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**Danubius Health Spa & Resort Margitsziget  
Margaret Island  
Budapest, Hungary**

**September 15-18, 2013**



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## **A Market Analyst's View: Monetary Policy & Debt, the Issues Raised**

By

**Steven M. Shelton MS, MBA, CFP®, CLU, ChFC,  
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## An Economist's View of Economists

Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is past and the ocean is flat again.

John Maynard Keynes



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## Agenda

- Monetary Policy Primer
- Quantitative Easing (QE)
- QE Monetary Policy
- Monetary Policy Impact or Lack of
- US Monetary Policy Results & Implications
- Summary & Conclusions



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## **Monetary Policy Primer**

- The term monetary policy refers to what a nation's central bank does to influence the amount of money and credit in the economy
- The goals of monetary policy are to promote maximum employment, stable prices and moderate long-term interest rates



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## Monetary Policy Primer - Continued

- Tools of US monetary policy makers & targets
  - Open market operations – FOMC - QE
  - Federal funds rate – 0 to .25%
    - If unemployment above 6.5%
    - If inflation rate is below 2.5%
  - Discount rate - .75%
  - Reserve requirements – 0 to 10%



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## Quantitative Easing (QE)

- Considered an “unconventional” monetary policy
- Central bank buys financial assets from:
  - Commercial banks
  - Other private firm
  - Open market
  - Thus increasing the monetary base
- Conventional buys or sells govies to target rates
- Another way central banks can stimulate an economy
- Invoked: if conventional policy ineffective



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## Quantitative Easing (QE) Continued

- Why did the US Fed and other Bankers use QE
  - Non-performing or defaulted loans
  - Zero interest rates
  - Needed increased money supply
  - Recession or depression systemic risk
  - A last resort to stimulate



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## US QE Monetary Policies

- QE 1932 – 1936
  - Fed purchased \$1 billion of treasuries
  - Treasury & White House \$4 billion
- Operation Twist 1961
  - Sold short term debt and bought long term debt
- QE-1 Dec 2008 to March 2010
  - \$1.350 trillion of MBS and agency debt
  - \$300 billion of Treasury securities



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## US QE Monetary Policies

- QE-2 Nov 2010 to June 2011
  - Purchased \$600 billion longer dated bonds
  - \$75 billion a month
- Operation Twist 2011
  - Purchased \$400 billion bonds 6-30 years
  - Sold \$400 billion bonds less than 3 years
- QE-3 QE Infinity - Sept 2012 to ?
  - \$40 billion/month open ended MBS
  - Fed Funds rate to be held near zero until 2015 or longer



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## US QE Monetary Policies

- QE-4 Dec 2012 to ?
  - Increased MBS purchase to \$85 billion/month
- QE-Infinity “Taper” Hint – June 2013
  - Hinted of rate hikes IF inflation at 2% and unemployment 6.5%
  - Hinted at cutting back on purchases
  - S&P dropped 111 points in 4 days at the hint of “Tapering”



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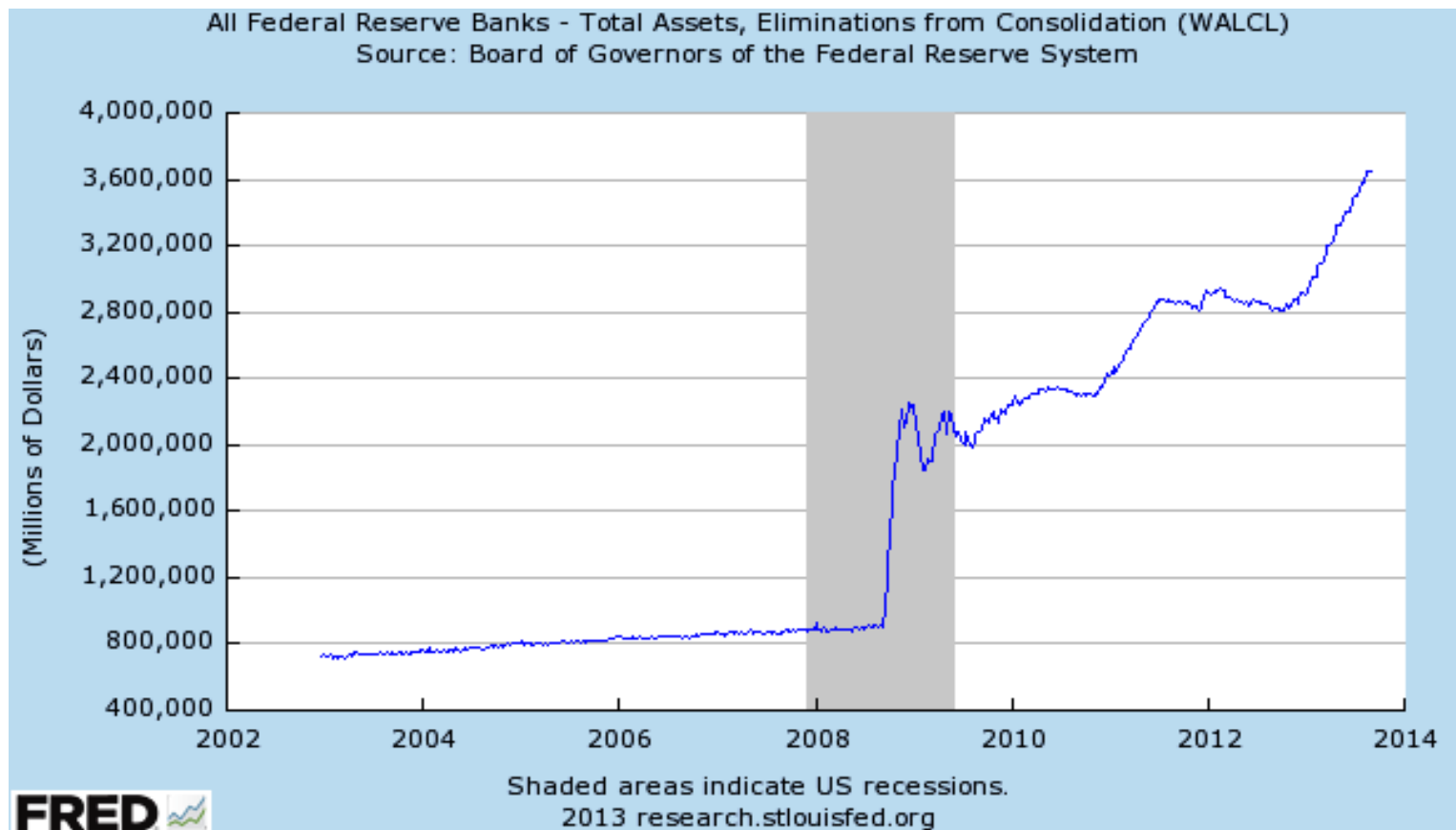
## **Monetary Policy Impact or Lack of**

- Fed assets
- GDP
- Money supply and velocity
- Employment
- Debt
- Commodity markets
- Currency markets
- Equity markets



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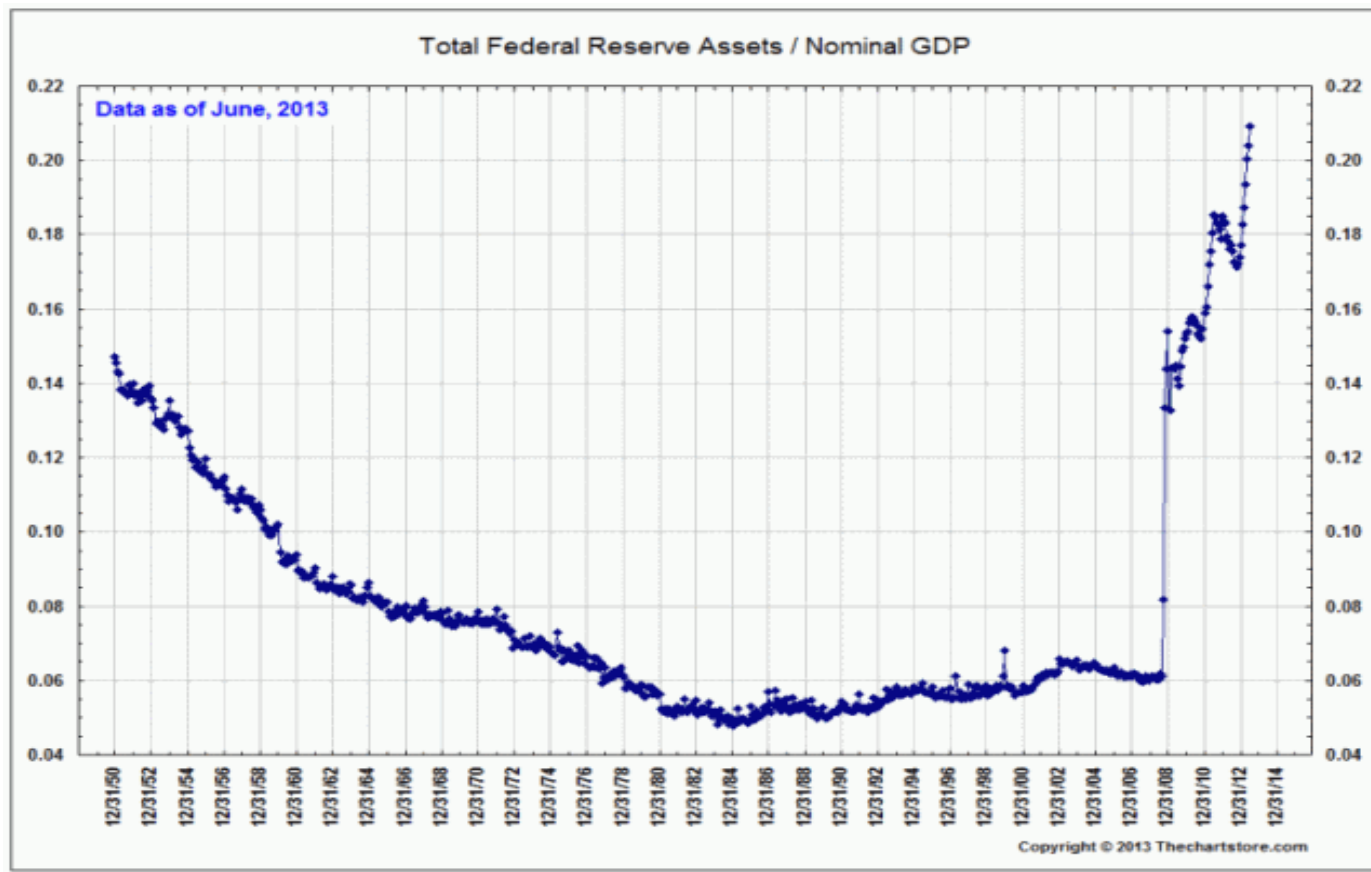
## Federal Reserve Total Assets





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## Ratio of Fed Assets to GDP





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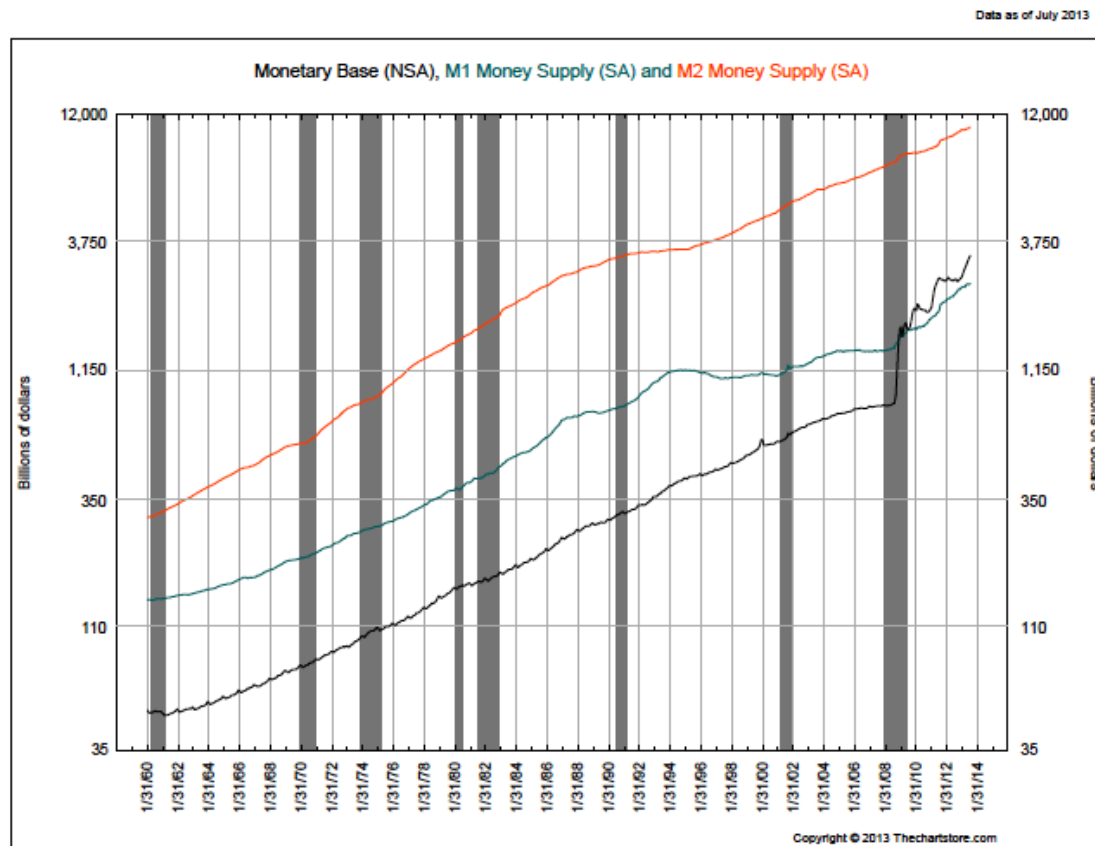
## Types of Money Supply

Type of money	M0	MB	M1	M2	M3	MZM
Notes and coins in circulation (outside Federal Reserve Banks and the vaults of depository institutions) (currency)	✓ <sup>[8]</sup>	✓	✓	✓	✓	✓
Notes and coins in bank vaults (Vault Cash)		✓				
Federal Reserve Bank credit (required reserves and excess reserves not physically present in banks)		✓				
Traveler's checks of non-bank issuers			✓	✓	✓	✓
Demand deposits			✓	✓	✓	✓
Other checkable deposits (OCDs), which consist primarily of Negotiable Order of Withdrawal (NOW) accounts at depository institutions and credit union share draft accounts.			✓ <sup>[9]</sup>	✓	✓	✓
Savings deposits				✓	✓	✓
Time deposits less than \$100,000 and money-market deposit accounts for individuals				✓	✓	
Large time deposits, institutional money market funds, short-term repurchase and other larger liquid assets <sup>[10]</sup>					✓	
All money market funds						✓



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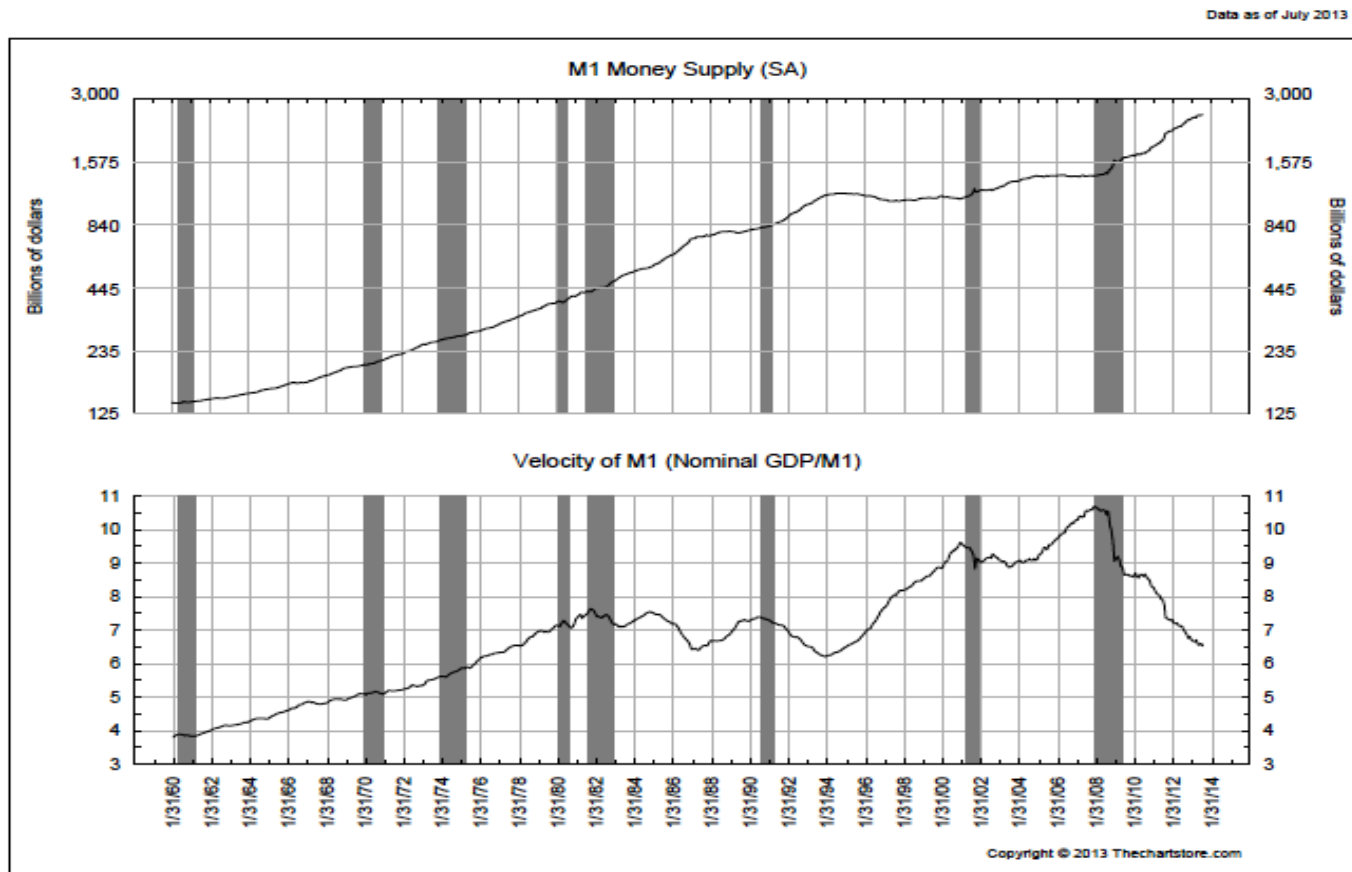
# Monetary Base, M1 & M2 Money Supply





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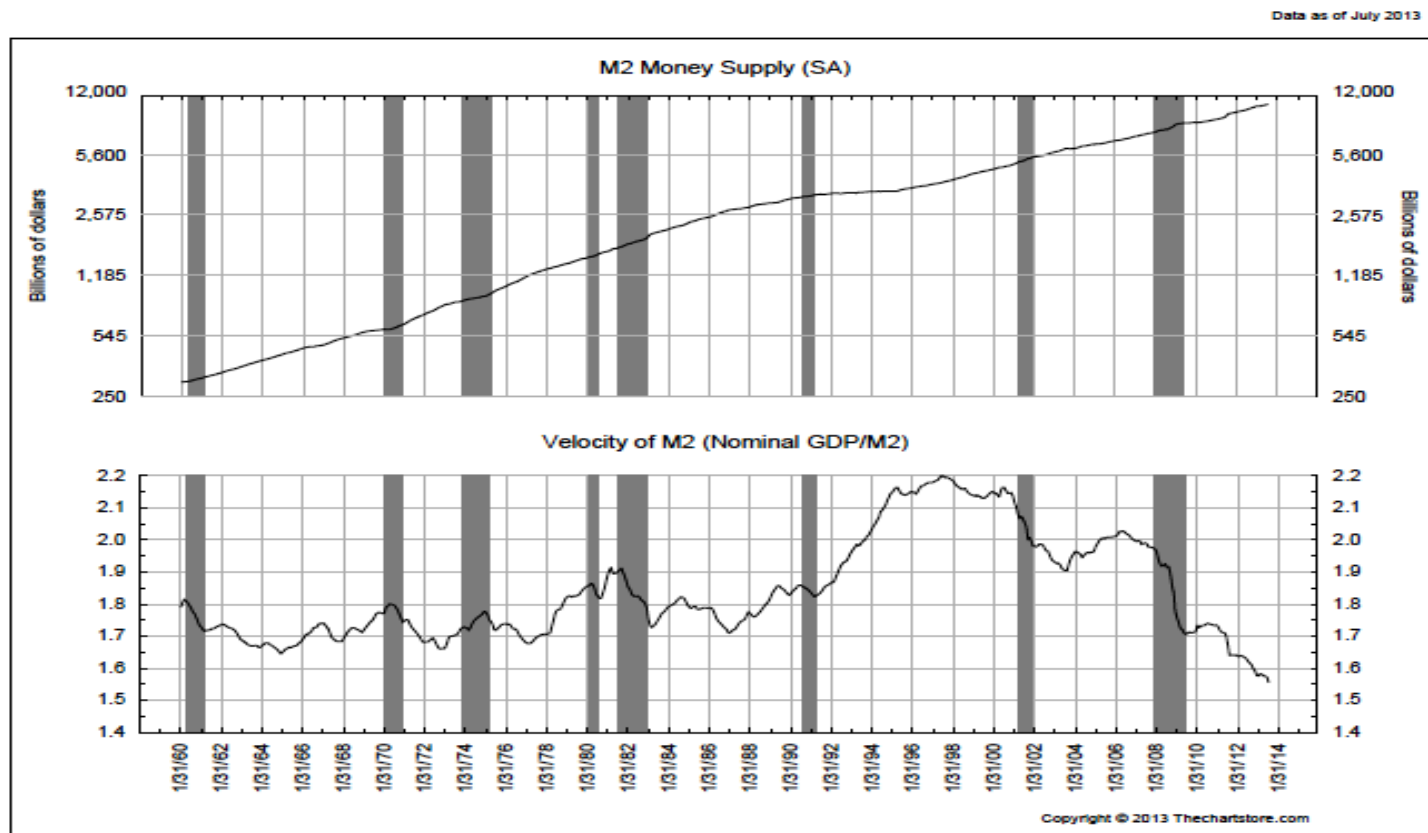
# M1 Money Supply and Velocity





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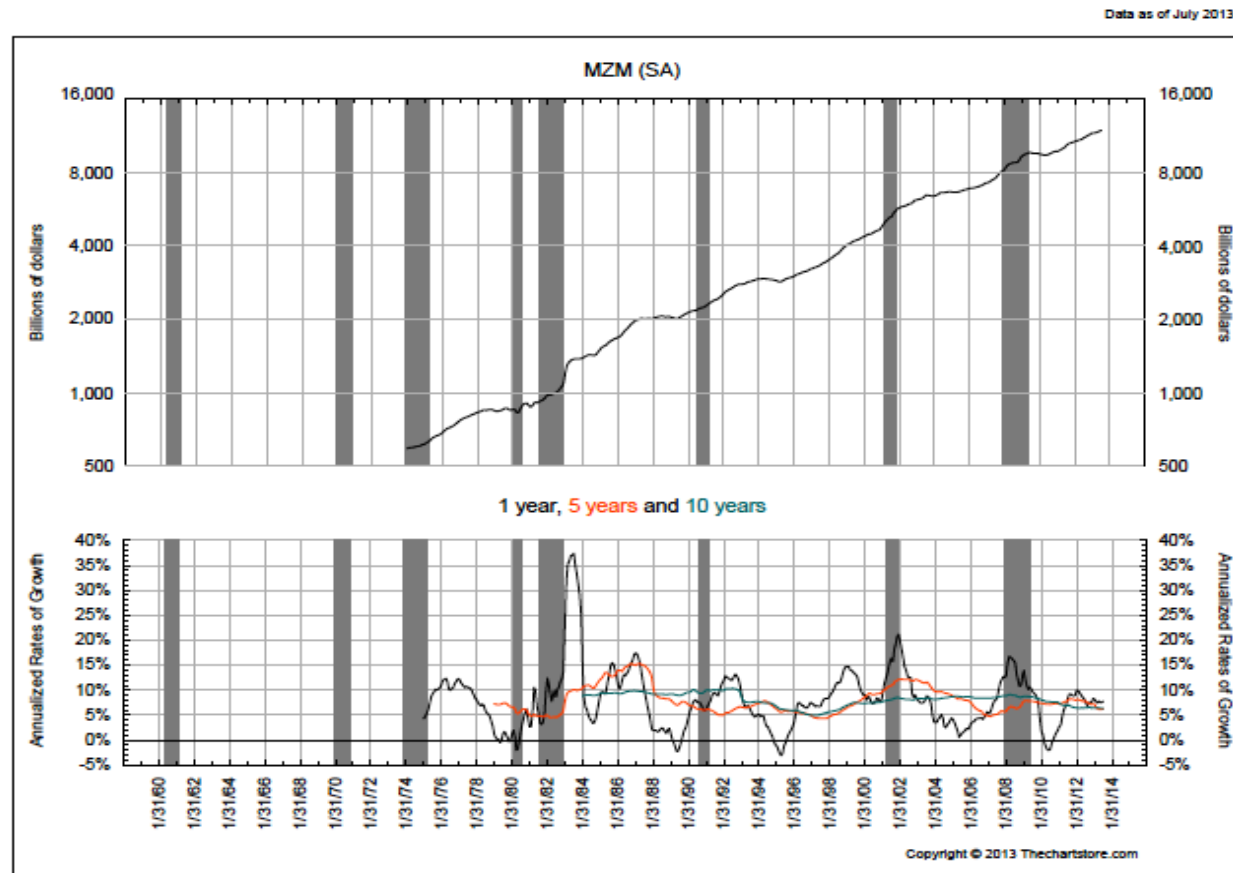
# M2 Money Supply and Velocity





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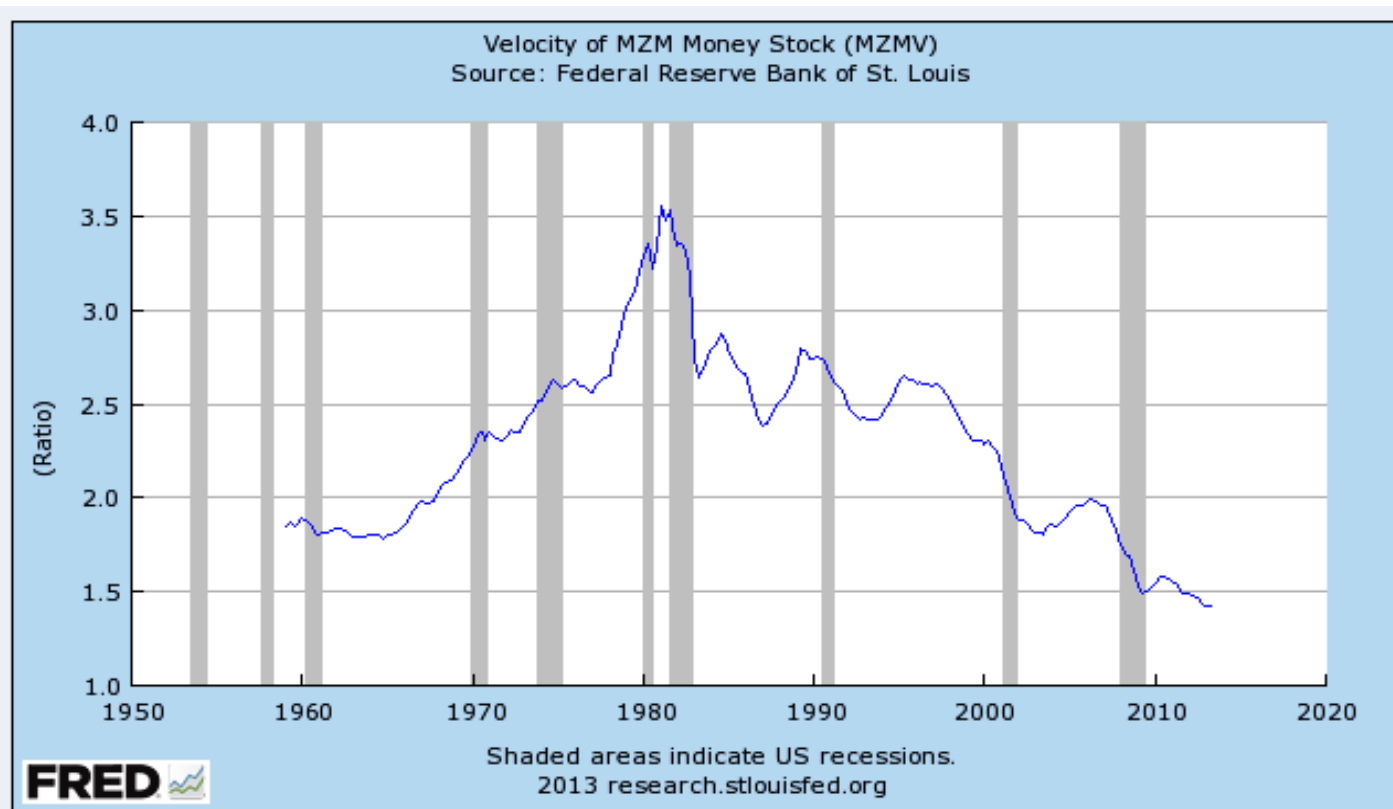
# MZM Money Supply





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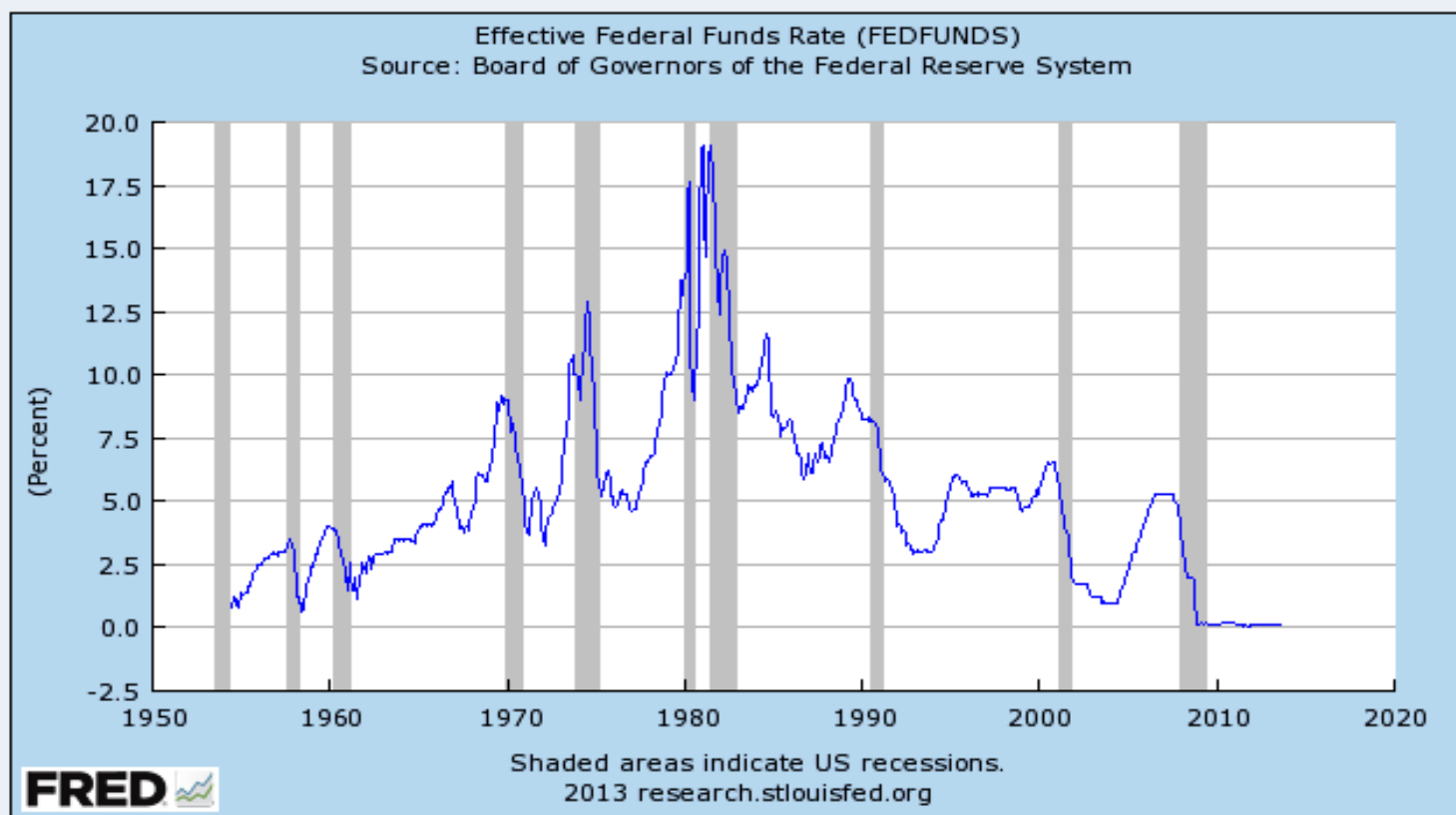
## MZM (Money with Zero Maturity) Velocity





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## Federal Funds Rate 1955 - 2013

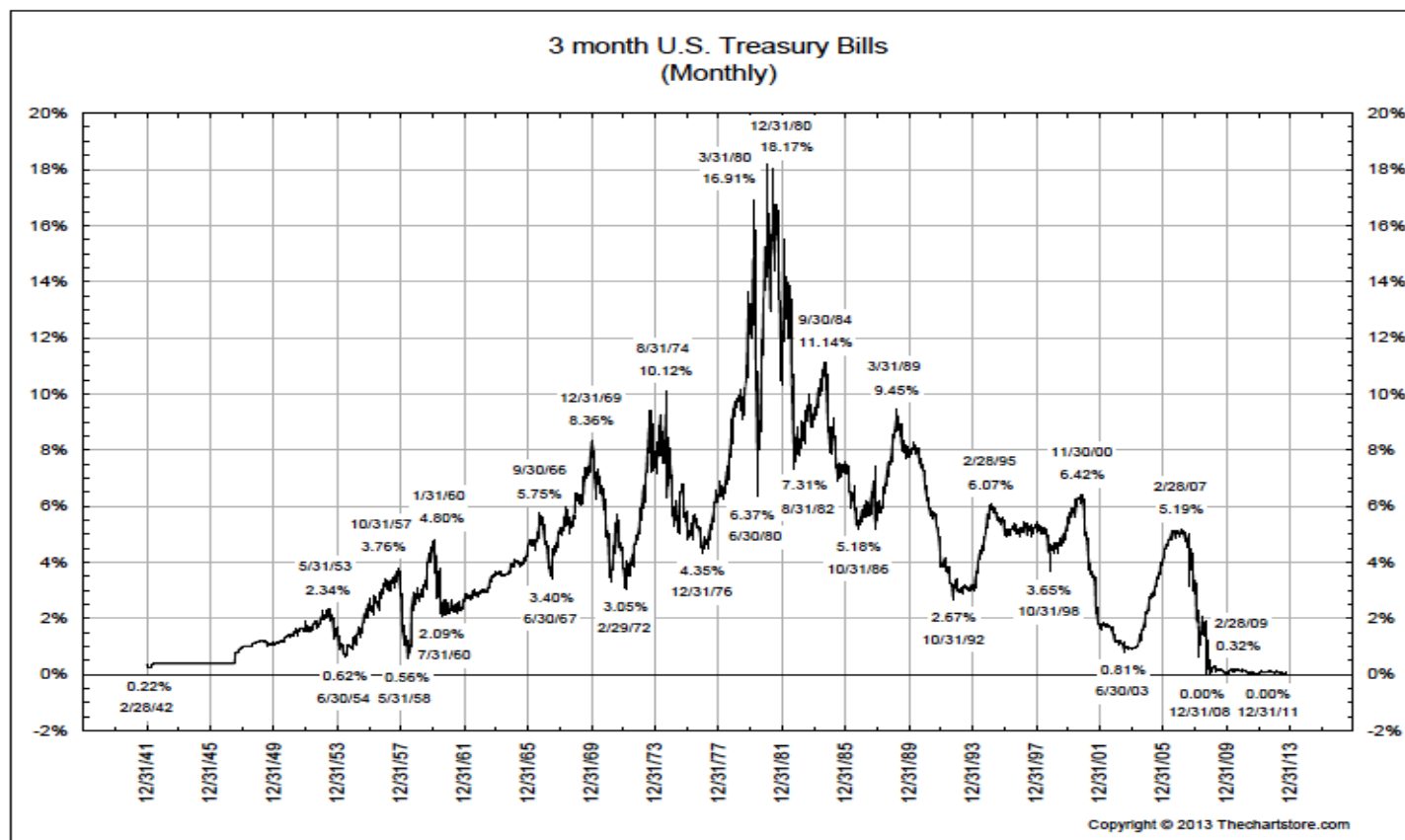




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## 3 Month US T-Bills Yields

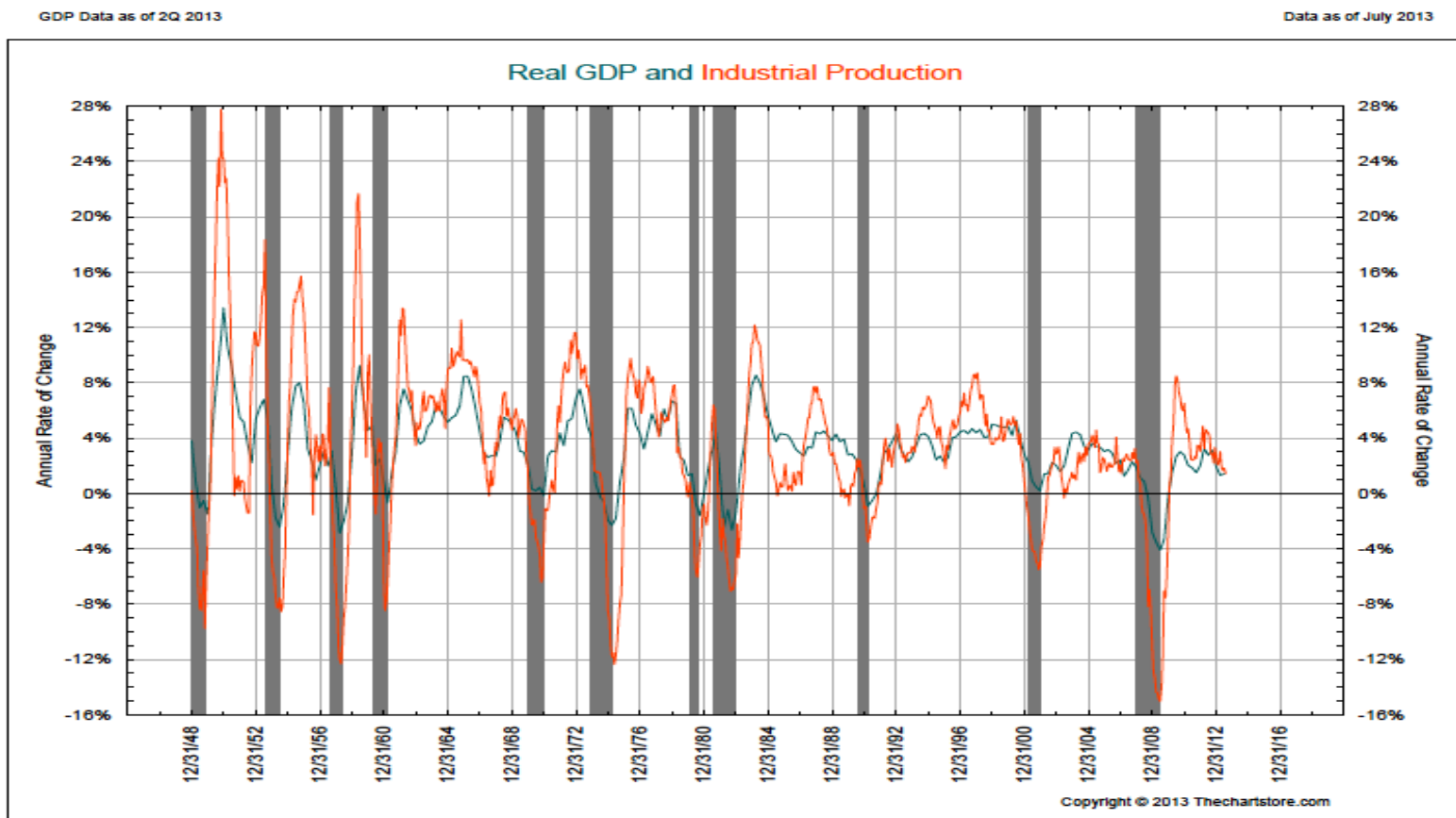
Data as of August 2013





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# Real GDP and Industrial Production

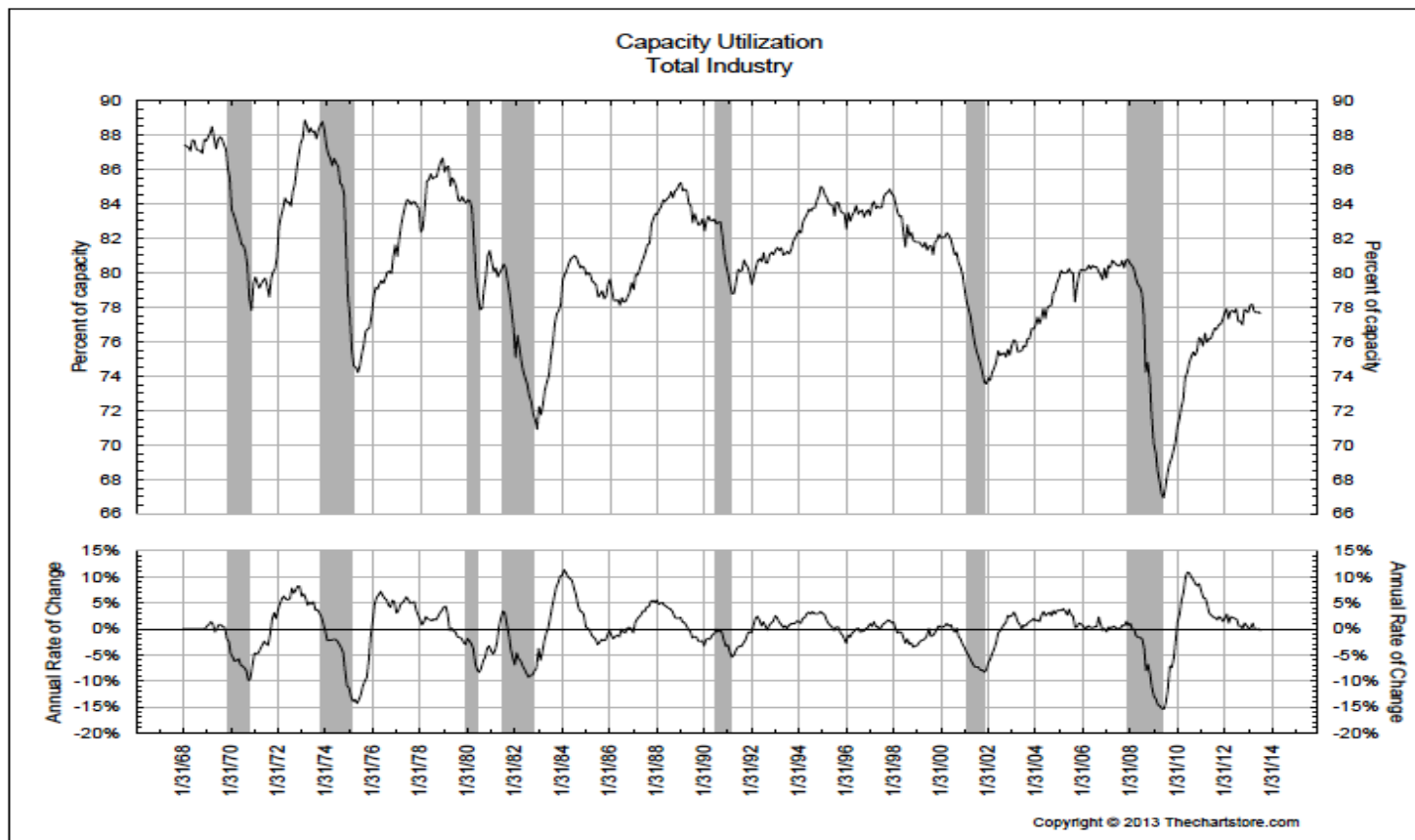




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# Capacity Utilization Total Industry

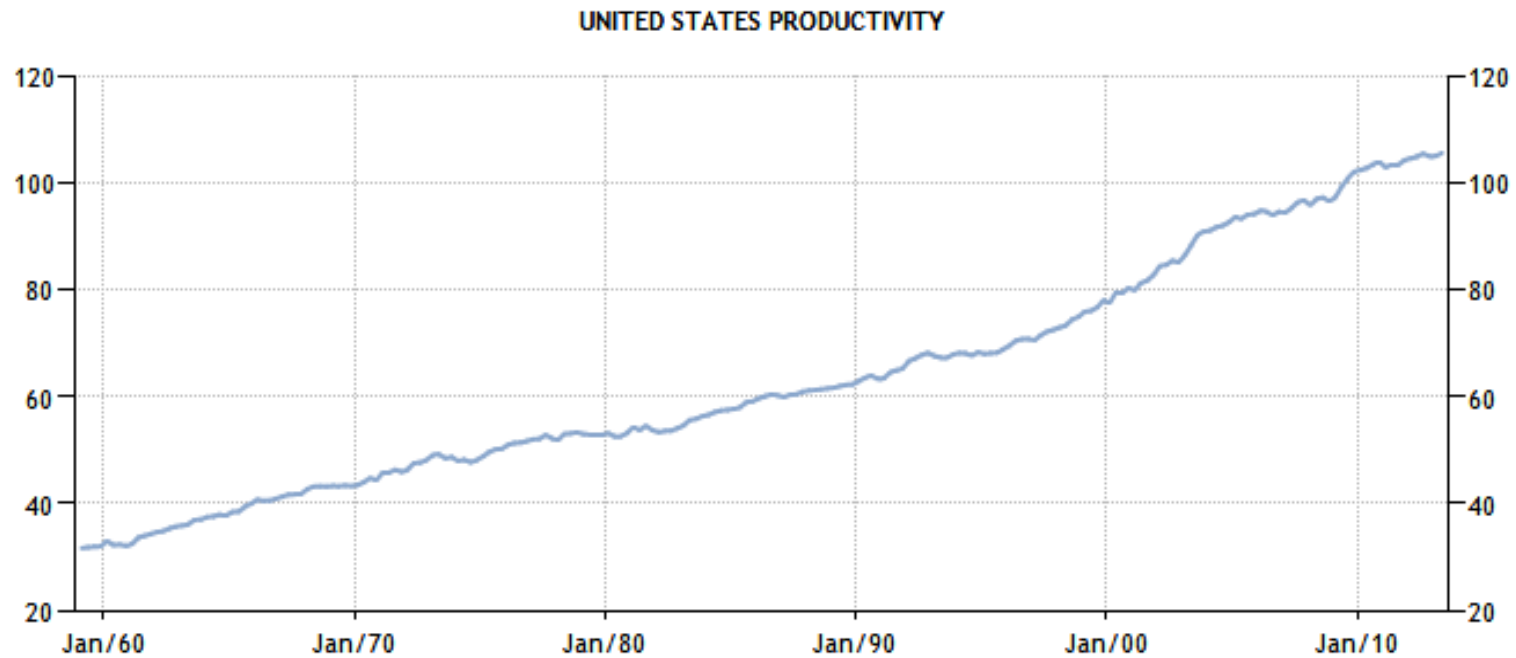
Data as of July 2013





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# USA Productivity



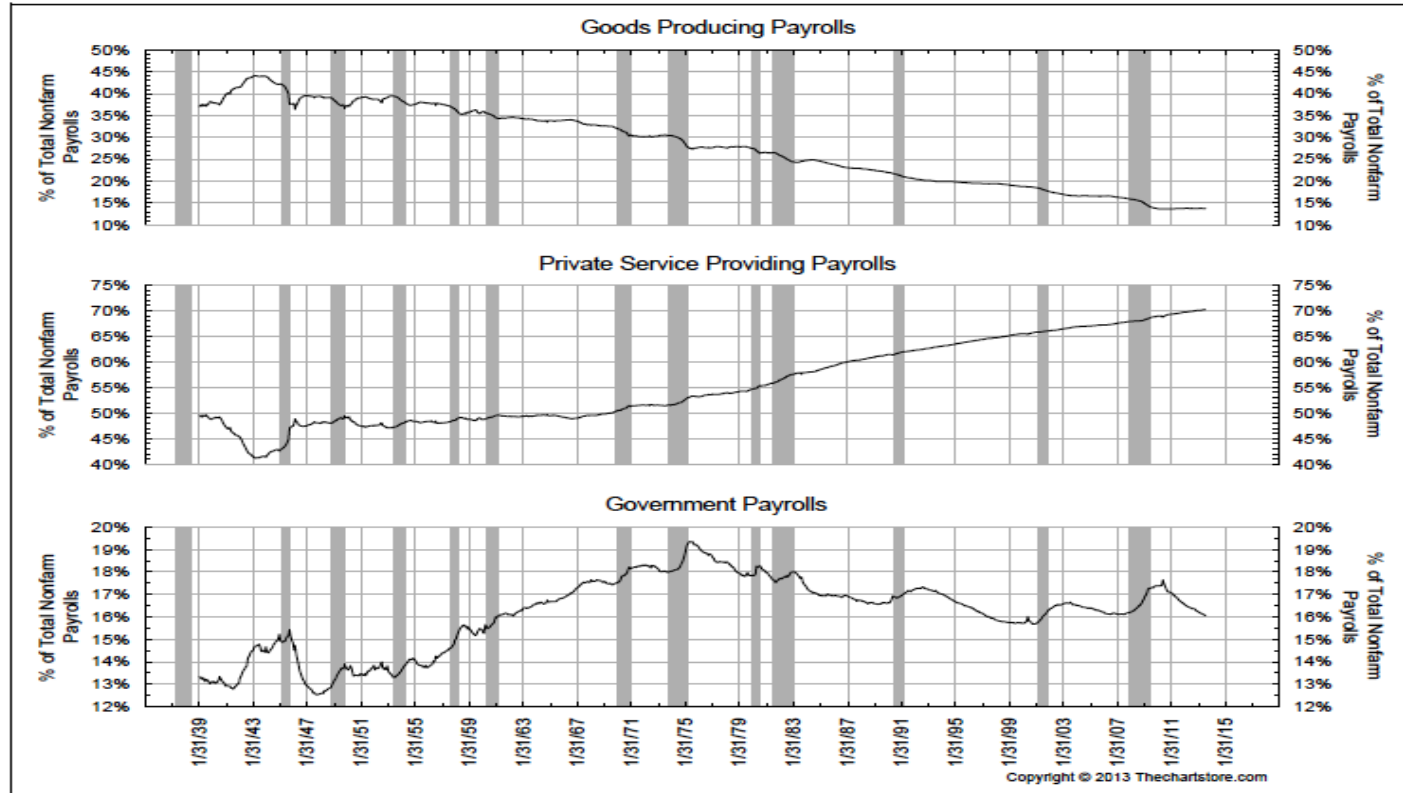
SOURCE: [WWW.TRADINGECONOMICS.COM](http://WWW.TRADINGECONOMICS.COM) | U.S. BUREAU OF LABOR STATISTICS (BLS)



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# Payrolls

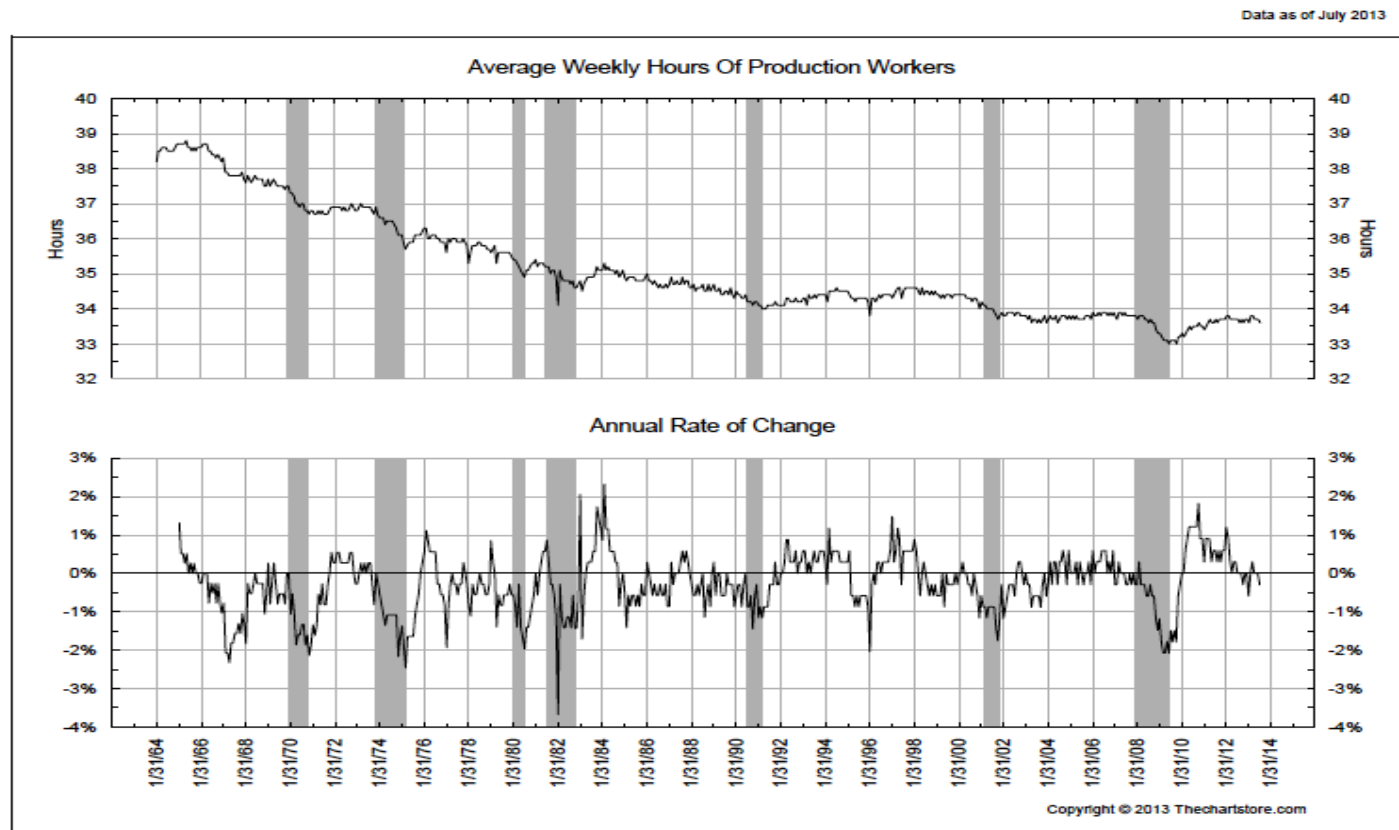
Data as of July 2013





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# Ave. Weekly Hours of Production Workers

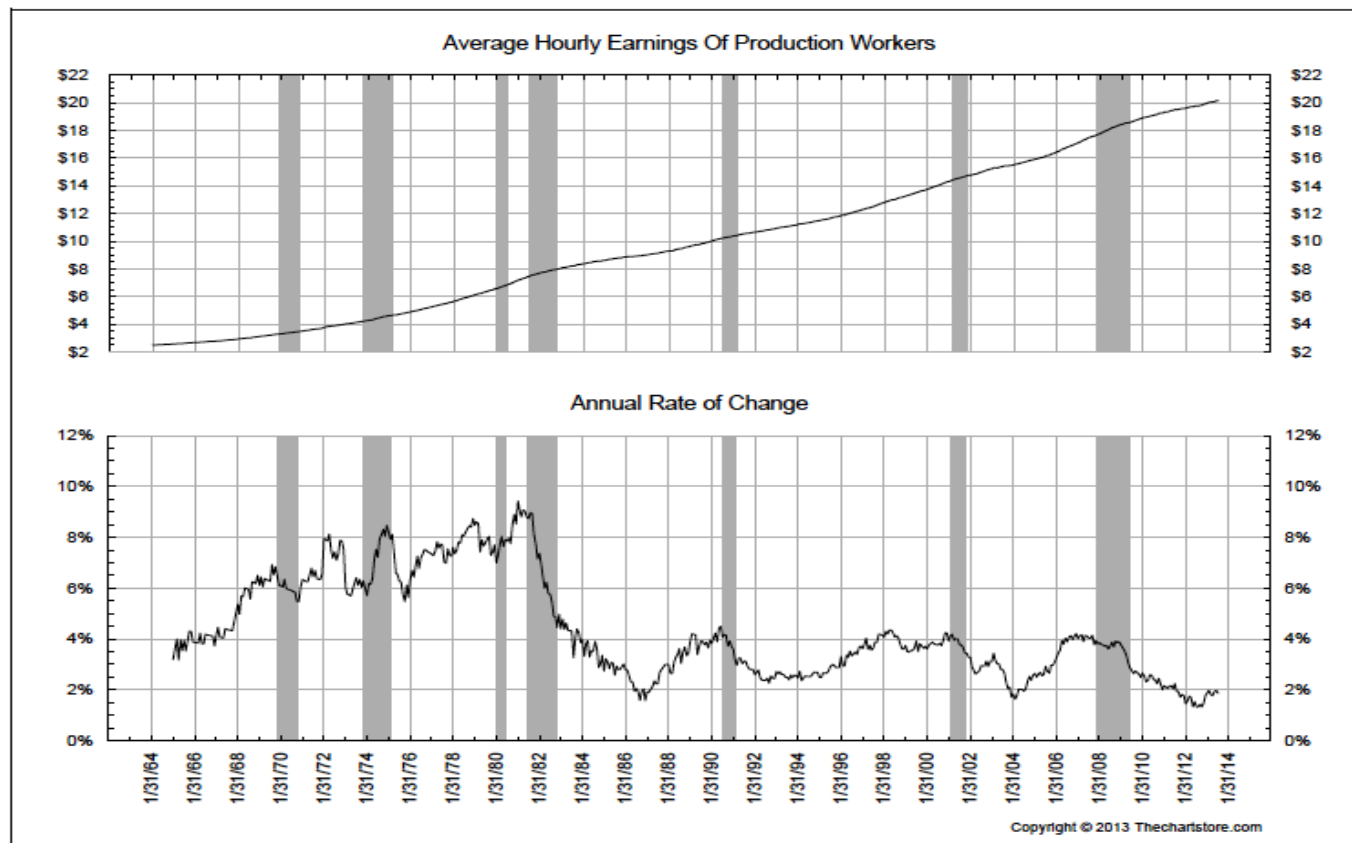




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# Ave. Hourly Earnings of Production Worker

Data as of July 2013

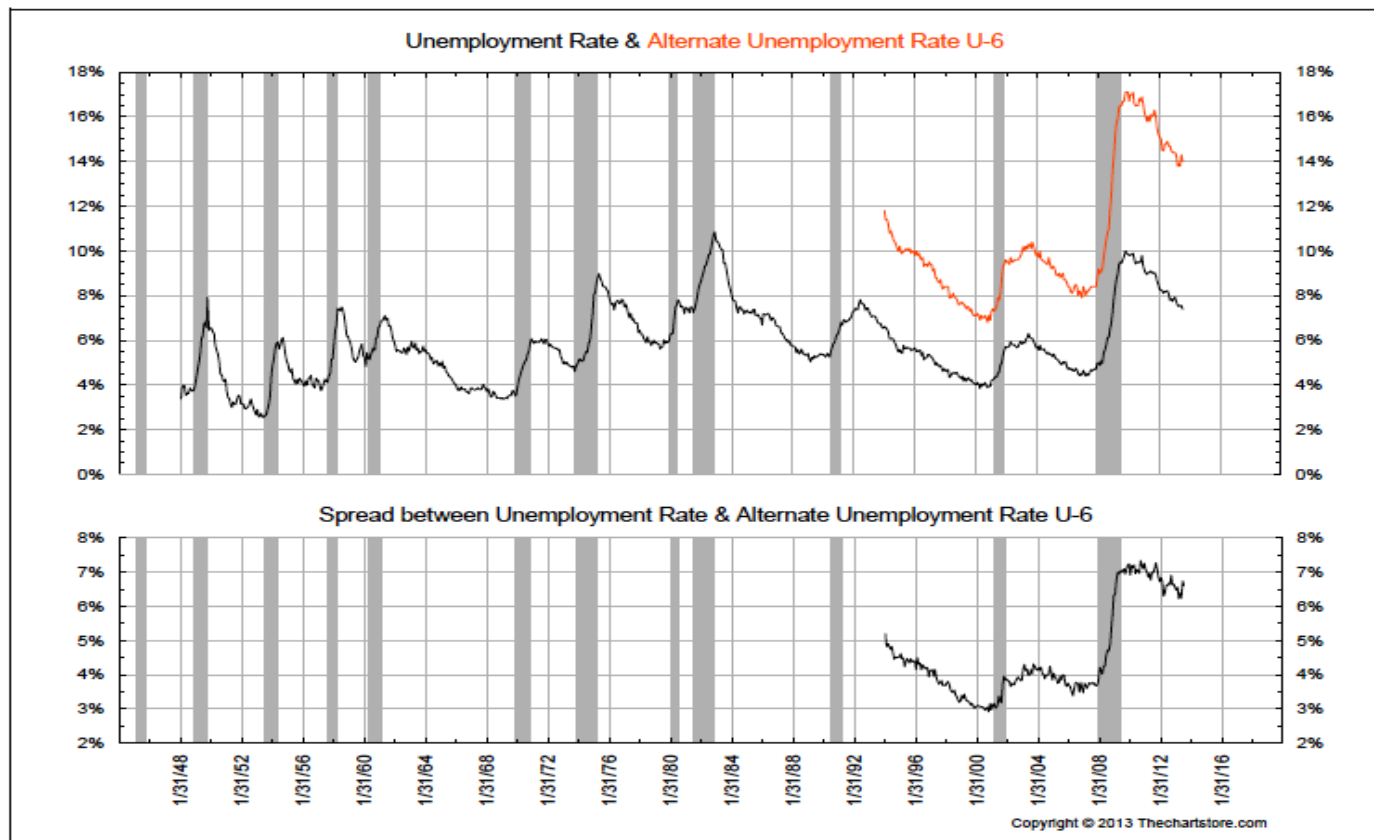




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# Unemployment Rates – U3 & U6

Data as of July 2013

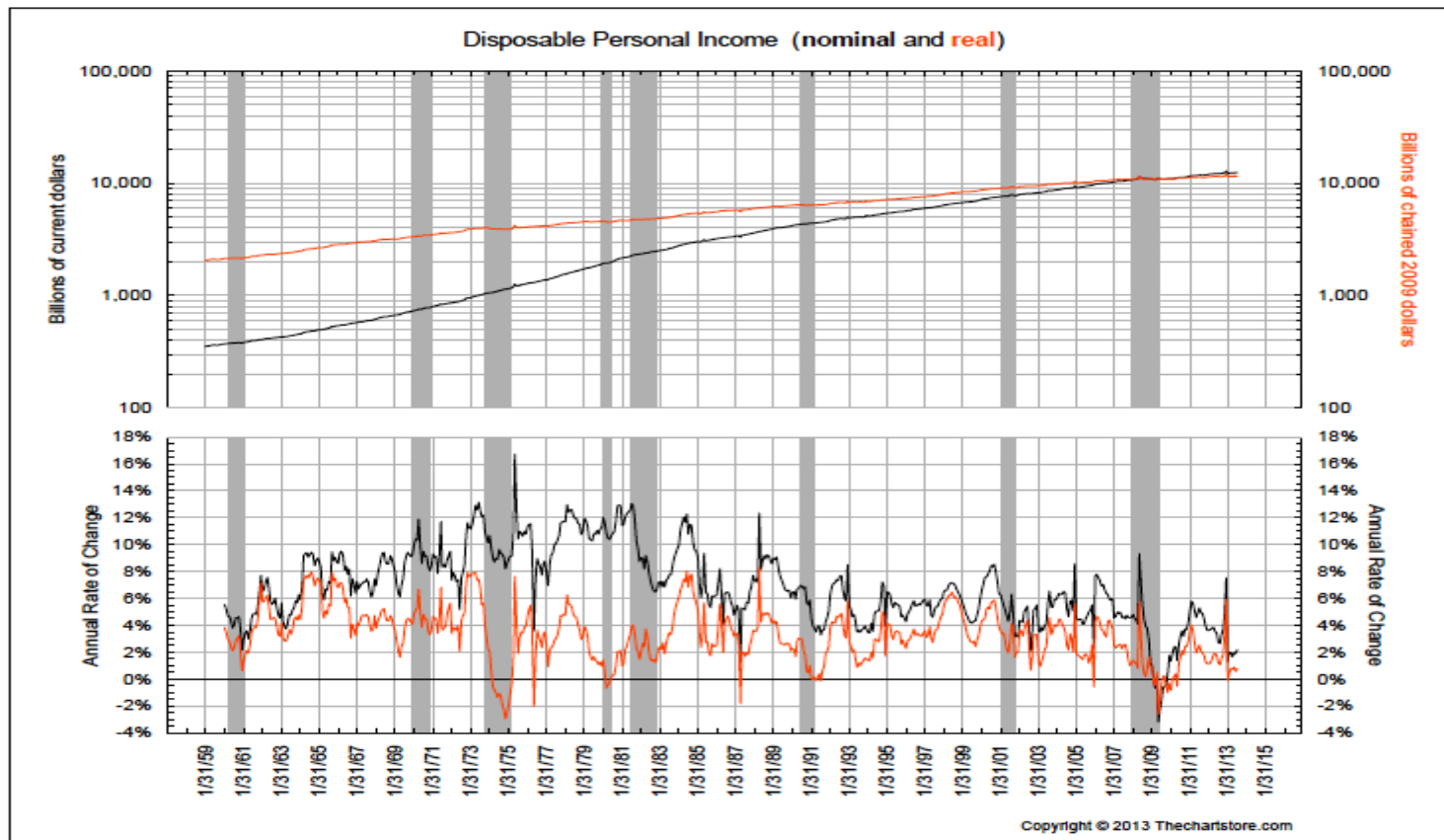




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# Disposable Personal Income

Data as of July 2013

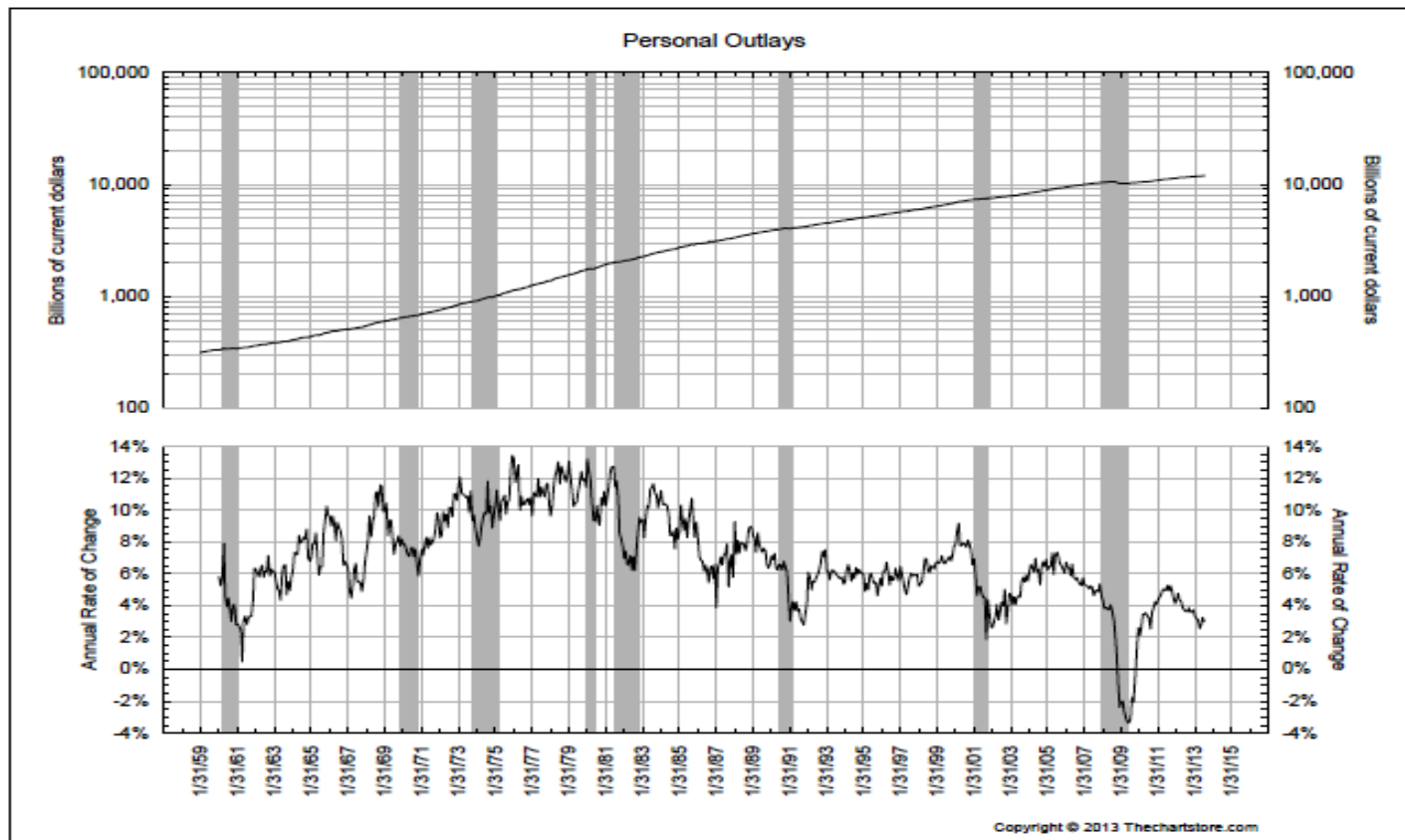




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# Personal Outlays

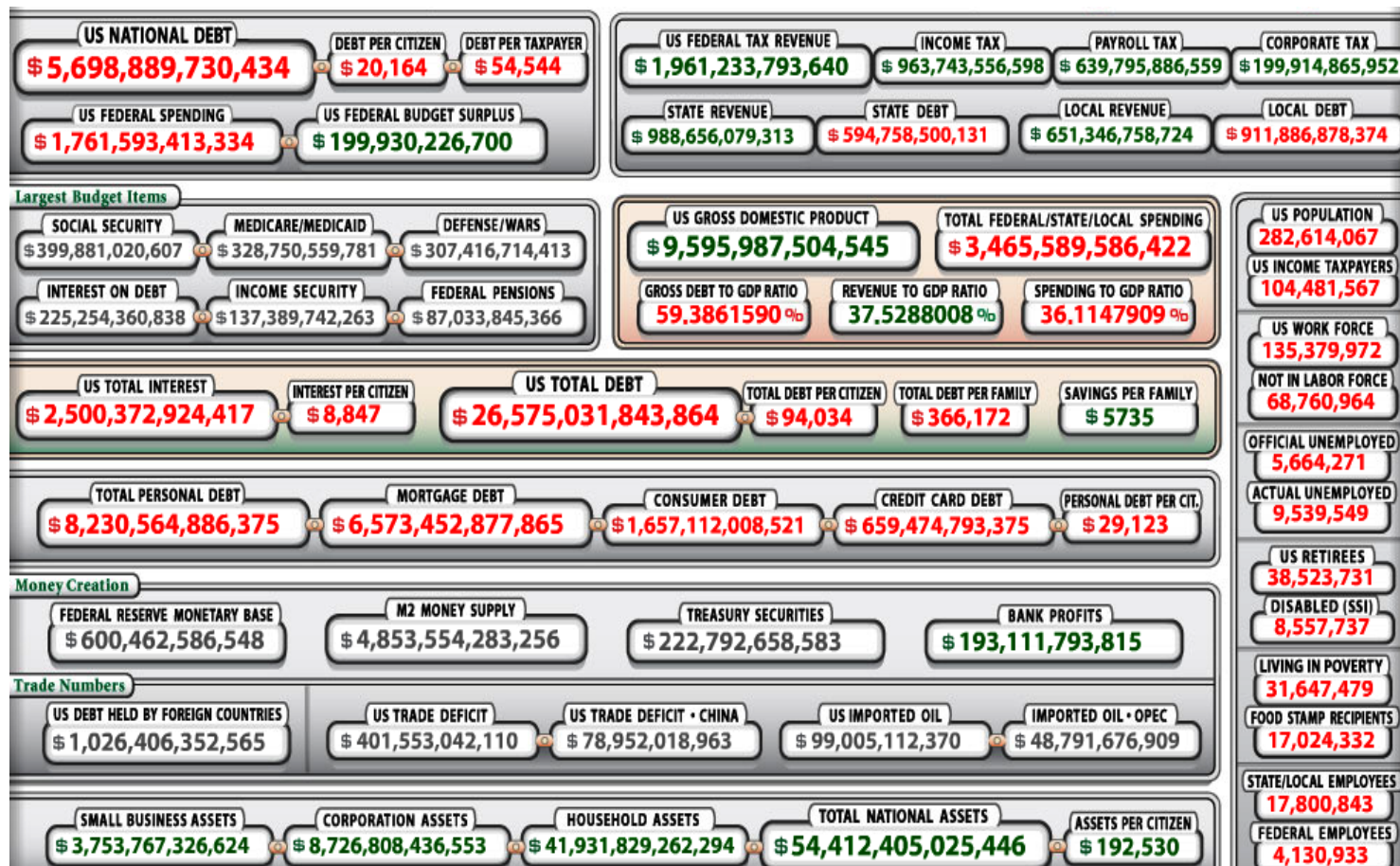
Data as of July 2013





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## US Debt Clock – 4 September 2000

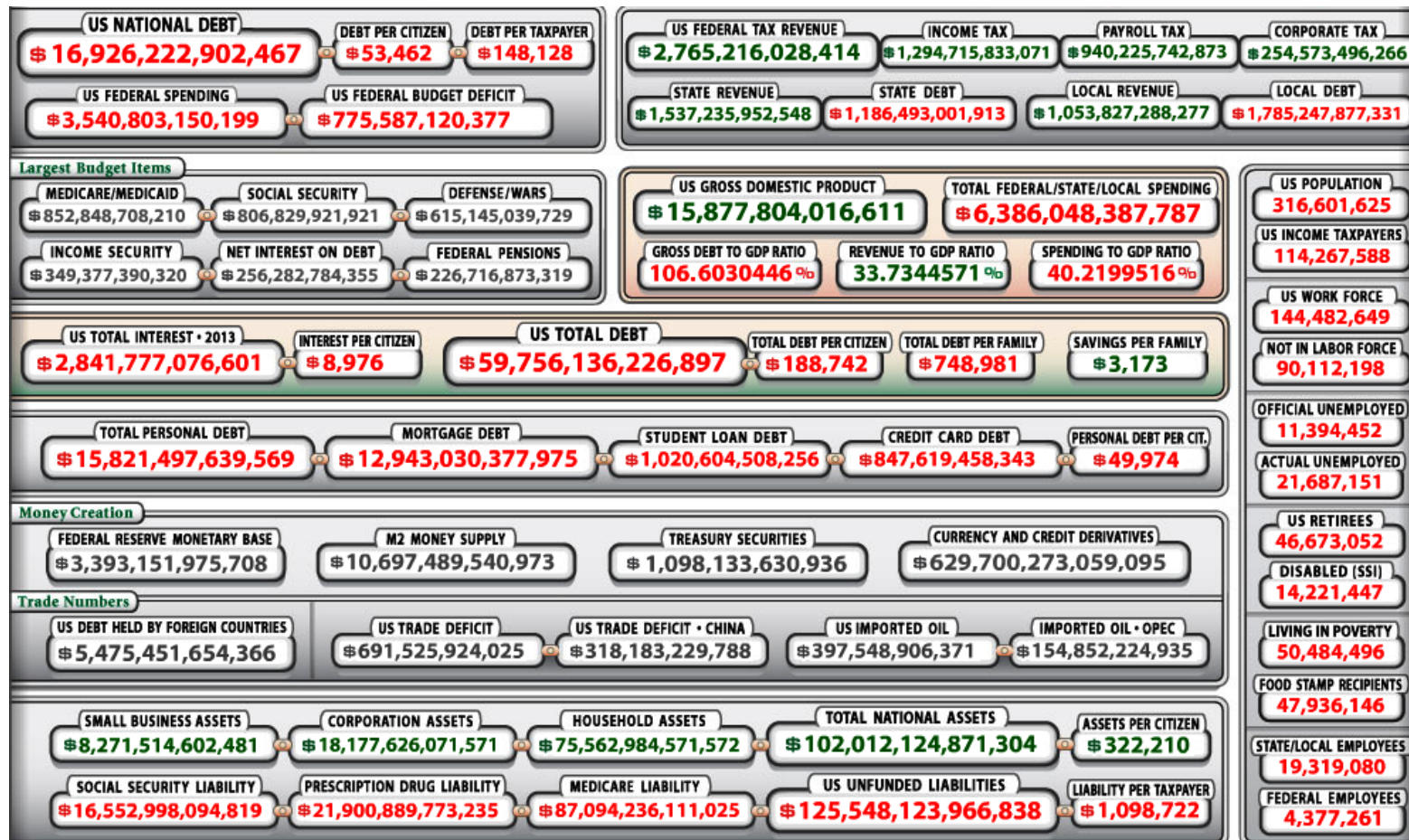


<http://www.usdebtclock.org>, 4 September 2013



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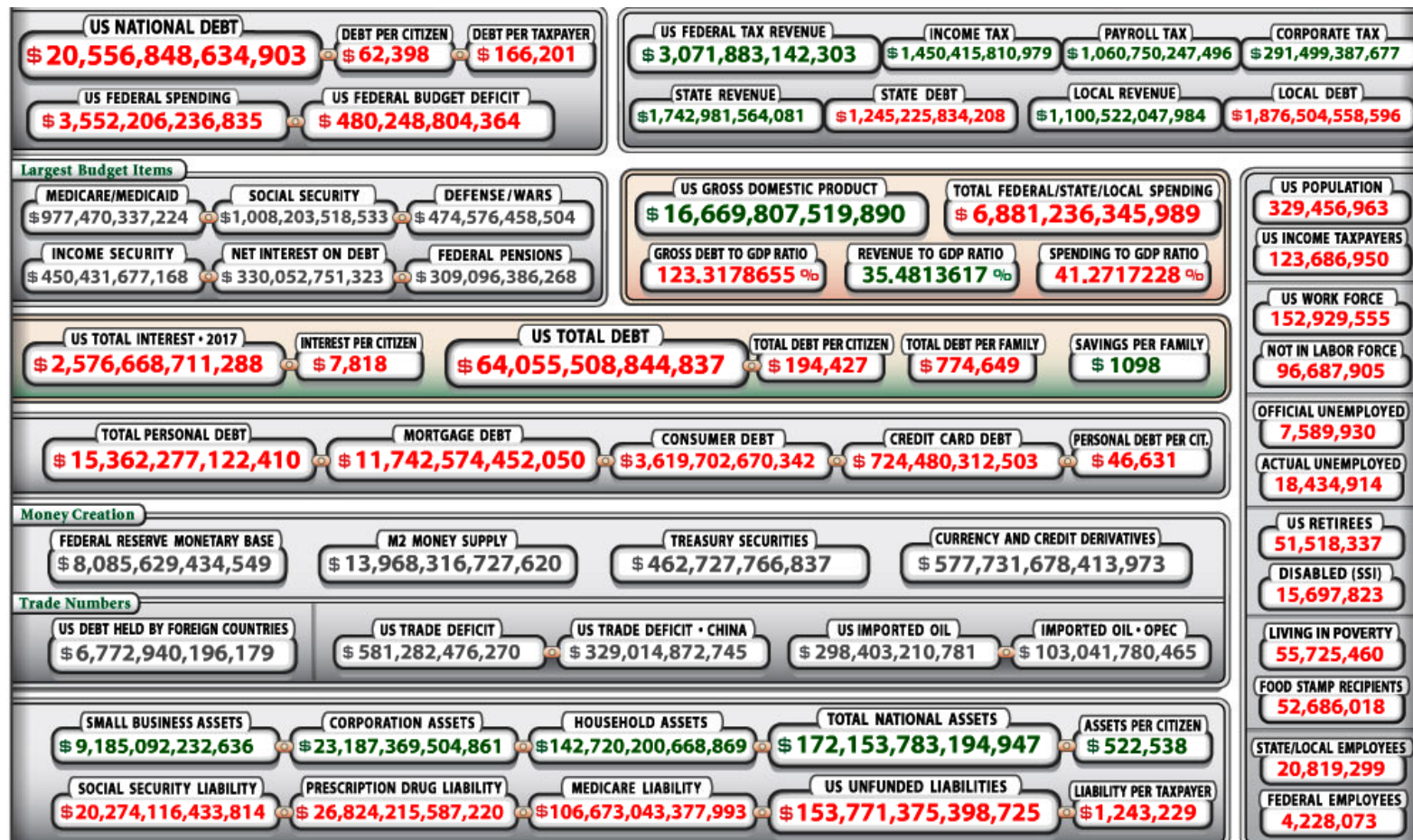
## US Debt Clock – 4 September 2013





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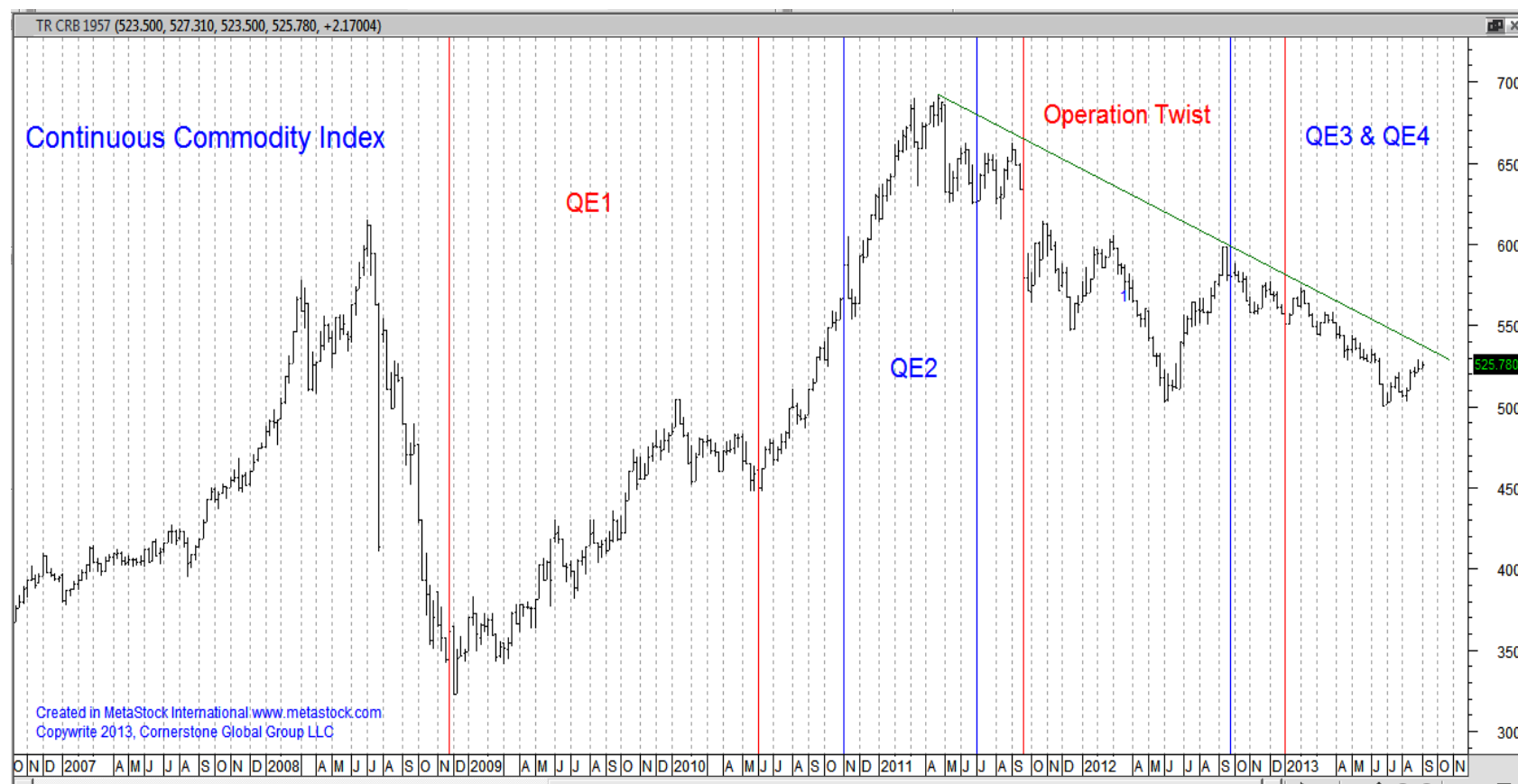
## US Debt Clock – 4 September 2017





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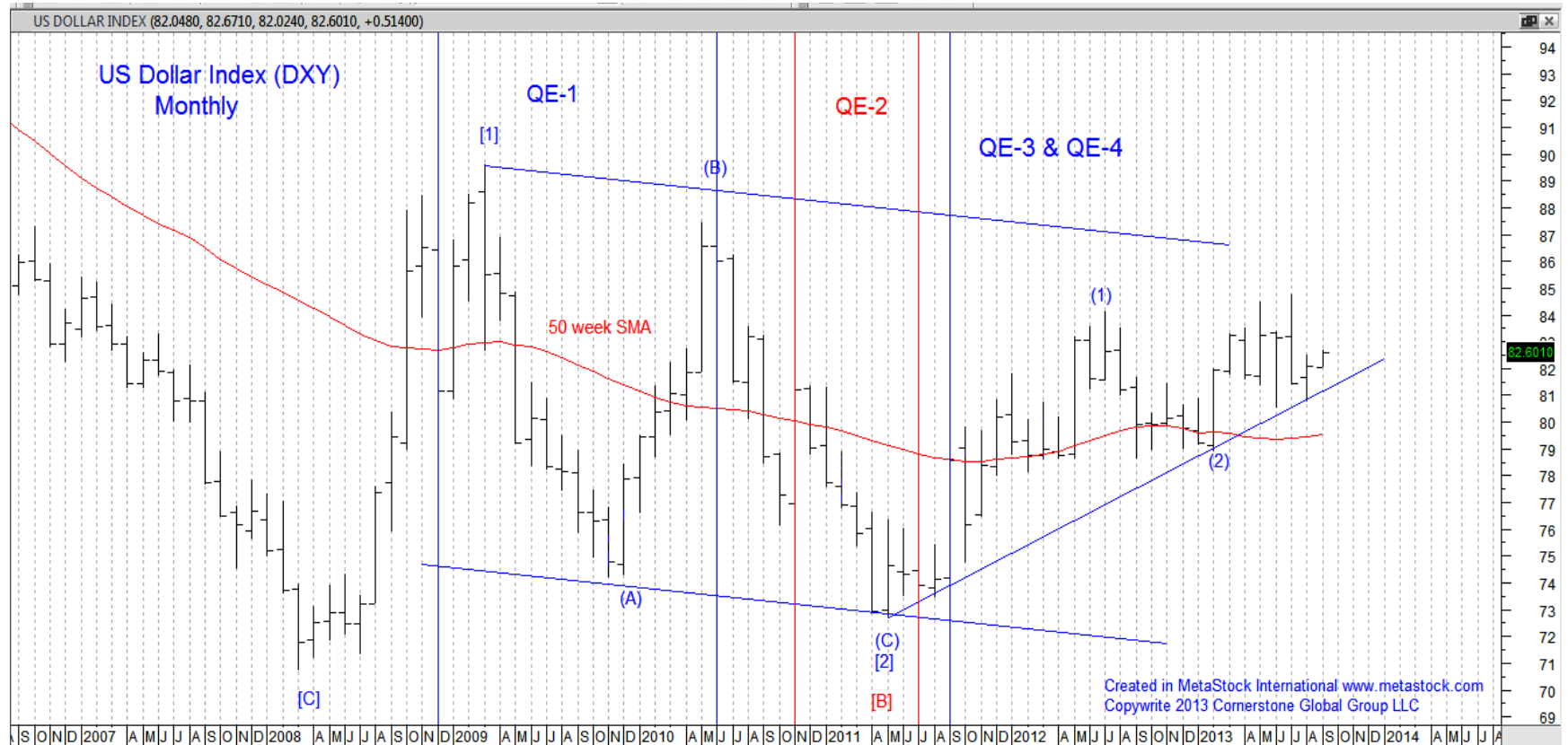
# Commodity Index CCI & QE





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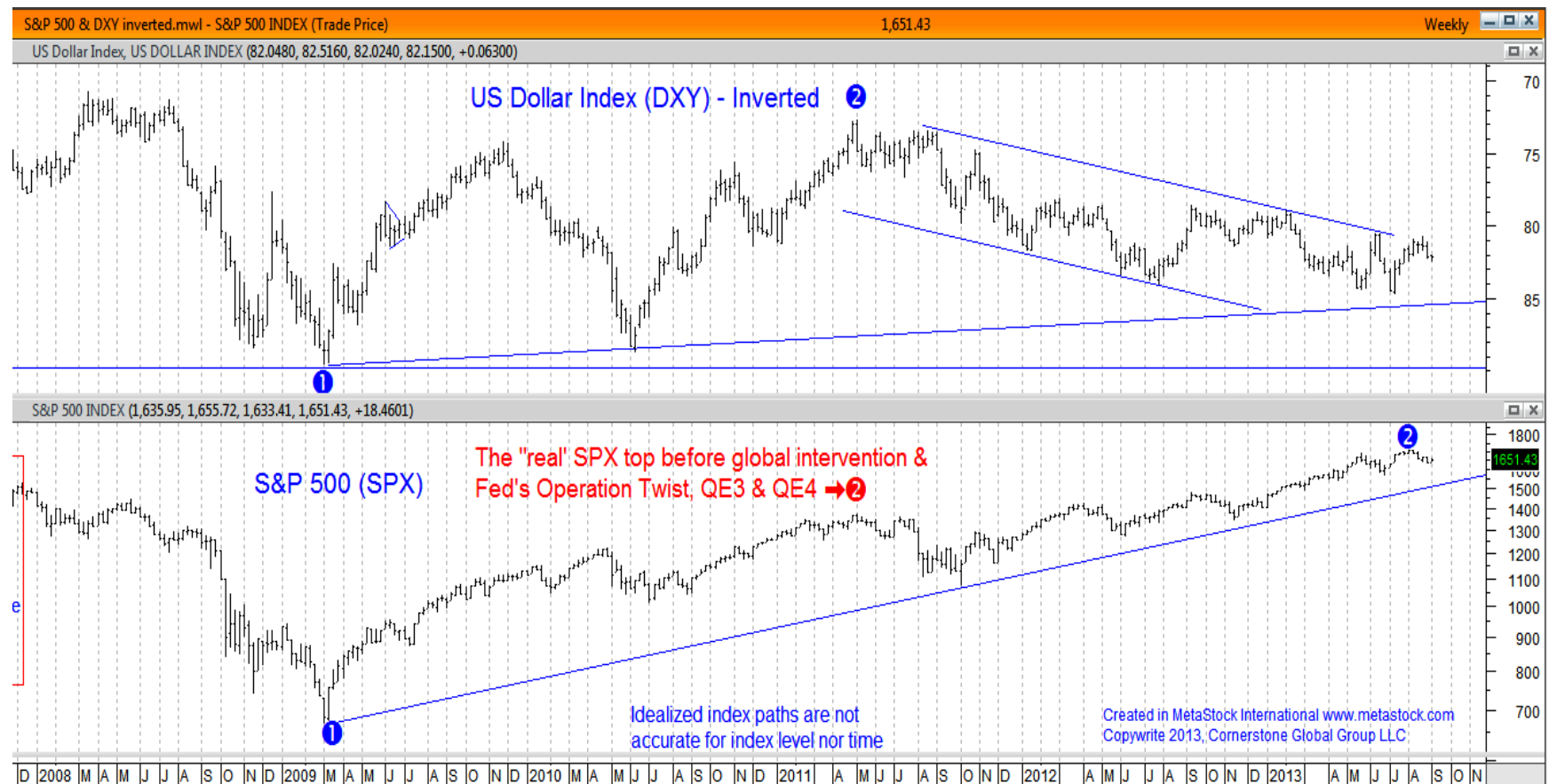
# US Dollar Index (DXY)





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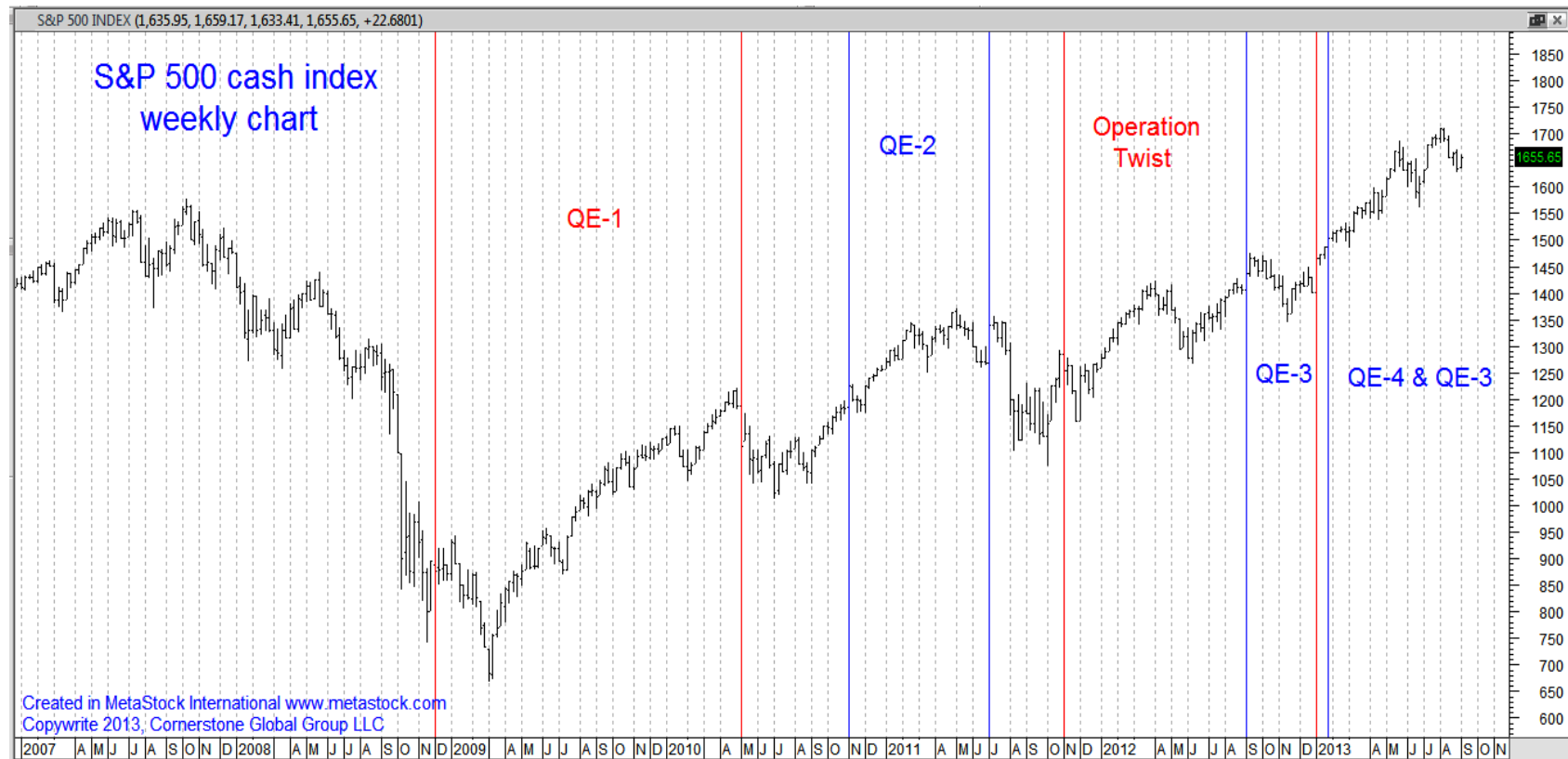
# US Dollar Index Inverted & S&P 500





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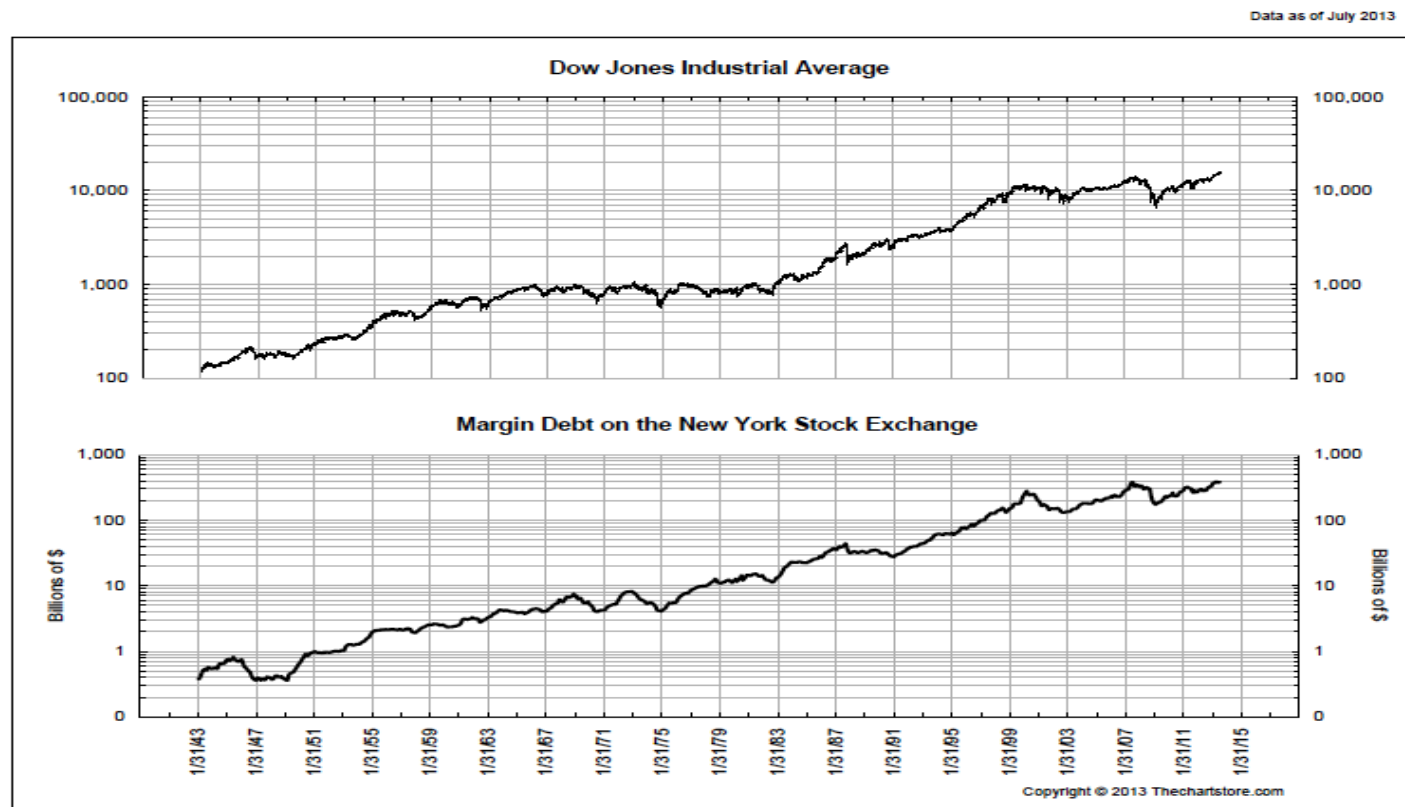
## S&P 500 and QE





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## DJIA & Margin Debt

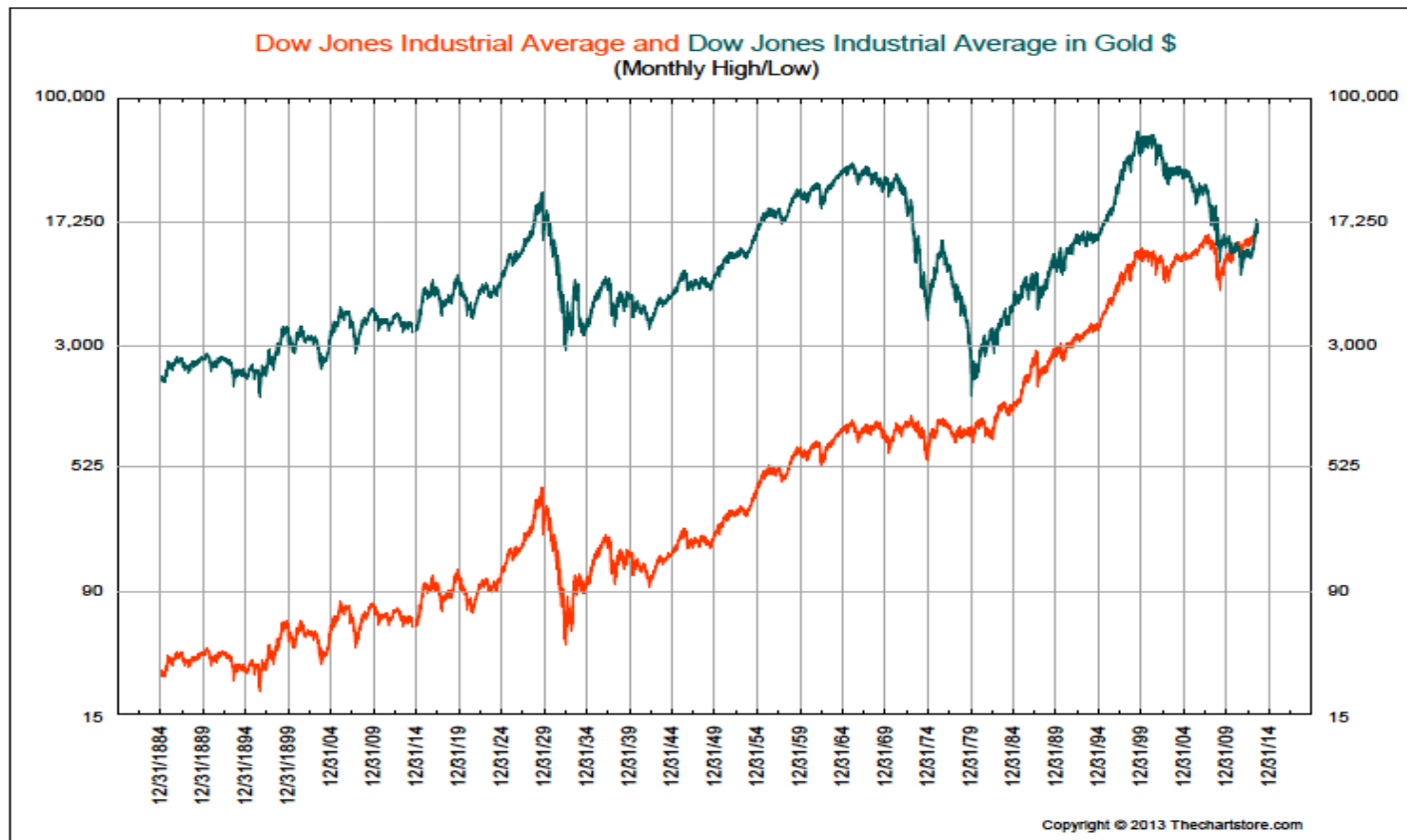




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## DJIA & DJIA in Gold

Data as of August 2013

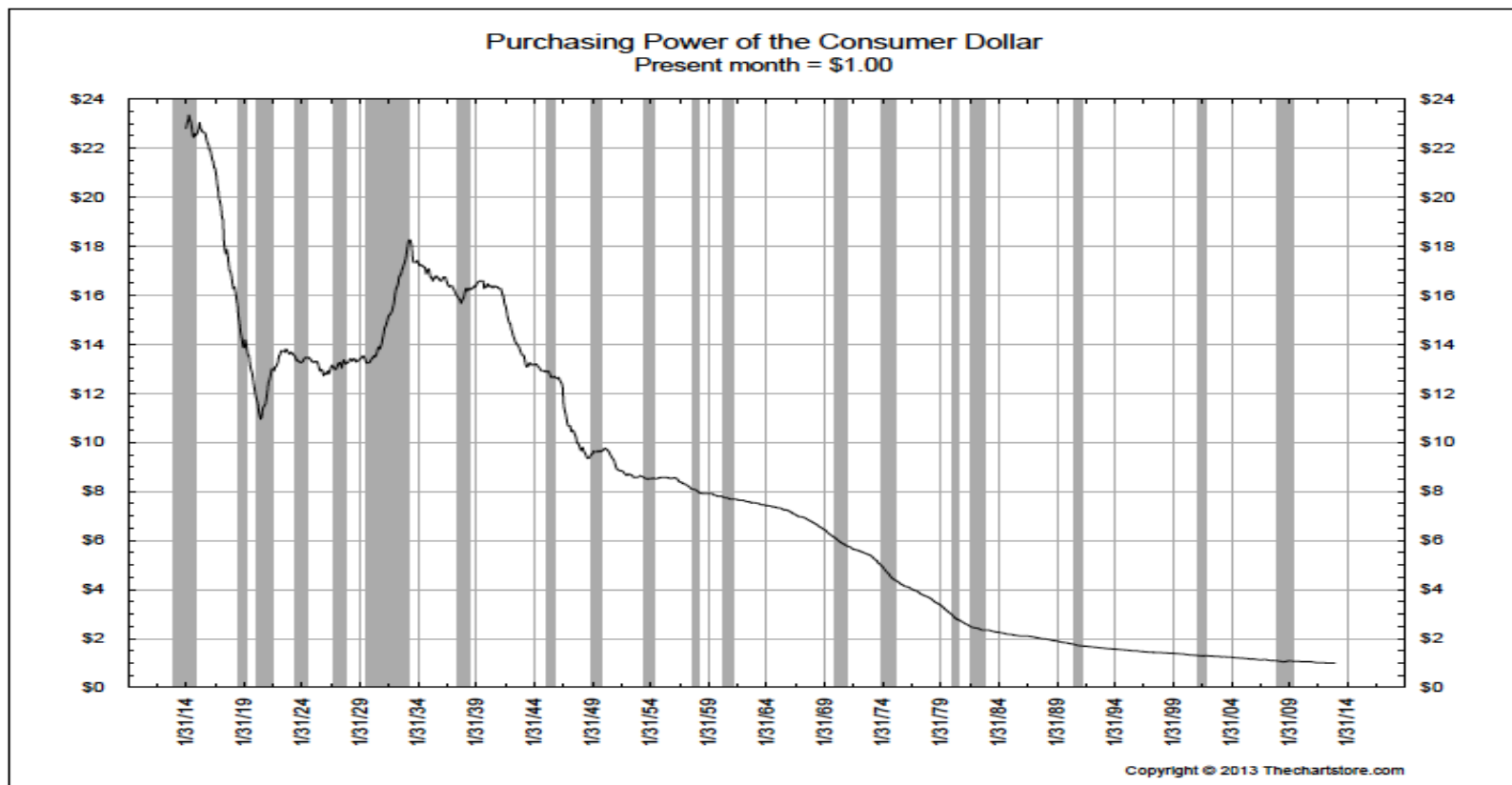




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# Purchasing Power of \$1

Data as of December 2012





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## 30 Year US T-Bond





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## Historical – S&P 500 Secular Bear Markets

- 9/30/06, -70% decline, 171 months to bottom, 263 months to recover prior high
- 9/30/29, -69% decline, 237 months to bottom, 360 months to recover prior high
- 11/30/68, -66% decline, 165 months to bottom, 289 months to recover prior high
- 3/30/00, -65% decline so far, 108 months to 3/30/09 low so far



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## **US Monetary Policy Results & Implications:**

- The Congress established the statutory objectives for monetary policy:
  - Maximum employment
  - Stable prices
  - Moderate long-term interest rates



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## **US Monetary Policy Results & Implications:**

- Policy of “LSP” and low rates resulted in:
  - A stubborn unemployment rate
    - U3 rate of 7.4%, average 40 weeks of unemployment
    - U6 rate of 14%
  - A low growth rate of real GDP
    - 1.1% annualized for the first quarter 2013
    - 2.5% annualized for the second quarter 2013
  - Long term rates – 30 year T-Bond
    - 2.4% in July 2012
    - 3.9% in August 2013



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## **US Monetary Policy Results & Implications:**

- Policy of “LSP” and low rates resulted in:
  - A current Inflation rate of 2%
  - An increased Fed balance sheet at \$3.7 trillion
  - Stimulation of more risky asset investments in US
  - Stimulation of emerging markets
  - Concern with lack of impact of QE3 & QE4
  - Tapering fears
    - Probable volatility in many asset classes
    - Premium on hedging
    - Cost to Federal Reserve



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## **US Monetary Policy Results & Implications:**

- US Equity Markets – QE induced bubble
- Concerning factors in August
  - Over valued - Schiller PE
  - Over bullish - sentiment
  - Over bought - technical indicators
  - Rising interest rate environment
  - Secular bear market status



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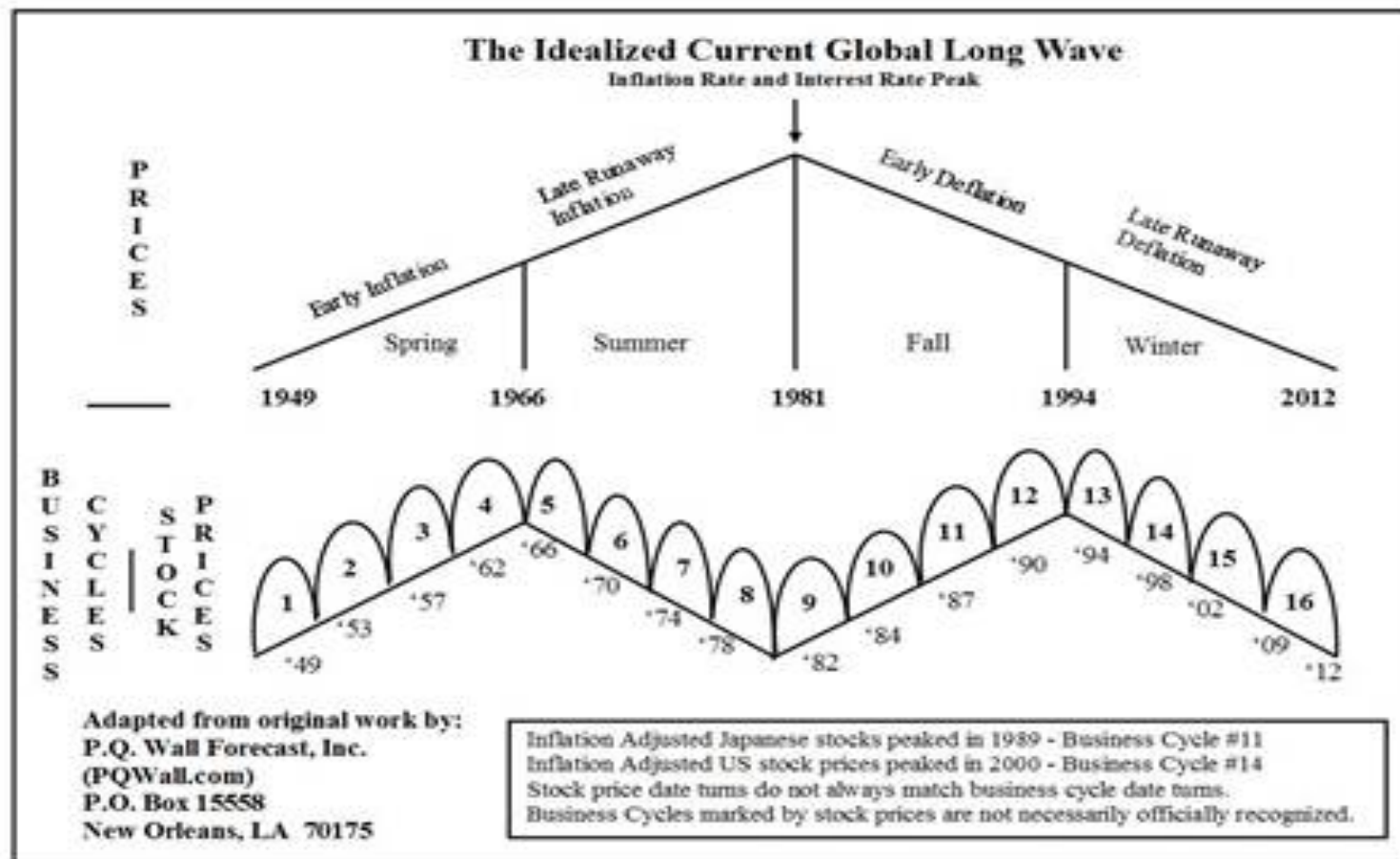
## Summary & Conclusion

- Natural market adjustments delayed
- Excess debt and too much capacity
- Probability continues to favor:
  - Commodities indices lower
  - US Dollar Index higher
  - A USA equities top, trend to a major bottom
  - US Bond yields bottom, then long upward trend
  - Global economies to bottom after equities
- *If so, great boom ahead in equities*



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## Summary & Conclusion





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## Take Away Summary

- There can be few fields of human behavior in which history counts so little as in the world of finance. Past experience, to the extent that it is part of memory at all, is dismissed as the primitive refuge of those who do not have insight to appreciate the incredible wonders of the present.

John Kenneth Galbraith



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