

Key Points

- ◆ Rate cuts were panic move by the Fed
- ◆ Pumping liquidity did no good
- ◆ A Cycle delayed only gets bigger and more dangerous

The Fed Buys a Round

(With an emergency ½ point rate cut)

John Riley, Chief Strategist

The party was beginning to wind down, some people started to leave and there was even talk of some party-goers getting sick from overindulging.

But have no fear, Bartender Bernanke is here, and he's got just what everybody needs – a little more of the hair of the dog that bit 'cha! So everybody back into the bar, the party isn't over, the drinks are on the Fed!

And just like that, everybody forgets all their problems and crowds back into the party like nothing ever happened. They rush past the bodies of the mortgage brokers too sick to stand on their own, they step over the collapsing Dollars on the floor and they completely ignore those party-pooper, teetotaler Bears outside warning about the evils of excess and greed.

Panic

The markets have been marked by a single investment theme recently – PANIC. Panic drove markets down as investors wanted out and panic drove them back up as investors panicked back into the market, not wanting to miss a single penny of gain.

The surprise was that panic was not limited to individual investors. No, it swept through the hedge funds and professionals that should know better. Worst though, it even infected the Federal Reserve. They are supposed to be the stable guiding hand of the economy. They are supposed to be in control.

Friday morning they were anything but. They were reactionary and reckless. They saw the US market having taken a few hits in the past couple of weeks and the housing market reeling from collapsing prices, but it wasn't until the overseas markets started to fold, and fold they did, that the Fed decided to act.

The Federal Reserve is nothing if not organized and methodical. The FOMC meets eight times a year, usually on a Tuesday. We've all seen what

happens on those days, waiting to see if smoke will come from the chimney, I mean what direction interest rates will go. And we've all seen how the market reacts to the FOMC's announcements. The markets wait eagerly for the news from the Fed.

Moves on interest rates outside of the normally scheduled FOMC meetings are rare. And ½ point cuts in the discount rate are almost as rare. It shows the Fed is in panic mode. The Fed's decision to cut rates hours before the markets opened in NY was as much to calm the US markets as it was to settle the overseas markets.

Liquidity

Markets were driven down recently as investors in virtually every market, stocks, bonds, and commodities were trying to re-liquefy as quickly as possible. It didn't matter what the investment was, it didn't matter what the fundamentals were, all they wanted was to be a bit more liquid, have a bit more cash.

It goes back to our article ("Money, Money...") written last month. The markets had ground to a halt because of a lack of liquidity. And investors wanted nothing more than to re-liquefy.

For the past couple of weeks, the Fed pumped tens of billions of dollars into the system, trying to help float the markets. But none of it helped. That was the scary part. And that is what probably got the attention of the Fed.

So they did the ultimate, they lowered the Discount Rate. There is nothing more powerful the Fed can do. This is the Fed at its most influential.

Consensus in Agreement

Already accolades are pouring in from every corner of the bar... errr... Wall Street praising the Fed for their actions. One head of a mid-size brokerage said it was "exactly the right thing to do" as Bernanke topped off his Vodka Martini. A Wall Street strategist was heard to say "We knew the Fed wouldn't let us down..." as he handed an empty beer stein to the ever-ready bartender. Smiles were on everyone's faces



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Key Points

- ◆ Will the Fed always come to the rescue to bail out investors?
- ◆ What happens to markets without risk?
- ◆ Is the Fed bigger than natural economic cycles?

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again as the sunrise shone through their newly filled drink glasses raised in honor of a generous barkeep.

Conclusion

It is also the Fed manipulating markets and eliminating what makes markets work right in the first place - properly priced risk. But if you know that the Fed will always come along to bail you out, what difference does risk make? What risk is there in a market that is not allowed to have declines, to eliminate excesses? Will the Fed always come to the rescue and bail out

investors? Is that their job?

The answers to those questions will be debated for the next several weeks, but our opinion is that natural economic cycles are bigger than anything the Fed can do and natural cycles always win. A cycle delayed only gets bigger and more dangerous.

But until then, its belly up to the bar, the Fed is buying and nobody has a care in the world! (*Oh, no... none for me thanks. I'll be outside with the teetotalers waiting to clean up the mess after the party crashes.*)

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