The Outlook: Sept. 9, 2016

Running for the hills, pausing to ask "Why?"

The market plunged 400 points today. Why?

Before we answer that question, let's say something true about the reason for the market's cliff-dive . . . no matter what it is. The reason for the market's plunge will either be shown, eventually, to "make sense;" or it will be shown, eventually, to make "no sense." (Yup, "nonsense.") We all—from speculators to investors to innocent bystanders—have completely different opinions about that reason, today . . . but we must agree on a "self-evident truth:" the plunge and its rationale will turn out to be one of two things: very smart, or completely silly.

We investors can't help but feel a pang of fear when the market acts like this. We are human, and it's our life savings. That fear whispers in our ears that the "reason" will turn out to be "smart," rather than "silly." We might remind ourselves, as we listen to the whisper, that the market acts like this over and over again, year after year and decade after decade . . . and all market history shows that those actions are not "smart" but "silly," most of the time.

The Wall Street Journal informed us, this afternoon, that the market ran for the hills because the big Central Banks are dropping faint hints that they might stop their historically unique "Quantitative Easing" programs, sometime in the vague but possibly near future. The Journal quoted a typical Eminent Authority, State Street's Michael Metcalfe, who said:

> Both in Europe and in Japan, "we just assumed central banks would push the quantitative easing button when things got bad again, but it seems we've reached the limits of that."

Then the Journal informed us, not as a quote but as a statement of fact:

> "Recent gains in stock markets have been underpinned by accommodative measures from the Federal Reserve, European Central Bank, Bank of England and Bank of Japan, leaving investors focused on any signs that global central bankers may be changing their tune."

Now we are arriving at familiar ground. In other words, the Fed and its foreign counterparts created the bull market, and if they stop making their continuous and valiant efforts to keep it going, there will be hell to pay.

We're at the heart of the matter. Either that "statement of fact" is mighty sophisticated and very smart; or it's silly beyond belief. Either it's right, or it's completely wrong. From their actions today, we can all agree that very many speculators think it's right—and their spokesmen are highly-respected people like Mr. Metcalfe. At Outlook Capital Management we are unknown bit players from the boondocks, compared to Mr. Metcalfe and his peers. But we state our opinion anyway, which we hold with a confidence factor of 100% (which is saying something.) "The market's reason for plunging was silly, and wrong. Mr. Metcalfe's and his peers' belief in that reason is also silly, and wrong."

Let us listen to economist Brian Wesbury:

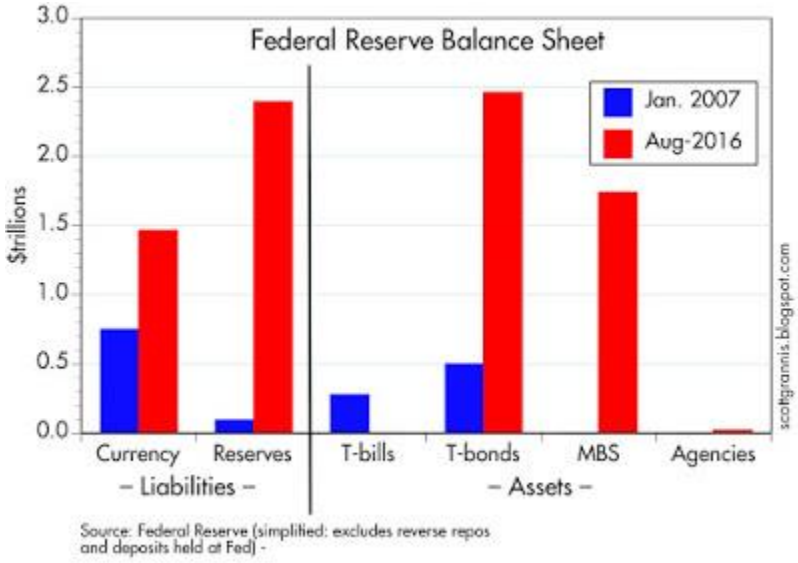
In the Wild West, traveling salesmen sold Magic Elixirs that cured anything that ailed you. These days, the elixir is Quantitative Easing (QE) – it supposedly saved the world from Armageddon, lifted stock prices, drove down bond yields, and, according to at least one analyst, created the fracking boom.

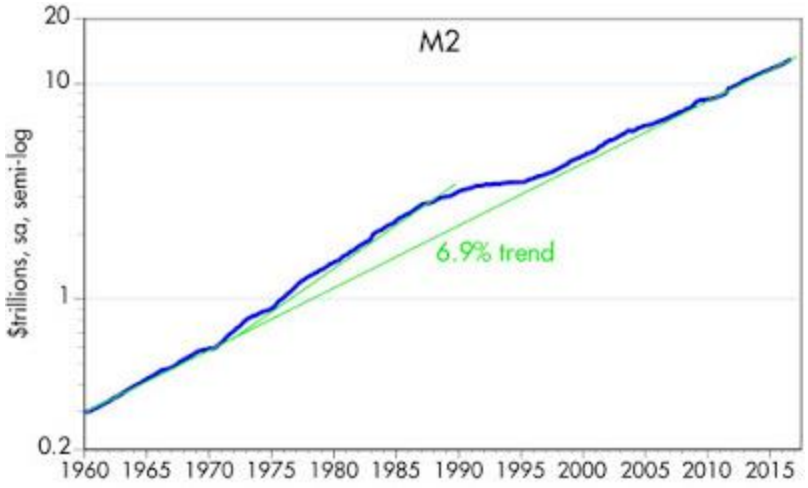
We get it. Many investors and analysts, who have consistently predicted doom and gloom for the past seven years needed to come up with a reason why they were wrong. So they developed a theory that everything is fake: the economic recovery and the bull market, all built on temporary factors, like QE, that were about to reverse.

But the theory makes no sense. QE has been a great big nothing. It hasn't boosted inflation, hasn't helped growth, and has been meaningless to the bull market in stocks, which has been driven by entrepreneurship.

There really is nothing special about the current bull market. If anything, it should have been stronger. And it would have been if policymakers did their job right. But that doesn't mean we shouldn't have had any bull market at all.

Finally, let us look at 2 charts, courtesy of economist Scott Grannis:





These need explaining, but they deserve the effort. They show what the Fed's "Quantitative Easing" actually did for the economy—namely nothing. On top, the red bars are the Fed's liabilities and assets today; and the blue are from 2007, before the Calamity and Quantitative Easing. That's a fantastic explosion in the size of the Fed, isn't it? "Cash and Reserves" have grown almost $3 trillion: meaning, American banks' deposits of cash in the Fed. "T Bonds and Mortgage Backed Securities" have grown the same amount—of course. It seems confusing, but isn't: the Fed printed 3 trillion dollars, used it to buy bonds from American banks, and accepted the $3 trillion in cash paid to those banks as deposits.

The $3 trillion has not been loaned out, has not been used to buy common stocks. It has simply sat in the Fed (the banks' bank) as deposits . . . because U.S. banks have not seen remotely close to enough loan demand to make loans with the cash, instead of parking it at the Fed. So the $3 trillion has not circulated throughout the economy; has not created hyperinflation or even normal inflation; and certainly has not "underpinned the recent gains in the stock market," per the Wall Street Journal. The proof of that lies in the bottom chart, showing the growth in America's money supply, which has deviated not one whit from its 7% half-century growth rate.

The Fed handed banks a lot of cash. The banks, having been burned to a crisp during and after the Calamity (with Federal regulators bringing plenty of torches and tossing on the much of the gasoline), had no interest at all in making any loans except safe loans . . . and to say that there has not been $3 trillion of "safe loan demand" since 2009 would be the understatement of the century.

In other words, the Fed acted silly; but the bankers refused to go along with it. They acted human and sensible, given what they'd just experienced.

As usual, we plan to act sensible, too. The market can be counted on, regularly, to give away good values. We must do whatever we can to take what the market gives.

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