MV Capital Management Weekly Market Flash

Bernanke to Market: Party On

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The phrase “BlackBerry Panic” gained currency back in the dark days of 2008. It was a wry, very apt touchstone for how policymakers kept one nervous eye on the flashing screens of their smartphones while trying to figure out how to save the financial world from ruin. Well, it’s 2013 now. BlackBerries are well on their way to becoming quaint relics of a time gone by, and financial Armageddon is not looming directly overhead. But whether from a high resolution iPad 4 or a sleek Samsung Galaxy, the daily upticks and downticks of asset prices continue to jump out of cyberspace and into the attention spans of Ben Bernanke and his Board of Governors colleagues.

English Lessons

After the sharp run-up in bond yields and a (relatively minor) correction in US equities, Bernanke used his microphone time this week to belabor the point that there is no definition of “tapering” in the dictionary that equates to “imminent rate hike”. Markets got the point. The S&P 500 clawed back all of its June losses and then some, closing out July 11 at 1672. The 10-year Treasury yield fell back below 2.6%, and the VIX Volatility index – Wall Street’s “fear gauge” – crawled meekly back below 13 after surpassing 22 in late June. So the gods are in Valhalla and all’s right with the world?

Beware the Net Outflows

Not necessarily. It’s perfectly understandable why Bernanke wants to jawbone markets, particularly bond yields. The surge from 1.6% to 2.7% on the 10 year note was overblown and not justified by credit market fundamentals. But investor behavior is not rational, and an outcome of selling begetting more selling could inflict real damage on business decisions around hiring, capital investment and the like. Hence Bernanke’s deliberate spelling out the difference between tapering and an actual change in interest rate policy.

Kick the Habit…But Not Yet

But the subtext to this is that once again the policy goalposts are susceptible to being moved. Since the announcement of QE3 last year the oft-quoted benchmark for economic improvement was an unemployment rate of 6.5%. Now some of the more dovish Fed governors are floating 6.0%, or maybe something else instead. “We’ll know it when we see it”, one supposes the governors to be saying to each other in their private conversations. Meanwhile, keep the punchbowl spiked so that assets don’t do something crazy like go off and respond to actual, real supply and demand dynamics.

Waiting for Capitalism

Amid the nervous chatter in the past several weeks there have been not a small number of voices expressing pleasure in the expectation that these real-world fundamentals might be on the horizon again. Sure, there might be a few months or more of unpleasant adjustment, but then the patient will be able to stand on its own two feet again. Credit markets can reflect the equilibrium between borrowers and savers without the Great Nanny hovering overhead with $85 billion worth of monthly injections. We’re not there yet. When Ben Bernanke switches off his smartphone and sits down to make policy without wondering where the Dow’s at, or how much net outflow took place in bond mutual funds this week, then we’ll be a bit closer to letting capital markets do what they do best – to discover their own prices and values.

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