"The choice is between which mistake is easier to correct: underdoing it or overdoing it."

Timothy Geithner
Former U.S. Central Banker
Secretary of Treasury 2009-2013

THE FED IN A BOX

By James K. Tonrey, Jr., Chief Executive Officer

The U.S. Federal Reserve Bank (Fed), through its own actions, has positioned itself at the center of the economic recovery debate. Not a day goes by that someone in the investment community has an opinion on what the Fed is thinking, what statistical trend they are looking at more closely, or what Chair Yellen had for breakfast that day. The Fed has always been important to investors. They manage our country's monetary policy, specifically watching inflation and employment data. Their role is to try to smooth out hiccups in our economic system when prices of our goods and services create imbalances or when our economy's employment situation needs attention. Thousands of books and articles have been written about the role of the Fed over the years but one word summarizes their mandate best. And that word is *balance*. Their periodic meetings throughout the year, in the simplest of terms, attempt to review and scrutinize the most current, complex financial data to determine if any form of interest rate change or other type of stimulus is needed to keep the economy in *balance*. Not too hot, not too cold.

The debate will continue for decades as to their extraordinary measures taken during the darkest times of the financial crisis. As always, history will be the final judge. However, that is not the issue most economists and market watchers focus on at the moment. That, as they say, is history. The attention rather is on why the Fed has possibly overstayed its welcome, like a distant relative visiting on a long holiday weekend. There is an old saying, *"If during dinner and drinks tonight, we ask you to stay over for the weekend, please remember….we don't mean it."* And so the Fed has found itself somewhat like the unwanted weekend guest. Let's be honest, it is really great to see that old uncle initially, but welcomes do wear out.

New York Times columnist, Jeff Sommer, in his recent article, *The Fed Has Gotten Into a Tangle*, frames the discussion well:

> *"But the Fed faces difficult choices. A look at its own data suggests that its policies have led to financial imbalances that place it under pressure to raise rates, as it has repeatedly said it will do.*
>
> *One problem is that the purchases of trillions of dollars of bonds by the Federal Reserve and other central banks in a strategy known as quantitative easing have contributed to the extraordinary low yields in much of the bond market.*
>
> *Another, less obvious problem is that by helping to engineer such low rates, the Fed has helped create a surge in American household wealth that has far outstripped growth in wages and incomes. Low interest rates increase bond values directly, because rates (also known as yields) and bond prices move in opposite directions. Those low yields have made many other investments, from stocks to houses and other real estate, much more appealing in comparison. This increase in wealth may have helped stimulate the economy, but because wealth has grown so much faster than wage income since the last financial crisis, measures of inequality, in both wealth and income, have worsened."*

It is the *"because wealth has grown so much faster since the last financial crisis, measures of inequality, in both wealth and income, have worsened"* that has most Americans generally on edge. By the Fed stimulating the monetary system to the great extent it did, flooding the financial system with low cost money over the past seven to eight years, who do you think stood to benefit? Well, people that own assets; stocks, real estate, high priced art and collectibles, companies leveraged to the system, etc. Simply stated, the rich have gotten a bit richer. Some would argue at the expense of the average worker, who depends on that weekly paycheck more and is not in a position, or does not have the risk appetite, to own things. To further illustrate this point, the Organization for Economic Cooperation and Development (OECD) last year estimated that the richest 10% of American households earns roughly 28% of the overall income pie. Historically speaking, this is not out of line. But, interestingly and alarmingly, this same wealthiest 10% have accumulated almost ***76%*** of all the wealth in our country.

The artificially low interest rates have additionally penalized those on a fixed income which tend to be people in middle and lower income brackets. The cost of goods and services has gone up and the income received by the average American, whether from social security benefits (last year no increase and this year will see only a .4% increase), pensions or bank accounts, has stayed relatively flat. One does not have to be on the right or left principally to not only witness this disparity but also see it play out in our current political theater. A lot of people on all sides of the aisle are visibly upset.

All this got me thinking about an article I read recently by Moshe Bar, MD, a neuroscientist and professor at Harvard Medical School, titled, *Think Less, Think Better*. In the piece, he writes, *"our minds are too occupied with thoughts to allow complete immersion even in what is right in front of us."* He goes on to say, *"Too often we eat meals without tasting them, look at something beautiful without seeing it. An entire exchange with my daughter (please forgive me) can take place without my being there at all."* He and his colleagues performed a series of experiments with the goal of overloading the human brain with information. They found that *"with a high mental load, you need more time to generate even a conventional thought."*

One wonders whether the good people at the Fed have overplayed their hand. Just maybe too much data, in fact, distorts reality and actually forces people into a corner where they find it difficult to even make a decision. As Dr. Bar argues, given a high mental overload, it is hard for anyone to think squarely. At some point the problem becomes overthought. Paralysis eventually sets in. Any action at all sometimes can loosen this intellectual grip.

It is fair to say that today most Americans sense an increasing imbalance in our society. No doubt the Fed has contributed to it but in all fairness they were not dealt a very good hand in 2008. There are always unintended consequences when confronted with big decisions. However, now is the time they should face the music and ***trust*** *that the American economy and free markets can and will find that important* ***balance*** *again*. Bumps in the road along the way are inevitable. But haven't we already been living through increased uncertainty and volatile markets? Timothy Geithner, former Secretary of Treasury, maintains that we will correct this mistake at some point. Since we are now at the juncture where the Fed seems to be overdoing it, why not get on with the interest rate decisions and begin down the path of correcting the imbalances that, if left unattended, will continue to drive us apart.

In accordance with SEC regulations, we ask that you contact us in the event there have been any material changes in your financial circumstances or investment objectives, or if you wish to impose any reasonable restriction on the management of your accounts or modify any existing restrictions.