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And The Oscar Goes To…….

- Yellen and the FOMC's experimental policies came **under attack** this week from a multitude of directions. The question and answer exchanges during her testimony had elements worthy of Hollywood and Oscar-winning performances. Suspenseful attacks spread beyond Humphrey Hawkins to the Institutional Investor Alpha forum where legendary investor Stan Druckenmiller bashed the Fed with his own riveting performance.
- Grand experiments often have great **unintended consequences** which eventually manifest. It appears that lawmakers are beginning to recognize and worry about surfacing potential problems. Last October, I said the Fed's open-ended QE-infinity experiment reminded me of the scene in the Gene Wilder movie 'Young Frankenstein' when Igor dropped the 'genius brain' and simply got another one. When the monster went berserk, the doctor asked whose brain he fetched and Igor answered "Abby-someone". Dr. Frankenstein then asked, "Abby who?" with Igor replying, "Abby Normal's".
- The Q&A exchange this week reminded me of a scene from a Jack Nicholson movie. Tweaking the exact words, it went like this. "Dr. Yellen, I am a huge fan of your work, how do you understand the economy so well?" "Well, I start with my model and I remove reason and accountability." This may sound harsh, but this exactly what Stan Druckenmiller was arguing -- that maintaining **depression-like policies** five years after the crisis when the Fed is now only a spitting distance way from achieving its dual mandate is (either) baffling judgment or a poor risk/reward decision.
- In another scene from the same movie, Yellen, I mean Jack, walks into to a full room of people waiting to see a psychiatrist, turns to them and says, "What if this is **as good as it gets**?" Yellen basically told Congress that the FOMC has done as much as possible and the peak of the cycle has been reached. Several lawmakers momentarily looked up from their Angry Bird I-Phone app, but appeared not to hear her statement.
- Unfortunately, she missed the opportunity at this moment to advise Congress on the **limitations of monetary policy** and the Fed's lack of proper tools in addressing specific labor market ailments. Like the Wizard of Oz, Janet should have lifted the curtain herself instead of trying to appear 'great and powerful'.
- The most shocking moment came shortly thereafter, when Oscar-winner Yellen screamed to Hensarling after a question, "Because you can't handle the truth!" She then launched into an explanation about how the plan all along has been to **intentionally create asset inflation** (as opposed to asset bubbles). Such a proclamation means that Yellen must be an expert on market valuation metrics and can responsibly recognize the difference between asset inflation and asset bubbles. To be fair however, she admits that should (another) boom /bust mistake be made, she has great confidence (this time) that the FOMC has the ability to clean up the fallout through macro-prudential and regulatory tools.
    - Regrettably, not making the transcript was her barely audible whisper of "pump and regulate, baby".
- Fed history is riddled with examples of how 'too-low-for-too-long' Fed policies have created booms that caused busts. The crazy irony now is that current policy is specifically trying to create the boom with the belief that rules, promises, and a gradual change of any policy will be enough to massage a soft landing. Equally disturbing is the fact that the FOMC appears to believe that it has **no choice** but to keep policy exceptionally easy, because with rates at zero, it has no bullets left should the economy falter. It reminds me of that movie when Sargent Foley (Louis Gossett) was trying to get Mayo (Richard Gere) to quit boot camp and a broken Mayo cries out, "I've got nowhere else to go".
- "I'm forever blowing bubbles / Pretty bubbles in the air / They fly so high, nearly reach the sky / Then like my dreams they fade and die." – Cockney Rejects

- ADDENDUM: Fed credibility will likely come under further pressure which changes the return profile of risk assets. If the economy strengthens from here there will be cries that the Fed is being reckless and is behind the curve. Alternatively, if the economy softens, markets will question the effectiveness of the experimental Fed polices. Regardless, economic fundamentals are unlikely to improve enough to justify current credit and equity market valuations. Under each of the scenarios of future FOMC decisions - tightening into economic strength, tightening into (and despite) some economic softness, or staying on hold longer than expected - the backend of the Treasury market will likely perform very well. I cannot say the same for the uncertainties confronting the front end of the curve under the various scenarios.