Guy Haselmann
FETIgroup.com/library
April 28, 2020

If you have not already, please take the Survey,
you will get more out of this note:

Financial Professional: bit.ly/2KyCyHK
NON Financial Professionals: bit.ly/3eHmeSW

(Question are same but want to break out results)

General Knowledge of Federal Reserve
Survey Results and Commentary

FIRST OFF, THANK YOU!

Thanks to all for participating. Special thanks to George Goncalves, Karen McKenna, David Bonomo Jr. and Jay Michalowski for advice….And to Norm – you know who you are!

AN INTRODUCTION

For some of you, the survey might have felt like an uncomfortable economics exam that you did not prepare for. Good news, it will not be officially graded and your answers are anonymous.

The purpose of this survey was to draw greater attention to the Fed as well as to offer some important educational facets. In my attempt to increase knowledge about the Fed, I am fully aware of the strong biases in this survey. In a few instances I asked trick questions. Some questions were too subjective to have a absolute answer or might have been relevant in an earlier time period. No doubt this survey was far from perfect, but I hope the exercise was worthwhile.

My biases and leading questions were done with purposeful intent. I hope you'll understand why after reading this note and the commentary after each question. Since I have strong opinions about the Fed, I have tried to state them clearly with full transparency. I believe that collective dialog is best as many brains are better than one or a few. If Fed officials also subscribed to this view, then price discovery in financial markets would be left to the collective wisdom of markets, rather than to central planners who think they know what is best for all. Sorry – I couldn't resist.

WHY THE FED?

Some of you said, "Who cares about the Fed?" The answer is that we all should. The Fed is one of the most powerful institutions on the planet. Its actions effect every person on earth either directly or indirectly.

A recent Gallup Poll showed that the Fed's approval rating was at an all-time high. This surprised me because I believe very few people understand much about what the Fed does. Thus, the Gallup Poll was the impetus behind my wanting to compile this survey. The Fed's historical role is a complicated story with iterations that have changed over time. No doubt, it is certainly too complex to cover thoroughly here. Hopefully though, this note provides a good starting point for awareness and/or for further dialog.

IMPORTANCE OF WATCHING THE FED

I have no doubt that Fed officials are well-intentioned. Yet, I believe their actions have drifted so far away from their legal mandates, and have drifted so far into experimental policies, that the organization has become dangerous to the long-run economic health of our nation. The ramification of its aggressive actions are enormous and require greater attention from all of us.

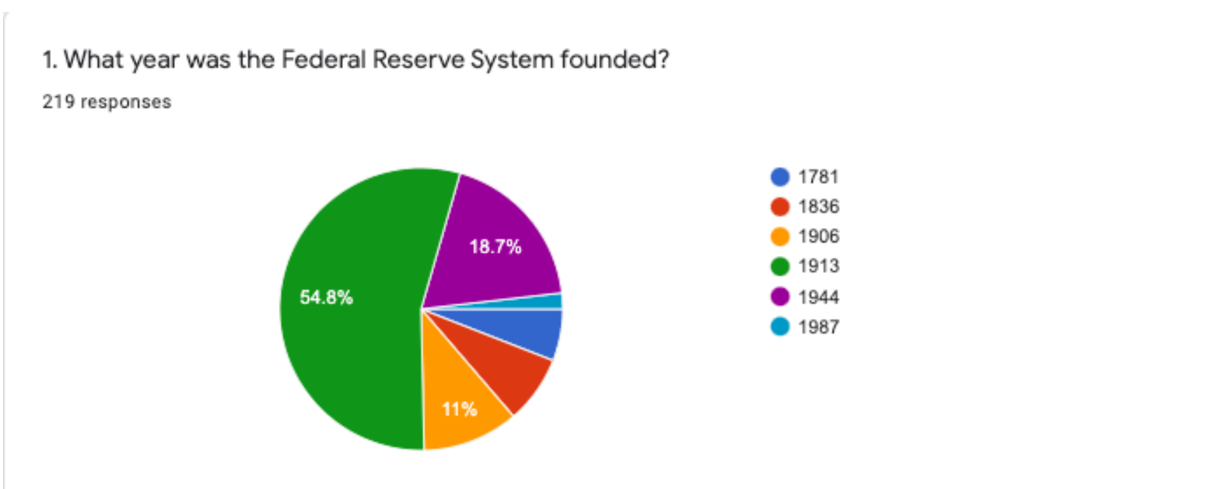
I believe it makes sense to continue providing these types of educational exercises and hope to find a corporate sponsor, partner, or employer wishing to join forces. (More at end of this note.)

THE SURVEY(S)

I was conducting an experiment within an experiment so there are **two sets of results below**. One survey link was set up for Twitter and another for LinkedIn / Facebook. The questions were exactly the same. My hypothesis was that Twitter users were more "finance" people, while the LNKD/FB crowd was more diverse with a larger set of "non-finance" individuals.

Despite my having far more LinkedIn contacts than Twitter followers, I received 1,265 Twitter responses and 219 LNK/FB responses. An astonishing aggregate sample set. The results are posted separately below in pie charts. The results are as of noon Wednesday April 29, 2020.

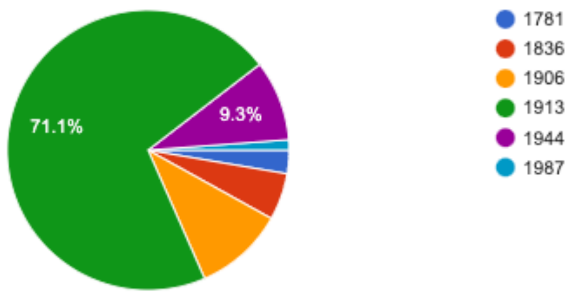
LinkedIn / FB Responses



Twitter Responses

1. What year was the Federal Reserve System founded?

1,259 responses



Answer: (D) = 1913

- Several of the other answer choices had historical significance but were incorrect. I will not go through all of them, but many chose 1944 which saw the end of WWII and the Bretton Woods agreement that defined the modern world order.

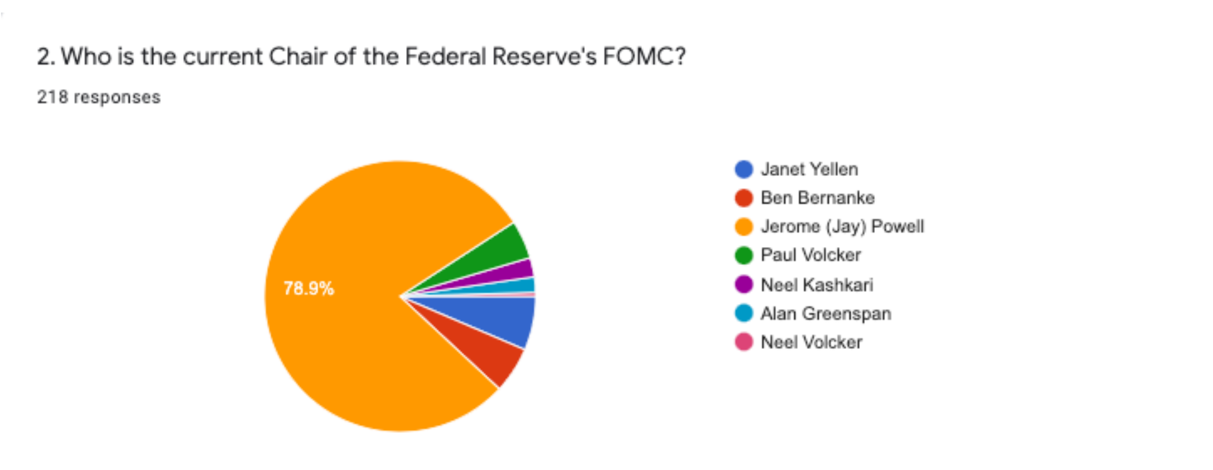
Facts:

- The Federal Reserve System was founded on December 23, 1913 when President Woodrow Wilson signed the Federal Reserve Act into law.
- It was the banking crisis of 1907 which gave rise for the argument to create a Central Bank (i.e., the "Fed"). The arguments lasted 6 years and were detailed in many books.
- The Federal Reserve comprises the Board of Governors in Washington D.C. and 12 regional Reserve Banks.
- The Fed's three main functions are to: 1) conduct the nations monetary policy; 2) provide and maintain an effective and efficient payments system, and; 3) supervise and regulate banking operations. (#1 is the most visible)
- Members of the Federal Open Market Committee (FOMC) vote on policy actions. The FOMC consists of the 7 Board of Governors and the Presidents of each of the 12 Regional Banks. The FOMC holds 8 meeting each year (one every 6 weeks).
- Typically all 19 members of the FOMC and a bunch of staffers attend each meeting but they all do not officially vote. Voting members include the 7 governors, the President of the NY Bank, and only 4 of the 12 regional bank Presidents (who are on an annual rotational schedule).

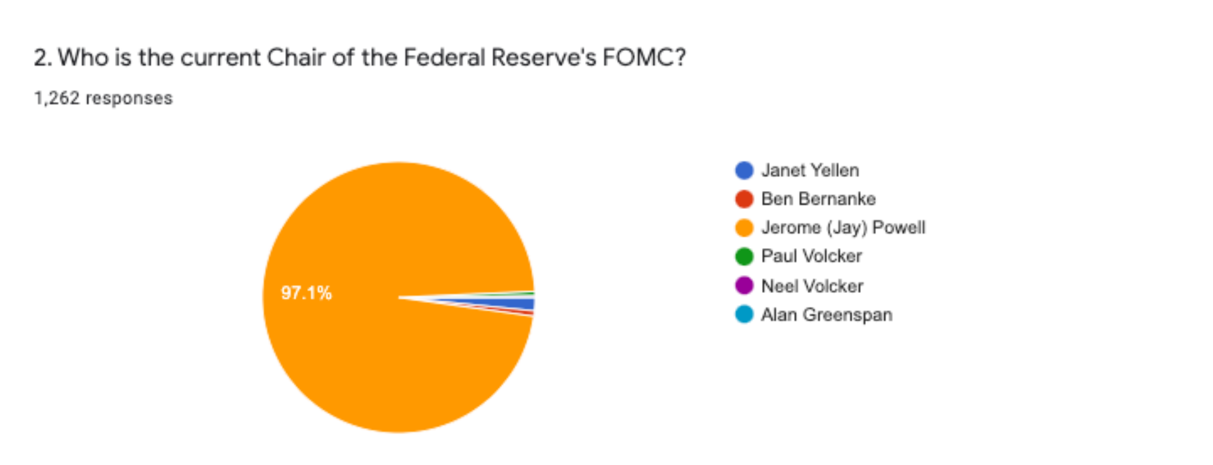
Opinion / Analysis:

- My three favorites book about the Fed are: 1) *America's Bank: The Epic Struggle to Create the Federal Reserve,* by Roger Lowenstein; 2) *The Creature from Jekyll Island,* by G. Edward Griffin, and 3) *The End of Alchemy,* by Sir Mervyn King

LinkedIn / FB Responses



Twitter Responses



Answer: (C) = Jerome (Jay) Powell

Facts:

- Jay Powell is the current and 16th Fed Chair.
- He was nominated by President Trump on Nov 2, 2017.
- After congressional approval, Powell assumed office on January 23, 2018.
- Prior Fed Chair's in descending order were: Janet Yellen, Ben Bernanke, Alan Greenspan and Paul Volcker.
- Neel Kashkari is the President of the regional Minnesota Federal Reserve Bank

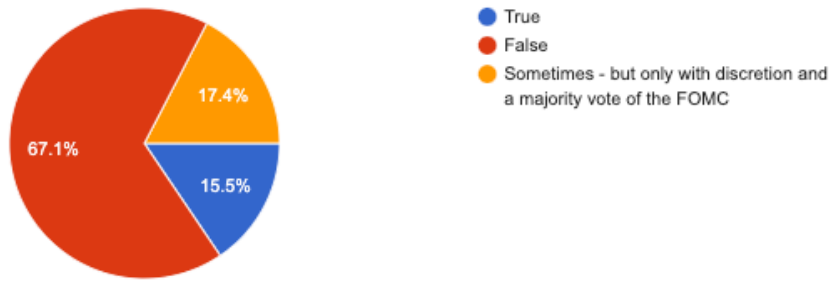
Opinion / Analysis:

- I miss Paul Volcker

LinkedIn / FB Responses

3. The Fed's mandate is to support markets and ensure financial asset values rise over the long term.

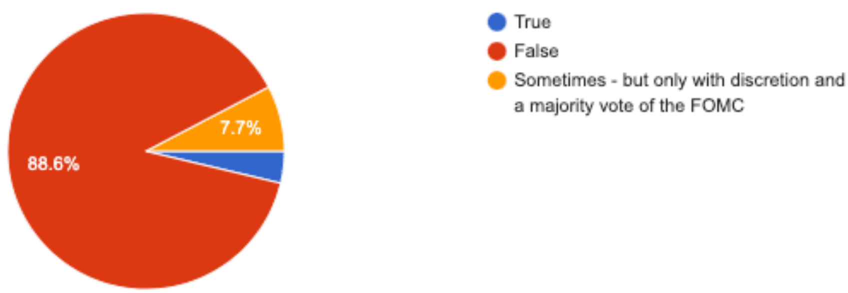
219 responses



Twitter Responses

3. The Fed's mandate is to support markets and ensure financial asset values rise over the long term.

1,262 responses



Answer: (B) = False

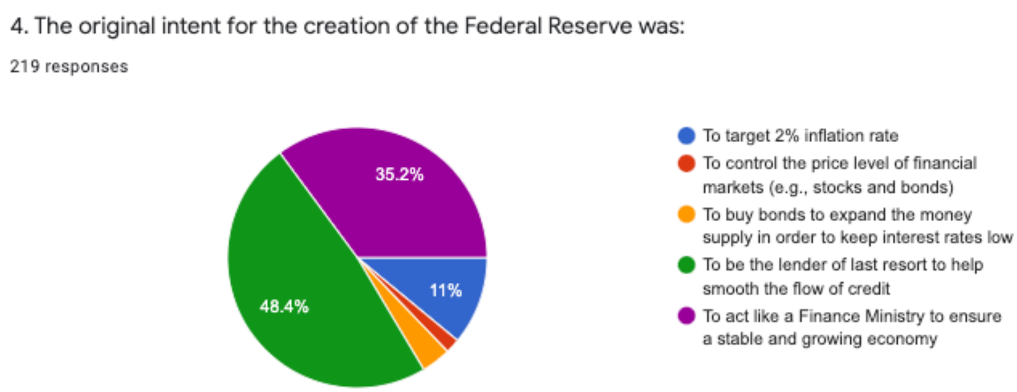
Facts:

- The Fed has no mandate to support market prices. ***<u>Hard stop</u>***. Emphasis added.
- In 1977, Congress clarified what has become known as the Fed's **"dual mandate"** which is to "promote the goals of maximum employment, stable prices, and moderate long-term interest rates".
- Yes, there are 3 mandates listed. So yes, this is a triple mandate not a "dual" one, but Fed officials usually don't mention the last one (but in many regards labor markets and stable prices should be captured in interest rates).
- The "dual mandate" is a "trade-off" between maximum employment and stable prices which is graphed by something called The Phillips Curve.
- The inverse relationship is a "trade-off" because when you improve one, the other one suffers.

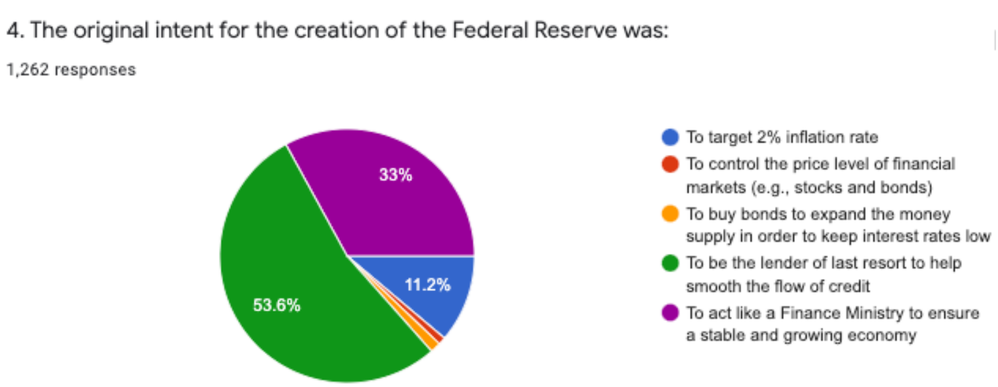
Opinion / Analysis:

- The "dual mandate", or Phillips Curve model, is lunacy and impossible to achieve.
- It is convenient for the Fed, because it allows Fed officials to select the one which fits it's narrative best, i.e., to talk out of both sides of their mouth.
- Think about it this way. It is like having an equation with two unknown variables. I remember from high school algebra that an equation with two variables cannot be solved.
- The Fed's Phillips Curve model should have been debunked in the 1970's with stagflation when the economy had both high prices (inflation) and high unemployment; something the Phillips Curve says cannot happen.
- The fact that so many people answered this question incorrectly is quite concerning. Since the Fed interferes with markets so frequently, people have begun to dangerously believe that the Fed's role is actually to prevent financial market prices from falling too much.

LinkedIn / FB Responses



Twitter Responses



Answer: (D) = To be the lender of last resort to help smooth the flow of credit

Facts:

- The key words in this question were “original intent”. The words were supposed to refocus the reader back to the original reason why the Fed was founded in 1913. The reason was to stop bank runs.
- To do so, the Fed’s original purpose was to act as a lender of last resort to banks after all other means were exhausted, including the selling of bank assets.
- If the Fed had to step in to grant a loan to a bank, it was in exchange for high-quality collateral at a penalty rate of interest. This aligned incentives.

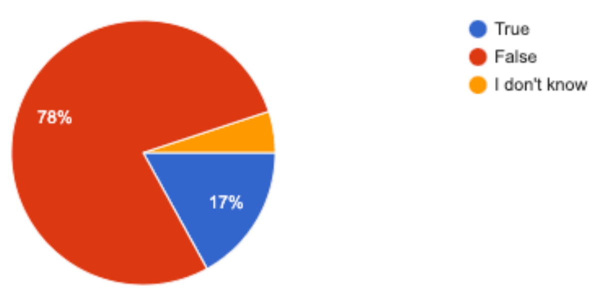
Opinion / Analysis:

- The arguments 107 years ago against setting up a Central Bank had to deal with concerns about strategy drift and fear that the unelected FOMC members would try to grab greater and greater powers outside of its mandates (This is a fact). Something that the Fed is clearly doing today (This is a wide-spread opinion).
- Answer E is incorrect. It certainly seems that the Fed today tries to act as a Finance Ministry. Given its limited tools and specific mandates, this behavior is driven more by strategy drift and the seemingly incessant need to support markets than it is structure or mandate.

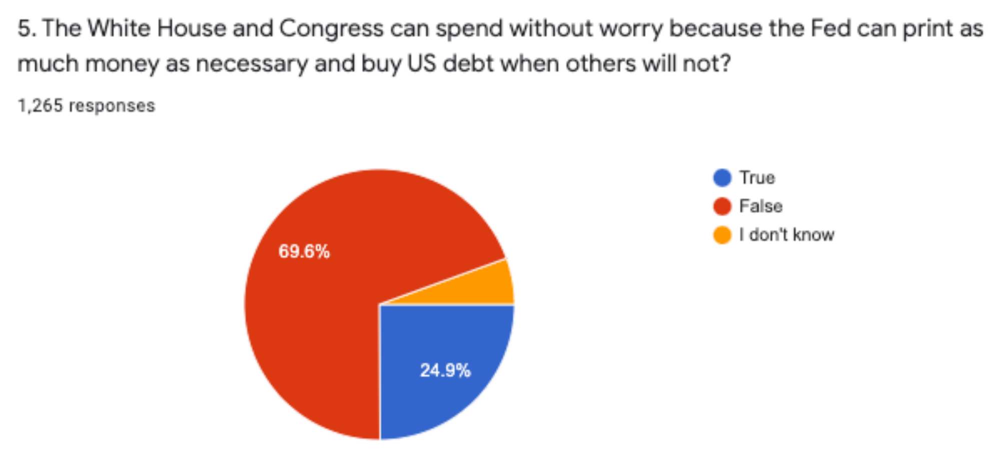
LinkedIn / FB Responses

5. The White House and Congress can spend without worry because the Fed can print as much money as necessary and buy US debt when others will not?

218 responses



Twitter Responses



Answer: (B) = False

Facts:

- Technically the Fed does not print physical money, the Bureau of Engraving and Printing under the US Dept of Treasury does. The Fed controls the money supply and when it expands the monetary base, the Fed is said to be "printing money".
- Actually, fancy accounting allows the Fed to seemingly 'create' money out of thin air by expanding reserves. When the Fed buys Treasury securities from a bank, the bank's account is credited. The Fed does not pay with physical paper money. Alternatively, when the Fed wants to shrink the money supply, they sell bonds to banks and debits the bank's account.

Opinion / Analysis:

- B is the best answer. One could argue otherwise, based on some subjectivity in the question, but I believe such an argument would require unrealistic assumptions.
- The Fed often uses the word "unlimited" to how much it can do, so this is where this question has some holes. But the words "without worry" were used.
- If the US "printed" too many dollars, it risks debasing its currency and risks hyperinflation. When the Fed adds too much liquidity it also creates asset bubbles that eventually pop (all bubbles pop).
- On a side note, Oil (per barrel) traded last week at a negative price for the first time in history. This happen due to too much too much supply and too little demand; so much supply in fact that people were giving it away due to lack of storage facilities.

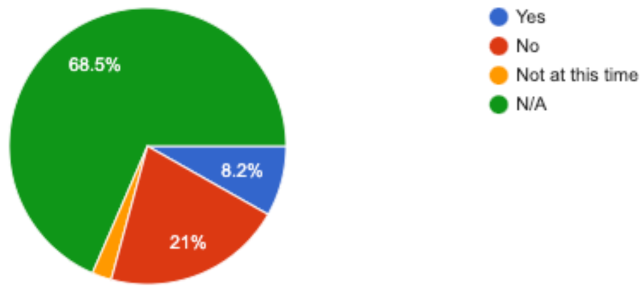
Fun Fact:

- I own a $100 Trillion Zimbabwe currency note…… which is worth…drum roll…nothing.

LinkedIn / FB Responses

6. The Fed should raise taxes, particularly on the rich?

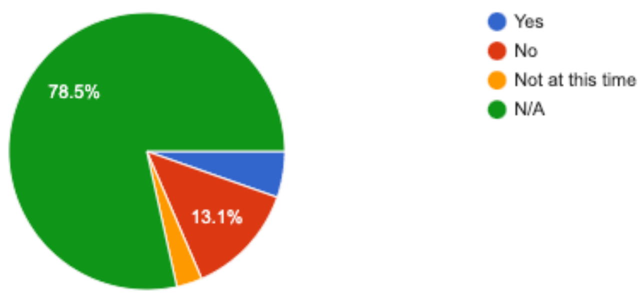
219 responses



Twitter Responses

6. The Fed should raise taxes, particularly on the rich?

1,265 responses



Answer: (D) = N/A

Fact:

- Congress, not the Fed, is responsible for fiscal policy and the raising or lowering of taxes.

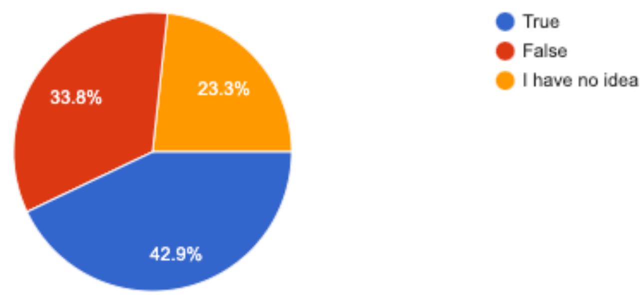
Opinion / Analysis

- This was a trick question, but few should have gotten it wrong.
- Many are also against negative rates because such financial repression is a tax on savers.

LinkedIn / FB Responses

7. The Fed is allowed to lose money

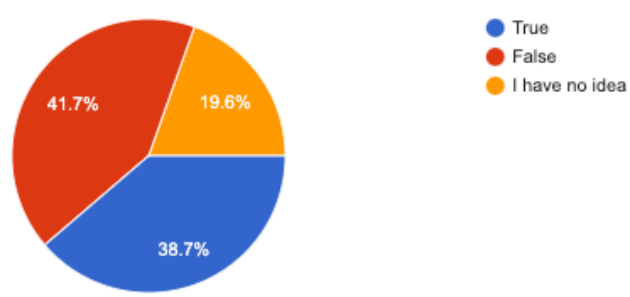
219 responses



Twitter Responses

7. The Fed is allowed to lose money

1,263 responses



Answer: (**B**) = False

Fact:

- The Fed is technically not allowed to lose money, and technically, it does not make money either. When the Fed "makes money" via interest earned on its massive bond holdings, it remits the "profits" back to the US Treasury (i.e., to taxpayers) at the end of its fiscal year.
- The US Government has provided the Fed with its ***very own accounting standard*** that prevents it from losing money. The Fed is not required to mark its portfolio to market. Therefore "loses" are only temporary "paper loses" and the Fed is never in a position to have to sell assets against, say, a margin call.
- In May 2013, for example, the Fed "lost" $155 billion. The Fed merely placed the paper loses into what is called a "deferred asset account". Eventually interest payments on its Treasury bond holdings reduces (i.e., offsets) the losses in the "deferred asset account". Once the deficit is fully plugged, the Fed begins again remitting money back to the US Treasury.

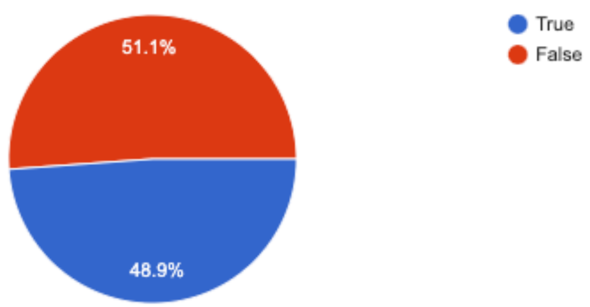
Opinion / Analysis:

- This was the most difficult question. Some might consider it a trick question. I believe B is the best answer, but I admit, it comes with caveat.
- See “note” in question 14.

LinkedIn / FB Responses

8. The Fed is capable of lifting the economy out of recession by buying financial assets?

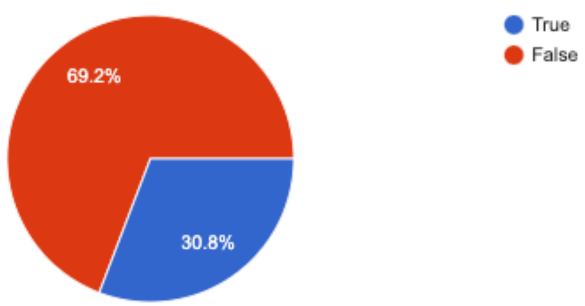
219 responses



Twitter Responses

8. The Fed is capable of lifting the economy out of recession by buying financial assets?

1,266 responses



Answer: (B) = False

Facts:

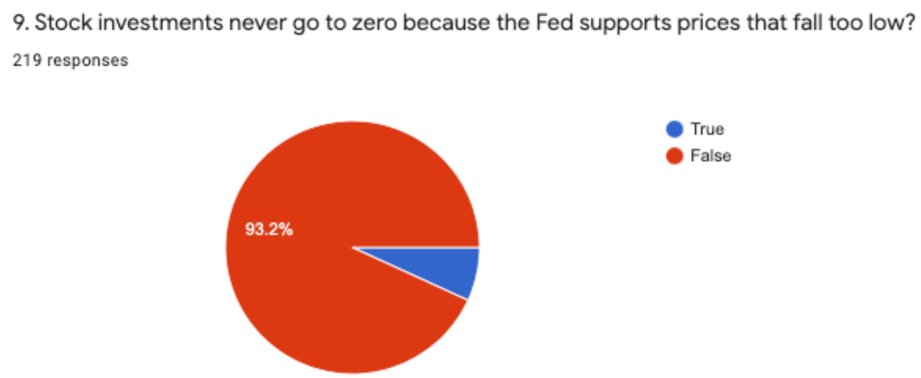
- There is a big difference between the market / financial assets and the economy. The economy is not the market and the market is not the economy.

- The Fed' policies of low interest rates (near 0%) and buying asset financial assets will lift asset prices, but it does very little if anything to lift an economy out of recession. I welcome the debate for those who disagree.

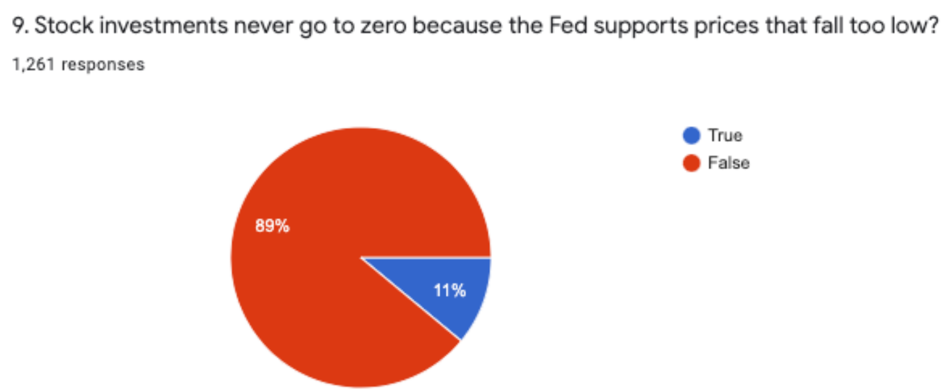
Opinion / Analysis:

- I found this the most surprising result. Some might argue this question is subjective and a matter of opinion. I strongly disagree.
- I believe President Trump often talks interchangeably about the stock market and the strength of the economy. I believe this is where much of the confusion lies.

LinkedIn / FB Responses



Twitter Responses



Answer: (B) = False

Facts:

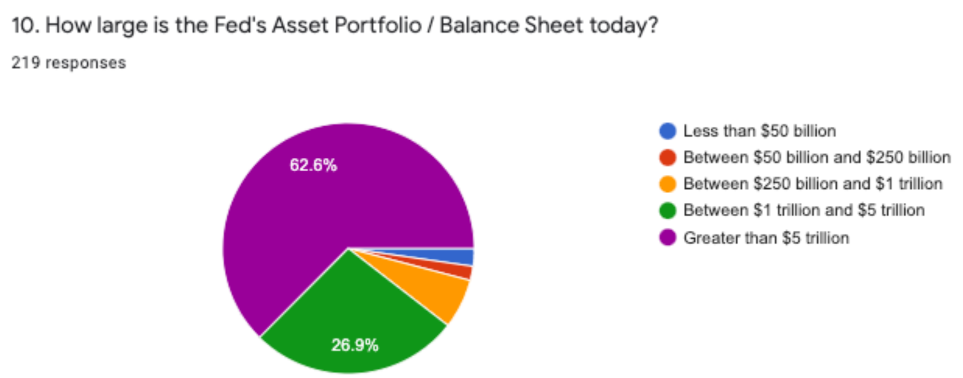
- Companies can go bankrupt and stock and bond holders can get wiped out.

- However, at times, the government initiates a bailout which might prevent this from occurring. Governments sometimes believe that a company or industry needs a bailout in order to prevent larger systemic risks that might lead to greater problems.
- The Fed is not allowed to purchase stocks. Technically, the Fed is not allowed to purchase any asset that is not government guaranteed. Yet, the Fed has found a loophole and is buying corporate & junk bonds.
- The Fed bypassed the rule by setting up Special Purpose Vehicles that are "owned" by the US Treasury. The US Treasury has assigned the Fed to run them on its behalf.

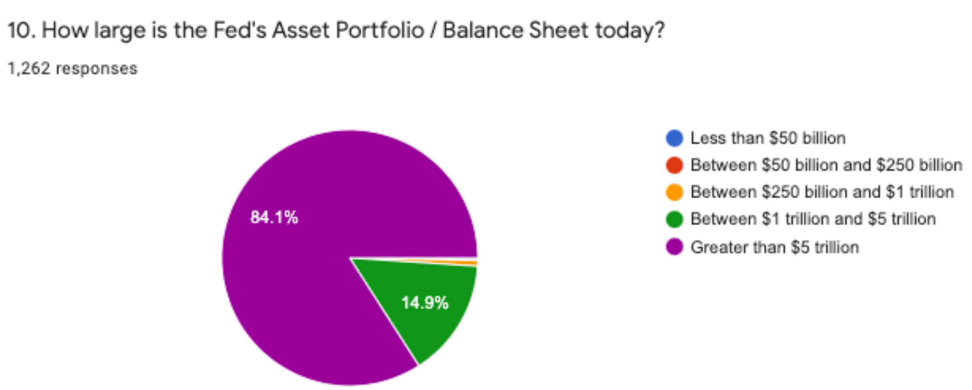
Opinion / Analysis:

- The basis of this question is very important, so I am personally relieved that so many answered it correctly. Capitalism still has a fighting chance.
- Many believe the government should not be in the business of subjectively picking winners and losers. There is political risk and room for malfeasance when bureaucrats subjectively decide which firm or industry is "systemically" important or who should get a bailout and who should not. Governments must be shown that the populace is watching.

LinkedIn / FB Responses



Twitter Responses



Answer: (E) = Greater than $5Trillion = 62% answered correctly

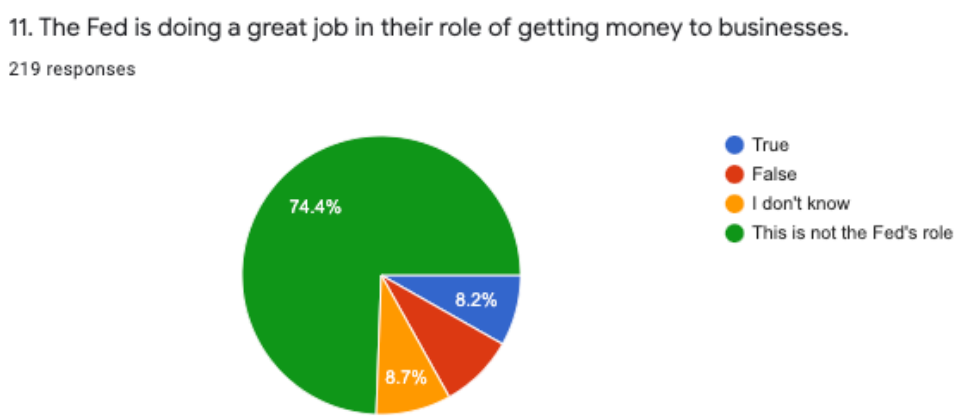
Facts:

- The Fed's asset portfolio / balance sheet now exceeds $6.6 Trillion and counting!!

Opinion / Analysis:

- There is wide-spread criticism of the Fed buying assets in the market place in such gargantuan amounts. This know at Quantitative Easing which can morph into something called Modern Monetary Theory (MMT) if coordinated with the federal government. These are topics unto themselves and beyond the scope of this note.
- MMT is neither Modern or a Theory. But it is dangerous with large moral hazard.
- Financial markets play a vital role as intermediary between borrows and lenders. Allowing supply and demand to discover the equilibrium price is important
- Fed intervention via QE artificially manipulates prices and distorts the process of market-based price discovery. This interference does not come without consequences. To name a few, it can give the illusion of prosperity, create large asset price bubbles (which will lead to financial instability), and can widen wealth inequality.

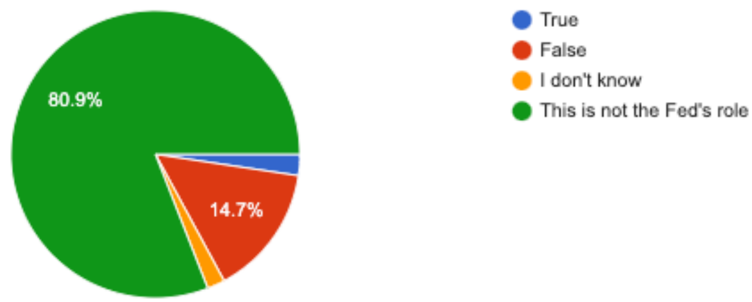
LinkedIn / FB Responses



Twitter Responses

11. The Fed is doing a great job in their role of getting money to businesses.

1,262 responses



Answer: (D) = This is not the Fed's role

Comments:

- Simply put, the Fed's role is not to get money to businesses. The private sector, such as commercial banks and other financial entities do this, central banks do not.

LinkedIn / FB Responses

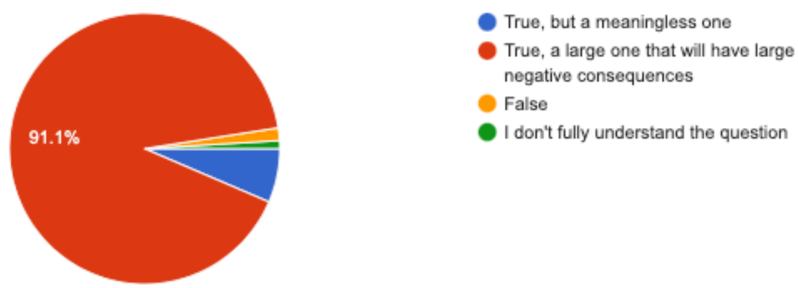
12. The Fed's easy money policy and intervention has caused a large disconnect between financial markets and the real economy?

218 responses

Twitter Responses

12. The Fed's easy money policy and intervention has caused a large disconnect between financial markets and the real economy?

1,260 responses



Answer: (B) = True, a large one that will have large negative consequences

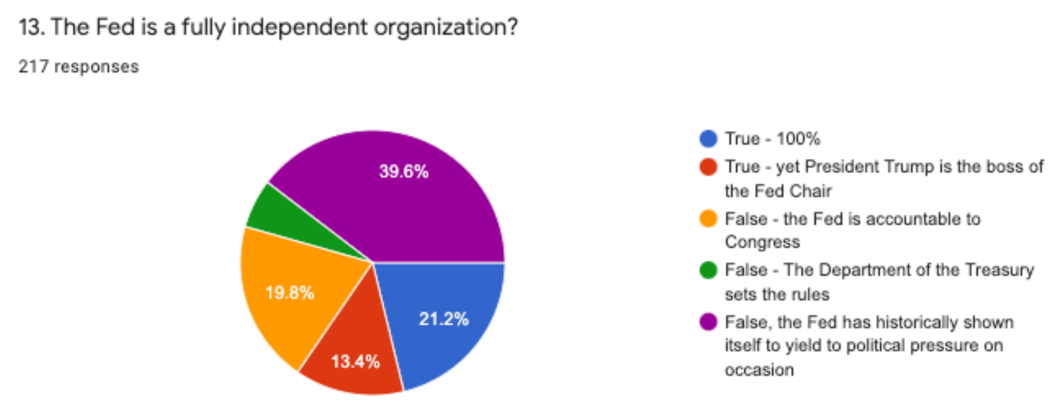
Facts:

- None. This question is one of the most subjective.

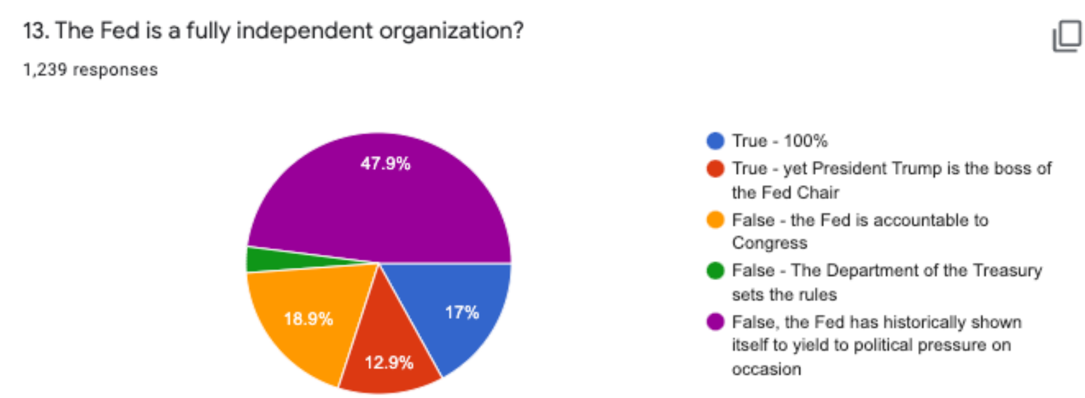
Opinion / Analysis

- Subjective, no doubt. The question never defines "large" or what is meant by "disconnect". Nonetheless, I was curious how people would answer it.
- Some important questions arise from the basis of this question. Currently, the US economy has declined more and faster than at any point in US history, yet financial markets are moving powerfully higher. This is a "disconnect". Why is it happening?
- Is it because of huge government stimulus? If so, then "Main Street" could become infuriated that the stimulus money is going more to "Wall Street".
- Rich people own the majority of financial of stocks and bonds. Wealth inequality will rise. If this "disconnect" continues, could it lead to troubling social unrest, or to advert it, a form of US socialism?
- Many questions arise here – let's keep the dialog going.
- This question overlaps a bit with questions #8 and #10.

LinkedIn / FB Responses



Twitter Responses



Answer: (E) = False, the Fed has historically shown itself to yield to political pressure.

Facts:

- In 1971 Fed Chair Arthur Burns caved into President Nixon's pressures to temporarily "fix the economy" in order to help him win reelection. This is well-known and can be googled. The actions he took, most believe, caused the stagflation of the 1970's.
- Answer B, the President is not the boss of the Fed Chair even though the President does appoint the Chair.
- Answer C is better, but arguably the Fed is not "accountable" to Congress; however it is mandated by law to report to Congress semi-annual updates.
- For answer D, the Treasury does not "set the rules", but I will admit the line between the Fed and Treasury has become more blurred in 2020 given all these new SP.

Comment / Analysis:

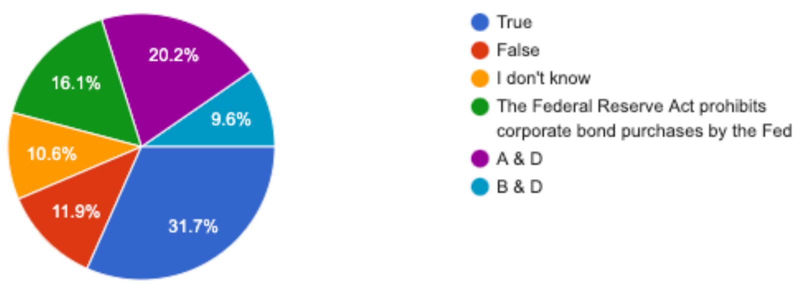
- No doubt this question and its answer (further proven over time) will annoy many people.

- The FOMC would like you believe the answer is (A), that the Fed is 100% independent, but them saying it does not make it true. How does it explain Arthur Burns?
- Many argue that the Fed in the past 10 years has also caved into political pressures, but examples that I would use here would be too controversial so I avoided them.

LinkedIn / FB Responses

14. The Fed is risking taxpayer money when it purchases corporate bonds?

218 responses



Twitter Responses

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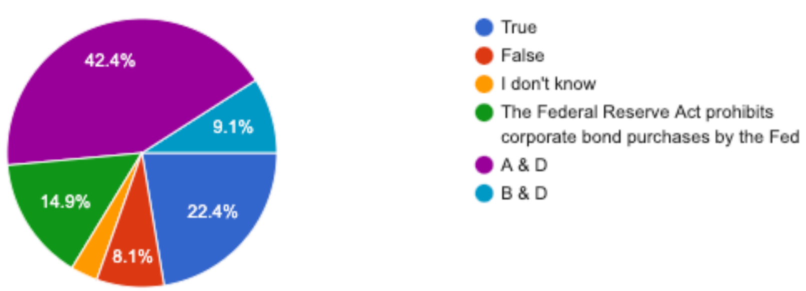


Answer: (E) = A & D but possibly (F) B & D……… Bad question, I am not sure the best answer

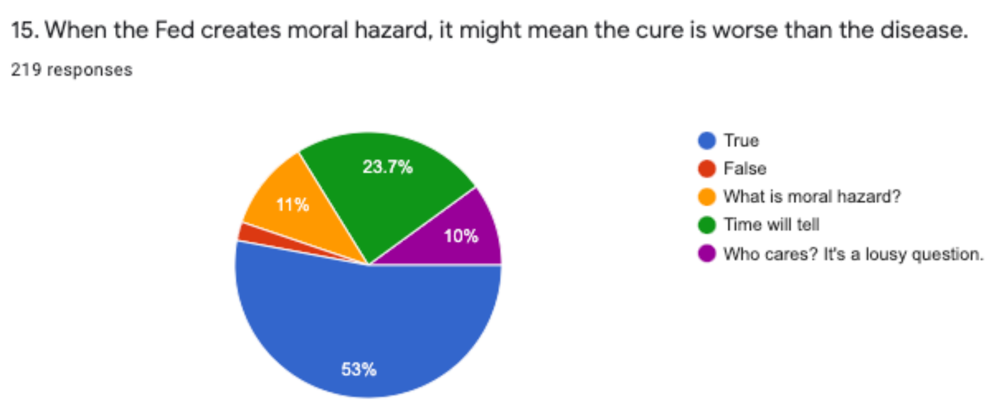
Facts:
- This question was well-meaning but too complex.
- The Federal Reserve Act does not allow the Fed to accept stocks and corporate bonds as collateral or purchase them outright. The act states that the only bond obligations the Fed can accept are "bond s and notes of the Government of the United States".

- D is definitely correct, but the Fed bypasses this rule by having the US Treasury provide seed capital for the Special Purpose Vehicle (SPV) from which it finances the purchases of corporate and junk bonds. (See question #9)
- I am not sure if answer D should then be combined with A or B which makes this question a nuisance. A loss is expected by the SPV which is why the Treasury seeded it with $50 billion of taxpayer money. This is the first loss position.
- The Fed can leverage the SPV's at 7:1 (10:1 in some cases). So who is taking the loss and does it even matter? Is the Fed violating the law and Federal Reserve Act?
- In **question 7**, we learned the Fed's special accounting prevents it from losing money.

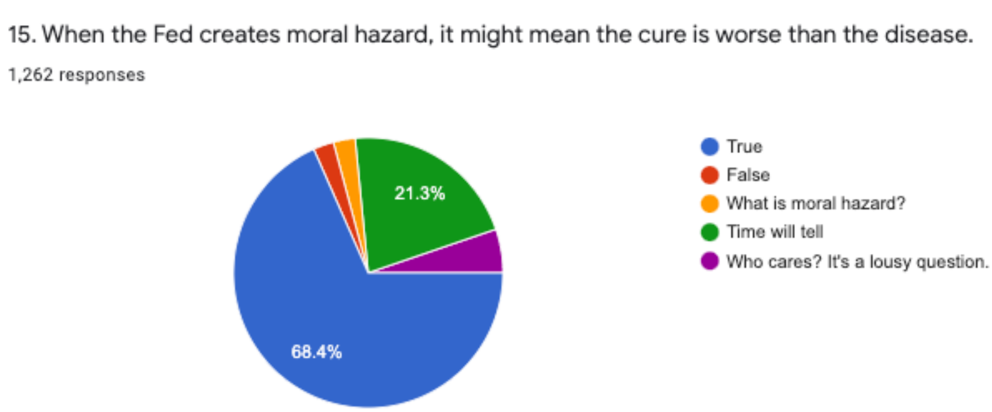
Note:

- The Federal Reserve Act had some tweaks in the 2010 Dodd-Frank Act. It specifically stated that loans has to be collateralized "sufficient to protect taxpayers from loses"
- It also mandated that any Fed facility "be terminated in a timely and orderly fashion.

LinkedIn / FB Responses



Twitter Responses



Answer: (A) = True

Facts:

- No doubt this question is subjective, biased and leading.

Opinion / Analysis

- I feel strongly that the best answer is True - that the cure might be worse than the disease.
- My goal here was to get people, and the Fed itself, to think deeper about moral hazard and the potential ramifications when it runs amok.

FINAL THOUGHT

I hope everyone was able to take something away from this exercise. Financial literacy is important, especially today when the Fed is playing a vital and important role in the economy and financial markets.

During a crisis that results in rapid-fire governmental responses and Fed hyper-activity, understanding the ever-changing rules of…. fiscal, monetary, trade, foreign, and tax….polices is made even more challenging. In this light, I am considering making a series of 3 to 5-minute short videos which cover a wide-range of topical and relevant issues. The purposes would be to provide explanation. I am open to receiving feedback on this idea and hope to find a corporate sponsor, partner, or employer interested to help make it a reality.

Lastly, many articles on markets and the Fed can be found on the "Library" tab of my website FETIGroup.com

Stay well. Thank you again for participating.

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