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INVESTMENT ADVISORY

MBMG Investment Advisory Update

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Taper Worming

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The financial media has been dominated in recent weeks and months with speculation about 'tapering', 'Septaper' and 'taper tantrums' which built to a crescendo in the run up to, coverage of and aftermath of this week's FOMC meeting at which The Fed announced to great fanfare that it intends to do absolutely nothing.

To be fair, I've been guilty enough of adding, albeit in a very small way, to this deafening cacophony. For several years I've taken the view that stimulatory policies are as addictive for policy makers as heroine is for users. Getting either to give up voluntarily is pretty unlikely. It's been a long-standing belief that policy makers would only renounce QE when they were forced to do by its indefensible, abject failure. I re-iterated this view on CNBC's Squawk Box in May when I was asked about the increasingly widespread belief at that time that the Fed would 'taper' asset purchases:

> *I don't believe a word of it – I think it's just throwing a bone to the more responsible members of society… I think that maybe I don't think they've got any intention of following through just yet… stimulus will be part of the background until some event happens that forces everyone's hands…it's not working because it's just pushing on a string. They're pouring water on a desert at the moment…….*
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> *I think that the Fed is aware that it's not working – that's why last year they were begging for Congress and everyone else to help…but they won't take the punchbowl away, they'll keep filling it and refilling it. So what can investors do in the short term? Last year I twice bought gold at 1600 and sold at 1800 making over 30%. I said at the end of last year, that particular trade had gone away but even today trading gold looks a lot less risky than being in equity markets. This year I'd be looking to buy gold at close to $1200 per ounce."*

On June 22nd in The Nation article Banana republic maybe, but not yet rotten fruit I talked about the ultimate effect of tapering on emerging markets, concluding that continued stimulus was supportive of currencies like the

Baht while a reversal or taper would not be so but, despite the price action implying that was coming imminently, it would take longer than most expectations:

> *Leaving aside the other currency crosses, what is fair value for dollar/baht exchange? I believe that direction will be driven far more by market expectations of global monetary policy than local policy. Increased monetary stimulus from China, Japan and the US in response to soft recent economic data may well see the baht move to 27.85. Longer term, a total reversal of such policies, starting with so called "tapering", is likely to see baht weaken. In extremis, a rapid baht depreciation in such a liquidity-negative scenario could see a drop of 30 per cent to the 37.98 level. This would be brief and could be a great time to buy baht or baht-denominated assets.*
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> *The question is when? It's hard to say, but we're not there just yet.*

In my blog post of July 1st, [Central Bank Bosses, Bananas and Beards](), I lambasted 'flip flop' Bernanke for his ambiguous position that had misled the markets into believing tapering was coming:

> *Mark Carney doesn't have a beard – which is a highly positive. Some sports teams have had a no-beard policy and they have achieved success. British football manager Brian Clough never allowed his players to have beards – possibly one of the 2 reasons why he didn't sign the famously bearded 1970's footballer Trevor Hockey; the other reason being that he wasn't very good. The New York Yankees baseball club still requires all players to shave; even the vastly experienced Kevin Youkilis had to shed his trademark facial hair when he joined them earlier this year.*
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> *Beards have played an important role in world financial history. Back in the twelfth century, French-born King of Jerusalem, Baldwin II, secured a loan using his whiskers as collateral – all this before there were any central banks dream up schemes.*
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> *Whilst in many ancient and modern cultures, a beard is regarded as a sign of wisdom, this is not so in the world of central banks. Bearded Ben Bernanke currently holds office as chairman of the Federal Reserve and has not shown much astuteness of late, with his hints at tapering QE, before quickly backtracking amid a cloud of dust.*

On top of which we've also reported comments of our guest speakers such as Michael Hasenstab, Mark Mobius, Scott Campbell and Martin Gray who tended to think that any imminent taper would be very limited, with Martin perhaps closest to my own view that Bearded Ben had tied his forked tongue in knots and was much more likely not to taper at all.

But that begs the question, why not?

For one thing real economic improvement – workforce participation, real income/GDP per capita growth, housing market revenue less stimulus – all look anaemic at best. Stimulus ends up on Wall Street not on Main Street and underlying economies still look sluggish at best.

For another thing there's the policy makers' dilemma. For Ben Bernanke his ultimate aim would be to get to the end of his term with the fictional recovery still appearing to be in place, his advocacy for scaling back on stimulus at this point now documented and his successor handed the dilemma while Bernanke's reputation remains intact. As for Janet Yellen, assuming that she'll succeed Bernanke as now looks increasingly likely, she's still a stimulus advocate/addict and would hate to see her predecessor act now with just a few months remaining and jeopardize the start of her rein. Neither of these 2 main voices within the Fed have any reason to risk the short run embarrassment of doing what is likely to be best in the long run.

I've been saying for some time that this feels a little like 1936/7; when such a groundswell against the Great Depression version of QE (AKA The New Deal) was so palpably failing to deliver benefits on Main Street that it was scaled back, creating a return to recession that FDR's government didn't have the stomach to tackle fundamentally, returning instead to orgiastic prompting. The words of Henry Morgenthau Jr., Secretary of the Treasury, are something none of us should forget if we get distracted with the 'Octaper' sideshow that is sure to dominate the headlines:

> *We have tried spending money. We are spending more than we have ever spent before and it does not work. And I have just one interest, and if I am wrong … somebody else can have my job. I want to see this country prosperous. I want to see people get a job. I want to see people get enough to eat. We have never made good on our promises. … I say after eight years of this Administration we have just as much unemployment as when we started. … And an enormous debt to boot.*

I'd rather focus on that bigger issue than the quantity and timing of any taper planes.

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