Bernanke respected tradition and conceded that the dollar was the domain of the US Treasury Secretary, but also respected tradition with the meaningless if not outright specious suggestion that a strong dollar was in the best interests of the US and global economy. The recent history of the trade weighted dollar (1985 – 2011) looks like this:

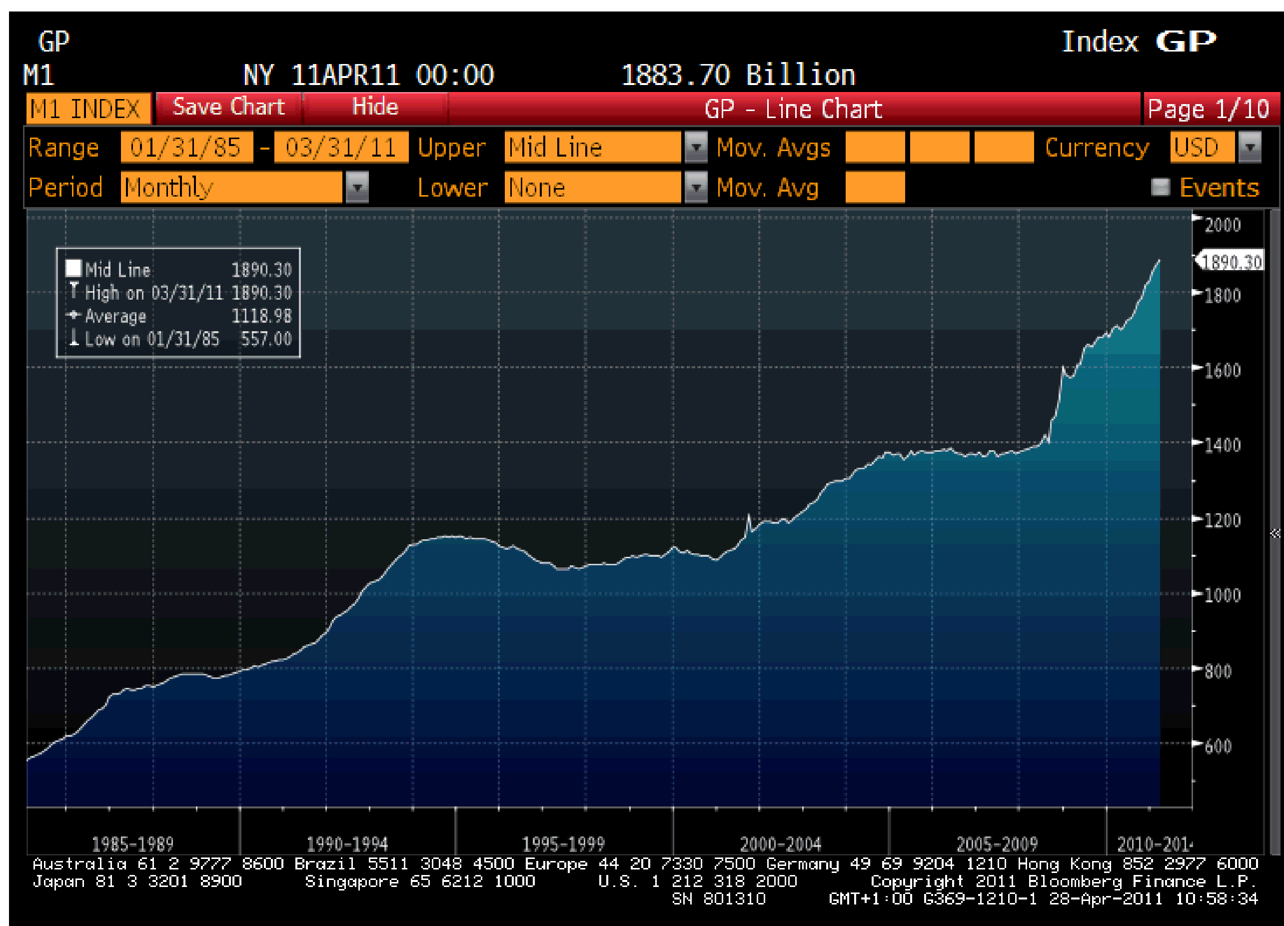
US trade weighted dollar, 1985 – 2011

Of course, anyone can say that a strong dollar is in the best interests of the US economy, just as anyone can say that we should all live forever, but simply saying so does not make it so, as the chart above would tend to imply. But then pretty much everything about the Federal Reserve amounts to a contradiction in terms. The Fed's own website makes a pretty good fist of Orwellian doublespeak:

"The Federal Reserve, the central bank of the United States, provides the nation with a safe, flexible, and stable monetary and financial system."

Anybody charged with managing investments during the last several years would feel obliged to take issue with just about every assertion in that overbold policy statement (note that its remit is stated as fact, not just objective; as the phrase has it, "Mission Accomplished"). The Fed may fulfil the role of a central bank but it is a private banking cartel, a tool of Wall Street rather than its master. If the Fed has given us safety in the financial system, it would be interesting to see what chaos looked like. The same goes for stability, monetary and otherwise. On this last point, the Fed's assertions about inflation go beyond the debatable to the outright surreal. Express inflation not as some woolly, easily manipulable measure of goods prices, prone to endless adjustment by a craven Fed, but instead as a straightforward increase in the money supply, and it looks like this:

US M1, narrow money – currency and "checkable deposits" – 1985 – 2011



The time period has been kept consistent with the first chart, which makes the decline in the dollar over recent decades look suspiciously like the inevitable outcome of Fed-sponsored inflationism. All of a sudden, the decision to start press conferences after years of near silence looks like a belated attempt to turn the tide of public opinion and initiate an exercise in expectations management. That it came on the very same day that the US President hosted a

press conference to publish his birth certificate would seem to suggest that American polity has become a game show in all but name.

So even acknowledging the content of Ben Bernanke's speech, let alone discussing it, might appear to be playing by the rules of a circus. Nevertheless.. We may wish things were otherwise, and that Wall Street (by means of the Fed) and the US government (in large part subsidised by Wall Street) played less of a role in attempting to direct the course of the US (and indirectly therefore the global) economy, but we must play the hand we have been dealt, until the system changes (or collapses under its own weight). Inasmuch as Ben Bernanke's words have any real meaning, we now "know" that the US economy still requires monetary support. But Federal Reserve language, notably extreme dissimulation on the very definition of inflation (which we would define as money creation), makes rational analysis of Bernankespeak almost impossible. Take the following:

"Ultimately, if inflation persists or if inflation expectations begin to move, then there's no substitute for action. We would have to respond."

Using more honest language and intent, that statement might read as follows:

"Inflation (as in further Fed money creation) will inevitably persist, but we will continue to equivocate with regard to what inflation really is, and when the jig is finally up and we can dissemble no longer, we will have to raise rates. But the system is too fragile for that, so you can write off the idea of tighter monetary policy for this year at least. We do not have to respond yet, and we won't."

So markets in Pavlovian fashion mostly got what they wanted and reacted accordingly. Stocks rallied (no real threat of tightening any time soon); the dollar weakened (more money printing, one way or another); Treasuries fell ("if" the Fed renounces quantitative easing, who will replace it as the buyer of last and perhaps only resort ?); and gold, the last apolitical asset, continued to surge.

Easy policy will continue inasmuch as while the Fed's $600 billion bond purchase programme ends in June, "we are going to continue to reinvest maturing securities, both Treasuries and [mortgage backed securities], so the amount of securities that we hold will remain approximately constant."

Even then, the stock market may decide to call Bernanke's bluff quite soon after the end-June termination of new bond purchases, in the form of a nasty correction. In which case, QE3 can confidently be expected to berth. The risk has to be that investors of all sorts have become addicted to monetary stimulus and its seemingly positive impact on asset prices, and will be reluctant to uncouple from the Fed teat. Market distortion and support then becomes a semi-permanent condition, which is obviously untenable.

So the press conference ultimately changed nothing. Investors are right to fear further dollar weakness (but since all currency is paper, the degradation of the dollar is relative; only against gold and silver is it absolute) and surely right to anticipate further inflation (both of the monetary and Fed-defined kind). That would tend to suggest that notwithstanding some inevitable volatility in prices, real assets are moving to the front and centre of the investment landscape.

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3rd May 2011.

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