MV CAPITAL MANAGEMENT

Weekly Market Flash

Janet Yellen's Long-Term Angst

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People, and markets, get fidgety in late August. It's the time of year when summertime fun turns into tedium. Kids are actually looking forward to getting back into the school routine. Asset markets, meanwhile, jump at any tidbit of event-driven news that can make the time to Labor Day weekend pass by more quickly. Today's distraction of choice was Fed Chair Janet Yellen's speech at the annual Jackson Hole monetary policy confab. Did financial media pundits really want to hear about the contribution of the new IOER (interest paid on excess reserves) policy to the Fed's ability to steer the Fed funds rate? Of course not! But they did want to spend a few minutes mining Yellen's speech for any trace of a hint of a possible "live" meeting in September, i.e. one with a rate hike on the table.

That hint, predictably, remains as elusive as the Yeti. Bond yields spiked very briefly when the phrase "case for an increase in the federal funds rate has strengthened in recent months" tumbled onto the CNBC news banner. But asset indexes of all stripes, from stocks to bonds to currencies and volatility, soon realized that there was nothing new under the sun in terms of specific rate timing. Dog days tedium resumed.

For those whose investment horizons extend beyond the next one or two FOMC meetings, though, there is plenty in Janet Yellen's thoughtful and probing words worth mulling over, and worth being concerned about.

The Politics of September

Before we focus on the longer term picture emerging from Yellen's speech, though, we should get the business of September out of the way. There has been a great deal of renewed speculation this week about the possibility of a live move when the FOMC meets on September 20-21.

We have argued several times recently about the highly unlikely nature of any such move. Nothing said by any Fed personalities this week, up to and including today's speech, changes our view on this for the following simple reason. In the absence of inflationary threats, with continued softness in domestic capital formation and weak foreign demand (the biggest drags on this morning's underwhelming 1.1 percent GDP revision, called out by Yellen specifically), nobody's feet are held to the fire for an immediate rate hike. On the other hand, 9/21 is just a few days away from the first Presidential debate in the most highly charged, toxic political environment of recent memory. Yellen's Fed is a cautious Fed, and a conflict averse Fed that will likely not insert itself into the politics of the moment – as a rate hike would almost certainly do – without an immediately urgent reason to do so. We stand by our view.

Where Do We Go From Here?

We're not sure if Yellen was actually channeling the Alan Parsons Project song "Games People Play" when she made "where do we go from here" – the opening line of that song – the subtitle of the most important part of her speech today. But the tone of this part of the speech was, in our opinion, quite in line with the somewhat dark musings of that 1980 song. "Games people play, you take it or you leave it / Things that they say just don't make it right / If I promise you the moon and the stars would you believe it / Games people play in the middle of the night."

Yellen appears to envision a world where an expanded toolkit of creative, envelope-pushing monetary policy solutions must be ever at the ready to "respond to whatever disturbances may buffet the economy." Such policies could, in the future, not just retain quantitative easing as a firefighting tool for the next economic recession, but actually expand the range of assets targeted in a future QE program. Expand to what? We already have a preview of such a world in Japan, where the Bank of Japan is the country's largest institutional shareholder via its outright purchases of domestic equities. Of course, she says, nothing of the sort is in any way on the table for immediate action by the Fed, but a bevy of such alternative approaches are very much part of the research effort underway in anticipation of future conditions requiring more than the current batch of approved measures.

A Little Help, Please?

The other thing one cannot help but see in Yellen's musings here is a well-deserved frustration over the apparent inability of any other policymaking entities to lend a hand in addressing today's economic challenges. To wit: "…these tools [monetary policy] are not a panacea…policymakers and society more broadly may want to explore additional options for helping to foster a strong economy." That, as we read it, is a polite way of saying that a bit less dysfunction in other parts of the government could make it possible for the Fed to not have to distort the natural workings of asset markets in moving the economy towards positive growth. Finally, she concludes that nothing can replace good old-fashioned organic productivity growth as a way for the economy to deliver actual, meaningful improvements in the standard of living: "…as a society we should explore ways to raise productivity growth."

To sum up: there is very little in today's Jackson Hole speech that should change the calculus for what the Fed may or may not do before the end of the year. We fail to see any likely case for live action in the political cauldron of September. December is simply too far away to even speculate: all it would take would be for one more technical correction in the interim – a pullback of 10 percent or more in the S&P 500 or an out-of-the-blue spike in bond yields – to take a holiday hike off the table. Yellen speculates that there is a "70 percent chance that the federal funds rate will be between 0 and 3-1/4 percent at the end of next year," a non-prediction which of course does not preclude the possibility that rates may not move at all or even go down again.

But most of the portfolios under our management have a time horizon well beyond the next handful of FOMC meetings, and to that end Yellen's longer term concerns are our concerns. Political dysfunction and persistent underperformance in productivity growth loom large indeed as forces that keep us up at night. Where do we go from here?

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