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By Greg Gann

Bad=Good. Good=Bad.

The September-October timeframe is traditionally one of the most volatile for the stock market. It is during this season when the unexpected has often become reality. This year is no exception. On Thursday September 18, 2013, the Federal Reserve shocked the market which was being prepped for a tapering of its most massive bond buying stimulus program in its history.

In September of 2012, the Fed initiated its third round of stimulus known as quantitative easing with hopes of igniting a tepid economy. Quantitative easing is a fancy term for the Fed calling on the Treasury to provide it (including printing) dollars so as to buy government bonds as well as mortgages from private banks. These purchases have occurred at a rate of $85 billion per month, or approximately $1 trillion per year. To provide some perspective, it is important to appreciate the full context of these purchases. In 2007, the entire balanc sheet of the Fed was $1 trillion. This year alone, the Fed is increasing its balance sheet by absorbing assets from banks in the amount o its entire balance sheet value as of a mere six years ago.

Beginning in earnest in May, the Fed started dropping hints that it was looking for ways to curtail these purchases, and most were expecting it to announce at this September's meeting some form of "Septaper", even if it were only modest and symbolic. The common thought was that the economy is improving, and as such, the Fed should clearly be in a position to limit its purchases a mere $5 billion - $10 billion a month.

By the way, quantitative easing is a highly contentious issue not only for the public and policy makers at large, but even amongst voting members of the Fed Board, there are many who not only question the efficacy of the program, but actually think it is harmful from a long term perspective on the economy. Nonetheless, The Fed announced that it would not slow down its purchases not even one iota. With high frequency trading the technology du jour, it only took seconds for the Dow to reach another historical all-time high. Just like an addi getting high from narcotics, the Dow is getting "high" from on-going Fed stimulus. The other 2013 all-time highs for the Dow were March

11th, May 7th, May 28th, July 11th, and August 2nd. So, with a series of unprecedented all-time highs, it begs the question is this becau things are good, or on a more sinister level, is it because things are actually not so good, but rather bad?

Although the market rallied significantly after the Fed's announcement to do nothing, I think this was a bad decision, and an objective indication that things are not so good. I say this because inherent in the Fed's decision is an acknowledgment that the economy, notwithstanding so many back-to-back record highs for the Dow, is not strong enough to stand on its own two feet. It still needs coddling from Mother Fed. Those in the know who are orchestrating monetary policy are announcing that we are not out of the woods, and things could easily slip backwards. Just like it takes time to adequately wean an addict, I do not believe the Fed should have jolted the system with a large taper. But, I think that once the euphoria dissipates from the fact that the drug was re-administered in full force, it will sink in that things are not as good as one would reasonably surmise based solely on stock market performance.

At this particular moment, the equation controlling the market is bad=good. And, the concern is that when the economy unequivocally indicates that things are steady and good, then the stimulus will be cut or at least tapered. And, so, the equation under that scenario is good=bad. Until times resume to normal and logic prevails such that good things in the economy translate into good things for the marke then this is a market that should be strategized by playing the "winning by not losing" game, rather than rolling the dice, doubling down a playing the "winning by winning" game. In other words, until good=good, and bad=bad, the market is subject to exogenous shocks that could wipe out the 2013 gains faster than most people can protect themselves.

Now, there are those who postulate that this year's gains in the stock market are real, and that they reflect a true and improving America and global economy. They point to the improvements in the stated unemployment figures, the amount of cash that major corporations ho on their balance sheets, the rebounding of the housing market, and incredibly strong auto sales.

For any who say that the stock market's gains are separate and removed from the Fed's purchases which have resulted in some of the lowest interest rates on record, I would simply refer them to last week's market surge. On Monday the 16th, the first day of trading following Larry Summers announced withdrawal from being considered for Chair of the Fed, the Dow went up over 100 points. (Larry Summers is much less supportive of Fed policies than Janet Yellen, the other major contender.) Then, two days later when the Fed announced it would do no tapering, the Dow increased 176 points above its previous day's close.

The market is treating bad economic news as good news because the thought is that the stimulus "punch bowl" will continue to be replenished. It is a short-sighted reaction without considering the long-term implications of manipulating interest rates or even how the policies are leading to "strengths", which may in fact be weaknesses. For example, I cite Bloomberg Businessweek that reports that the labor participation rate has hit a 35-year low. This means that much of the improvement in the unemployment rate relates to workers dropping out of the market rather than landing gainful employment. The amount of cash sitting on corporate balance sheets is also not a rosy as it is portrayed. Why? It is because corporations are afraid to deploy their cash. Inherent in hoarding cash is an acknowledgemen that although cash yields virtually nothing, there are no better places to deploy it. With respect to the highly encouraging auto sales, it is important to note that the average age of an automobile today in the U.S. is eleven years according to autonews.com. Autos been driver

far beyond their life expectancies. Furthermore, there has been a vast elevation in the number of auto leases rather than purchases, whi indicates to me that money is still quite tight. With respect to housing, there was an immediate slow-down in mortgage applications once interest rates started increasing over the summer.

The Fed's policies have significantly helped the banks and the very small minority of affluent Americans whose wealth is tied to financial instruments. It has resulted in a weak US dollar, which is good for exports. But because food, commodities, gasoline, and precious meta are priced in dollars, as the dollar has weakened, it has resulted in higher prices for these essentials. Also impacted are the millions of retirees who live on fixed incomes and depend on interest payments for their maintenance. So, clearly what is good for some is bad for others.

And, so we witness the law of unintended consequences. And, we live in a land of confusion where bad=good and good=bad. As we witnessed from the housing market, Fed policies do create bubbles that can inflate longer than predictable or rational. Without any recognition of debt ceiling debates, the ineptitudes of Washington, or geopolitical risks, it is important to appreciate in financial and risk management that it takes a lot more time to inflate a balloon than it does to pop it.

Today's market and risks are not like your daddy's Oldsmobile, a car which is now extinct. Unusual times call for alternative investment strategies and different perspectives. Drop me an email, and I am happy to share our research and/or market game plans because retirement is a terrible thing to waste.

Greg Gann

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