MBMG Investment Advisory Update

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Fed's base rate: no rise, no decision, no surprise

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Just before last night's announcement was made, I was asked what the Fed could do that would shock me. I answered that three things would surprise me: that it would be decisive, show leadership and communicate clearly.

On that matter, there were no surprises at all. As a contact on Twitter, Brad Moseley, put it as the announcement was being made, "If you suffer from insomnia, record Yellen now & play back tonight. Sleep is guaranteed."

Ever get the feeling you've been cheated? - Joe Lydon (a.k.a. Johnny Rotten)

What should have been a normal scheduled FOMC meeting was turned into a circus by the Fed's complete loss of control of its message during the previous 6-12 months[1] (just like the taper tantrum episode[2] a couple of years ago).

They'd confused everyone with *patience*[3], *considerable time*[4], *data dependent*[5] etc. Fundamentally, the Fed had two basic choices - hike or stick. They managed to get themselves into such a pickle that whichever one they chose, half the world would freak out.

You don't know what you're doing! – British football supporters' chant to inept referees

The Fed ultimately decided to stick. Not that it matters: whatever choice the Fed made would have been for the wrong reasons anyway. The world is in a major debt deflation, largely created – or at least encouraged by – the Fed, which seems to have been oblivious of this until they got smacked in the face by China's inability to continue sweeping its problems under the carpet.[6]

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[1] See various articles: http://www.bloomberg.com/news/articles/2015-04-29/fed-still-open-to-second-half-rate-rise-despite-slowing-economy http://www.marketwatch.com/story/yellen-repeats-fed-on-track-to-raise-rates-before-year-end-2015-07-15, http://www.telegraph.co.uk/finance/economics/11732748/Janet-Yellen-The-US-will-raise-interest-rates-in-the-next-five-months.html, http://money.cnn.com/2015/06/17/news/economy/federal-reserve-interest-rate-janet-yellen/

[2] http://money.cnn.com/2013/06/24/investing/stocks-volatility/

[3] http://www.bloomberg.com/news/articles/2015-03-18/fed-drops-patient-stance-opening-door-to-june-rate-increase

[4] http://www.wsj.com/articles/feds-considerable-time-policy-phrase-takes-focus-1418071999

[5] http://www.cnbc.com/2015/09/16/federal-reserve-should-hike-rates-because-us-is-ready-says-ubs-chairman-axel-weber.html

[6] http://www.mbmg-investment.com/in-the-media/inthemedia/59

Commentators are seeing this non-decision as throwing China a lifeline at America's expense.[7] But that's not right either. Using emergency measures as normal policy for 7 years has created massive distortions in developed economies.[8] Using extreme stimulus non-stop for so long in China has created the biggest and most widespread bubbles the global economy has ever seen.[9]

Last night's announcement just enables these distortions and bubbles to continue a while longer without being pricked. There's a creeping sense of unease among markets that the party can't go on forever.[10] The reason that last night was so important was that markets were worried that the Fed would 'take away the punchbowl', the distortions would unwind and the People's Bank of China would be unable to prevent the bubbles bursting.[11] It seems to me that the markets were also hoping for some silver bullet that would mean that all the future problems would somehow magically disappear. Last night just resulted in neither any fulfilment of hopes nor any realization of fears. All that has just been put on hold for longer.

The investor takeaway therefore is that we're no further forwards - we're still in an environment where policy is all about avoiding having to face the reality. The risk is that the unwinding of distortions will lead to the bursting of global asset bubbles and an extreme crash and depression. Again, all that has been delayed a while longer.

Depending on individual risk, liquidity and currency requirements and appetite, investors should in general be protecting their downside exposure to risk of drawdown and permanent loss, whilst looking to generate whatever returns that allows in a zero-interest-rate environment of high uncertainty. In controlling risk, returns will be constrained: welcome to the Janet Yellen Fed-sponsored New Abnormal.

In essence, we've all been cheated, not just by last night, not just since Yellen took over the reins, but by the whole Greenspan- Bernanke-Yellen unholy trinity and probably since the Fed was created in 1913. Welcome to Bubbleville!

For further information, please contact us by e-mail on info@mbmg-investment.com or call +66 2 665 2536.

Paul Gambles has completed CFA level 1 and is licensed by the SEC as both a Securities Fundamental Investment Analyst and an Investment Planner.

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[7] http://blogs.marketwatch.com/capitolreport/2015/09/17/live-blog-and-video-of-fed-decision-and-janet-yellen-press-conference-2/

[8] http://www.bloombergview.com/articles/2015-09-01/why-the-federal-reserve-should-raise-interest-rates

[9] http://www.mbmg-investment.com/in-the-media/inthemedia/59

[10] http://www.theguardian.com/business/2015/sep/17/federal-reserve-raise-interest-rates-timing-us-economy

[11] *idem*

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