Back in my days on the trading desk at JP Morgan ('85-'95), we were constantly monitoring world news and any data that could potentially move the markets. It was crucial to have experts who could interpret quickly and accurately. We always had several economist on the floor to translate data, but we also had a 'Fed Watcher'. The Fed Watcher was skilled at anticipating and interpreting every word spoken or printed and released to the markets. Because the Fed is one of the most powerful influences in the financial world, it is vital to know what they think. So, if you knew what the Fed was thinking, you had the edge.

Back then, the Fed was very covert, rarely tipping their hand to what they REALLY thought or were going to do. Today, the Fed is much more transparent, and frankly, in my view almost a bit of a loose cannon. It was unheard of for the Fed Chairman to speak so plainly about their strategy, confidence, and concerns for the economy. Today we see it all, or almost all, and the view it is rather precarious.

Below is last week's Fed statement straight from the Chairman himself, Mr. Bernanke and my chance at being a Fed Watcher. (His statement is in blue print and my interpretation is in black.)

The Committee expects economic growth to remain moderate over coming quarters **(2-3% growth- barely enough to reduce unemployment and grow earnings)** ***and then to pick up gradually*** **(they really don't know if growth will pick up, but are hopeful)*****. Consequently, the Committee anticipates that the unemployment rate will decline gradually toward levels that it judges to be consistent with its dual mandate*** **(this is fluffy, hopeful talk....their mandate is to keep th economy from falling back into a recession and to crank up employment without inflation.)** ***Strains in global financial markets continue to pose significant downside risks to the economic outlook.*** **(Say What? ...they don't sound very confident in the durability of the expansion.)** ***The increase in oil and gasoline prices earlier this year is expected to affect inflation only temporarily*** **(the price of gas is not the only component of inflation; but this is what they want us to focus on)** ***and the Committee anticipates that subsequently inflation will run at or below the rate that it judges most consistent with its dual mandate.*** **(yet they raised their inflation rate forecast - see below)**

To support a stronger economic recovery and to help ensure that inflation, over time, at the rate most consistent with its dual mandate, the Committee expects to maintain a highly accommodative stance **(print money til the cows come home)** ***for monetary policy. In particular, the Committee decided today to keep the target range for the federal funds rate at 0 to 1/4 percent*** **(Savers, forget about earning a positive real return on CD's or Bonds for years)** ***and currently anticipates that economic conditions--including low rates of resource utilization*** ***(weak growth)*** ***and a subdued outlook for inflation over the medium run--are likely to warrant***

exceptionally low levels for the federal funds rate at least through late 2014.
***(*This is a nice way to say they endorse 'Financial Repression' where savers are penalized, while borrowers recover.)**

New Forecast: *The FOMC reduces its 2012 jobless view to 7.8-8.0% from 8.2-8.5% projected in January. (*The rate is falling because the workforce is shrinking, not due to more people employed) *Inflation is estimated at 1.9-2.0% from 1.4-1.8%* (going the wrong way Mr. Chairman) *The GDP growth outlook is raised to 2.4-2.9% from 2.2-2.7%.* (a positive comment)*. Seven Fed members see the first rate hike in 2014, up from 5 previously.* (not everyone agrees with the Chairman) .

So there you have it, clear as mud!
How do you invest in such an uncertain, low rate, environment?

Three Investment themes:
Income: Just to preserve purchasing power, the portfolio must be returning at least 2% annually to over come the inflation impact. Thus, dividend paying stocks and income from Corporate and High Yield bonds are employed. (However, given interest rates are at extreme lows (See chart below), bond maturities must be kept moderate, around a 3-4 yr duration.) In addition to stocks and bonds, Gold is held in every portfolio as an inflation hedge and alternative store of value.

Stability : Slow growth typically causes shorter economic cycles which leads to more volatility in the markets. Thus, each portfolio is designed to ride through the volatility through well diversified allocations of non-correlating asset classes and generally lower volatile sectors than the broad market. The goal is not to beat the market, but to grow wealth.

Dynamic or Flexible Component : It seems every 3-5 months, the market shifts from 'fear- the sky is falling' to 'confidence in a solid recovery'. In other words, the market leadership shifts from 'risk-off' assets (consumer staples, large cap value stocks) to 'risk-on' (emerging markets, small cap, and growth stocks). Thus, each portfolio has exposure to dynamic fund strategies that can adjust risk/exposure as market conditions change. Global funds are typically used.

As a final thought, the chart below of the 10yr US Treasury rate since 1880, gives perspective on just how much farther rates can/should fall and begs the question: how much remaining power does the Fed have?


10 Year Treasury Rate
Ads by Google
Libor Rate
Interest Rate
Rate
Treasury Bond Rate
Forget Averages - 10-Year Treasury Interest Rates Are At Unprecedented Lows
Black Tuesday
2.01
15
14
13
12
11
10
9
8
7
6
5
4
3
2
1
0
1890
1900
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000
2010
1881-01-01
2012-04-25