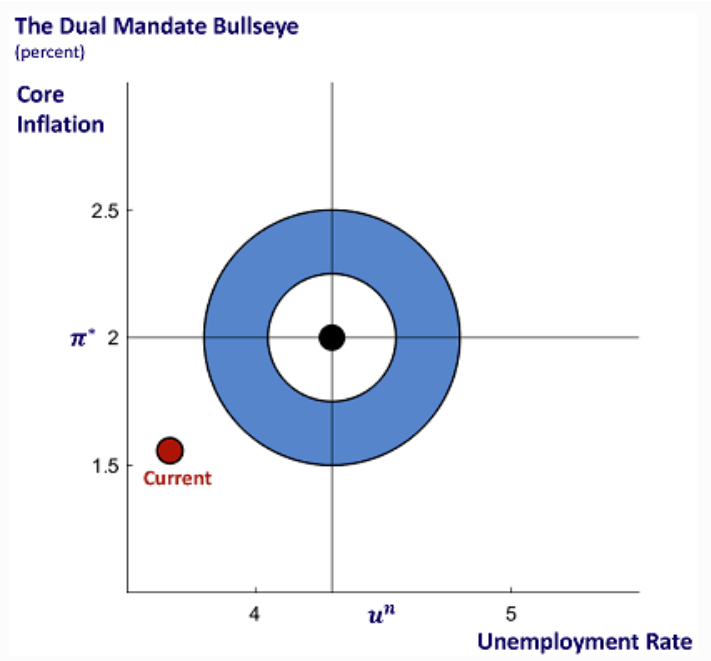
Does/Should the Fed Care About the Stock Market?

Posted on June 21, 2019

Once upon a time, in another millennium, I worked at the Federal Reserve Bank of New York. It was during the reign of Chairman Volcker, first of his name. One thing I did was prepare statistical packages for the officers to use in the run-up to the FOMC meeting. The tables and charts covered inflation measures, the non-financial economy, interest rates and exchange rates. Perhaps it was a simpler time or just a different time, but the stock market was barely, if ever, mentioned during my tenure. From the reign of Maestro Greenspan down through the present day, it has become an article of faith among stock market commentators that the Fed reacts to the equity market. Is this true? Should it be true?

The Fed's objectives were established by Congress in The Federal Reserve Act in 1977. They are maximum employment, stable prices, and moderate long-term interest rates. This is called the "Dual Mandate". It focuses on the real (non-financial) economy.



Source: Federal Reserve Bank of Chicago as of 6/12/19

- Stable prices has been defined as a core inflation rate of around 2%. Inflation means changes in the overall price level of goods and services. Asset price inflation, or the perceived overvaluation of financial markets, is not a policy target.
- Maximum employment is defined as getting to an unemployment rate that will not cause inflation to accelerate. Unemployment, beyond that amount, results from the economy running below its capacity. The current unemployment rate, despite being below the Fed's estimate of the appropriate rate, is not a cause for concern. Inflation is below its target too.
- Moderate long-term interest rates get no attention as a policy target. Perhaps because they should result if the first two goals are fulfilled.

Note that the stock market doesn't get a mention, not even a footnote. Continue reading →

Posted in Credit, Economics, Equities, Investing, The Fed | Tagged Bonds, Economics, Equities, The Fed | Leave a comment

Collecting Is Not Investing

Posted on May 31, 2019

When I was 17, on the cusp of driving age, I had dinner at a friend's house. I remember this particular dinner because of the question his dad asked me. This friend's family was wealthier than most of those I knew. They lived in a large house. The father was head of a family business. Dinner was cooked and served by a domestic, pretty swanky for our neighborhood. The dad, who had a high opinion of his business acumen, asked me if I had the money to buy the car of our choice, any car, what would it be?

I said that I would buy a Ferrari. He countered by saying that he would buy a Rolls Royce, because if you could buy any car you wanted such a high priced vehicle should be looked upon as an investment. He was certain that a Rolls would be the better investment. I picked the Ferrari because it was cool, much cooler than a fusty Rolls ex, perhaps, John Lennon's.

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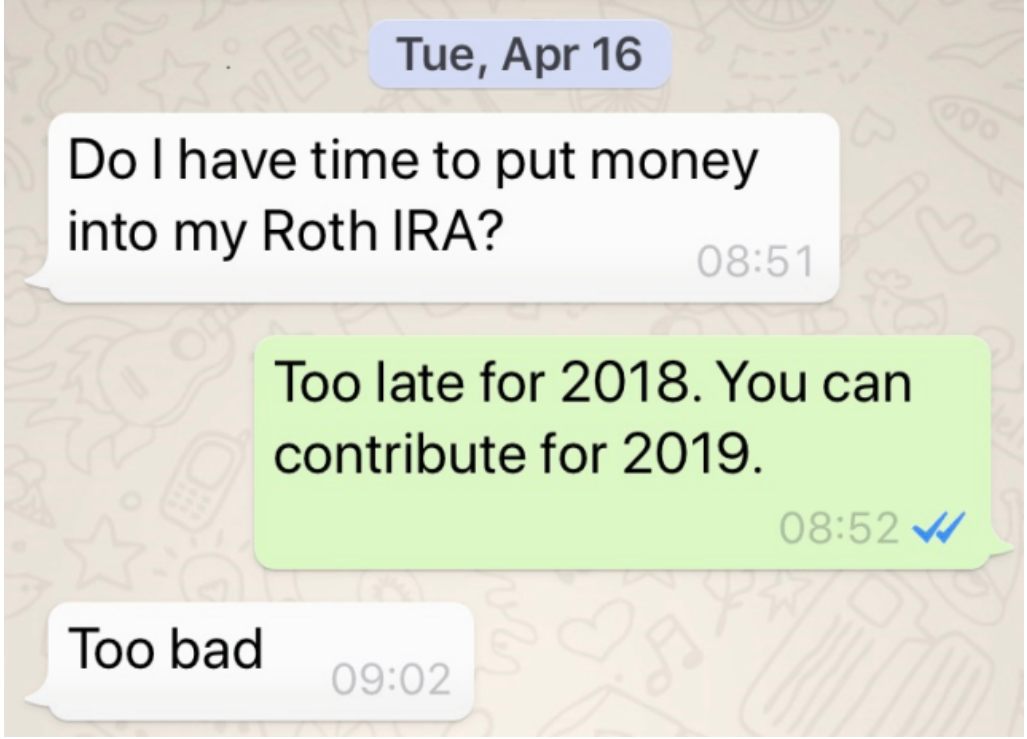
Posted in Investing | 3 Comments

Procrastination Has Its Price

Posted on May 9, 2019

April is the cruelest month, keeping me inside doing taxes while I stare jealously at my friends' Strava feeds detailing their adventures and the miles they've ridden. April is also the month that many inflict cruelty upon their future selves by funding their IRAs a full fifteen and a half months later than they could have.

Exhibit one, a text from someone I advise:



This is typical. Many fund their IRAs at the last minute. You don't give it a lot of thought until it's almost (or in the case above) too late. So, being curious about what might be lost by funding at the last minute, I decided to figure it out.
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Jeopardy and Understanding Your Goals

Posted on April 16, 2019

On April 9, 2019 James Holzhauer broke the figurative bank on Jeopardy by winning $110,914 in one day. The previous one day record was $77,000. James did it by going after high value clues first, by seeking out the Daily Doubles, by betting heavily when he found them and by not guessing at clues he didn't know. By executing this strategy flawlessly James froze out his opponents with a commanding lead before Final Jeopardy.

The next night Laura found herself in a position to challenge James. She hit upon the last Daily Double, giving her the chance to prevent a runaway and to position herself to potentially take the lead. She did not use the opportunity properly. Laura either didn't fully understand her goal or the risk she faced. Below are the contestants' scores and the points remaining on the board at that juncture:

James	Jeff	Laura
28,400	1,400	12,000

Points Remaining:	8,400

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Finance Is a Language

Posted on March 27, 2019

He walked quietly into the lecture room, tall, thin and pale. His suit hung loosely off his frame. He spoke softly: “This is 15.439, Problems in Finance. There is a list of 50 problems for this course. If we do all the problems, we will average 2.27 problems per class. The materials are in Graphic Arts. I see no reason why we shouldn’t begin. Problem one, Richard Gluck.”

Summer break had just ended. It was the first day of class. I hadn’t looked at the question or done the reading, much less bought the two foot high stack of articles from Graphic Arts. And this was Fischer freaking Black, co-creator of the Black-Scholes model, who had just picked me out of the sixty five or so people in that room to answer the first question in his class.

I scanned the question, something about the Capital Asset Pricing Model. One detail that sticks was a sub-question asking whether interest rates could go negative.* I answered as best I could. My classmate Steve, sitting next to me, raised his hand and backed me up. (I’m grateful to this day.) The arguments raged back and forth. I was losing. Fischer called for a vote. Nine for. He didn’t bother counting the nos. He just wrote “lots” on the board. Fischer allowed for a bit more debate. Then he summed up the problem and gave his view. Finally, he crossed off the 9, putting a 10 in its place. I’ve never been so relieved in my life. Continue reading →

Posted in Asset Allocation, Bonds, Economics, Finance, Investing | 2 Comments

Hitting ‘Em Where They Ain’t

Posted on March 19, 2019

“Keep your eye on the ball and hit ‘em where they ain’t”

— Wee Willie Keeler

It was at an “ideas” dinner that I was introduced to Mike. Someone from the host firm grabbed me and said: “You should meet Mike, he’s doing the same thing you are”. That thing was building a track record in global bond investing as a precursor to creating a business in the asset class. What I remember from our conversation was how Mike framed the problem. Our common yardstick, the FTSE World Government Bond Index, was dominated by three markets: the US, Japan and Germany. Mike thought that getting those three markets right was the key to his performance. I listened, nodded politely, but walked away feeling that I just did not agree with his view of the problem. I preferred to seek opportunities in niche markets, misperceived situations and mispriced securities.

Consistently timing large bond markets is nearly impossible. Most market commentators have been calling for higher rates every year for the last decade. Their batting average has been a lot lower than Wee Willie’s. Willie’s lifetime average of .341 places him 14th on the all time list. Pretty good for a guy who made a living shooting the gaps, bunting and dinking balls over the infielders.

Indexing large efficient markets like the S&P 500 or the US government bond market has been an efficient way to access their returns. Paying premium prices in attempts to beat them has proven to be a waste. Investments that can add to your returns versus your strategic allocation are likely to be found in niches that do not scale, in securities that should be unaffected but fall in sympathy with those that should, or in situations where prices overcompensate for risk.

There are such niches. They are hard to find and evaluate. Worse, they are often buried in portfolios of filler. In Portfolio Management: Cooking With Hamburger Helper, I talked about the fact that equity portfolio managers typically have a handful of high conviction ideas and that those ideas have been proven to do well. The rest of their portfolios were Hamburger Helper. This holds in asset classes like global bonds too.

In the global bond world, the major markets are beta, standard exposures that can be accessed simply and cheaply. I spent my time on other things like buying unrated Iraq bonds post US invasion, because US involvement meant I was overcompensated at the price I paid. I bought Mexican T-bills during the Asia crisis; their yields had risen to 35% and I was pretty sure that Mexico wasn't in Asia. I bought Israeli bonds and hedged them into US dollars with mispriced shekel currency forwards for a significant, yet low risk, yield boost. All of these things involved mispricing, misperception or niche markets. All were buried in my larger portfolio; they helped performance at the margin, but didn't dominate. I had to consider overall portfolio risk. My investors did fine, but they paid my employer for a large ribeye while receiving a just a taste.

In my opinion, the way to square this circle is to maintain a strategic allocation in low cost strategies while reserving a portion of your portfolio, if you're inclined, for strategies or individual investments that have the potential to add excess value. Some managers can provide such strategies, but don't be fooled; they cannot offer them across a well diversified portfolio. Do not pay luxury tax for a buffet size helping of filler leavened with an amuse bouche portion of investments with the potential to add value.

Posted in Asset Allocation, Bonds, Currency, Equities, Investing | Tagged Asset Allocation, Bonds, Equities, FX, Investing | Leave a comment

Portfolio Management: Cooking With Hamburger Helper

Posted on March 7, 2019

"Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally."

— John Maynard Keynes, The General Theory of Employment, Interest, and Money

Betty Crocker introduced Hamburger Helper in 1971. You took chopped meat and added it to the eponymous mixture of macaroni* and spices. In essence, you took the good stuff, the ground round, and added filler to stretch out the meal. Much of active management works the same way.

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Posted in Equities, Investing, Volatility | Tagged Equities, Investing, Volatility | 1 Comment

Missing the Forest for the Trees

Posted on February 22, 2019

There is a tendency among market commentators to seize upon a data point and declare that hellfire and brimstone are about to come raining down. They blow things out of proportion. They see fire when they should be on the lookout for ice. A recent example is auto loan delinquencies. This looks bad:

Here's a typical reaction, by which I mean, one completely lacking in perspective:

- *The number of **auto loans** at least 90 days late exceeded 7 million at the end of 2019 hitting the highest level in decades.*

An old boss of mine would have told them to stop hyperventilating.

Of course auto loan delinquencies are growing and hitting the highest number in decades. Population grows. Loans grow. Delinquencies grow. We need some context here. Continue reading →

Posted in Consumer Credit, Credit | Tagged Credit, Economics | 1 Comment

Heads Up, I'm Now "The Market Cyclist"

Posted on February 15, 2019

I am now ***The Market Cyclist***. This blog will continue to feature posts on markets and investing. Afterall, ***Market*** is in the title (and markets do have cycles). I anticipate adding personal finance related content and other, non-finance related, content. The change comes because my role has expanded beyond investing. As an advisor, I help people in many aspects of their financial lives.

Like anyone who moves I'll want you to have my new address. It is: themarketcyclist.com The old URL, globalinvestmentstrategy.wordpress.com, will redirect to the new one, so no worries there.

I would like to thank everyone who has followed me or visited this blog over the last several years. I hope you come along for the ride.

Waiting for the start of The Farmer's Daughter Gravel Grinder in 2017.

Posted in Uncategorized | Leave a comment

Diversify When the Upside Is Limited

Posted on February 12, 2019

While having lunch with a client recently, I asked about his attitude towards risk. His half-joking response was that he would like high returns with no risk. I've heard similar sentiments echoed many times down the years. We all want the magic pill, weight loss without dieting or exercise, gain without pain.

Because we all want that, we fall prey to the idea that there are ways to engineer returns without having to endure volatility. It's why investing with Bernie Madoff was so attractive. He proffered a long term record of over 10% per annum with few down months and no down years. It didn't end well. Continue reading →

Posted in Credit, High Yield, Investing | Tagged Credit, Equities, Investing, Volatility | Leave a comment

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