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The Fed's Monstrous Attack on World Order

Three decades of benefits from globalization and free trade have come to end.

I have absolutely no doubt that today's monstrous world order is a creation of the Fed's own making. It was started by the Fed when the FOMC pushed rates to the 'emergency' level of 0% in 2008, but then failed to raise them when markets resumed functioning properly and were no longer considered to be in an 'emergency' state.

The Fed rightly gets the blame, simply because the US has the world's reserve currency; therefore, all other central banks had to follow the Fed's lead in cutting rates, or their country's currency would have strengthened too much, leaving their exports uncompetitive.

Japan may have been the first major developed economy to move rates to 0%, but this is the wrong comparison for three reasons: 1) the Yen is not the world's reserve currency; 2) most of its debt is owned by its own people; and 3) Japan's real problem is a rapidly shrinking population.

Today, currency wars are sprouting up everywhere and are an indication that countries have urgently decided to put themselves first. With global indebtedness at multiples of GDP and far above 2008 levels, alternatives have diminished. Certainly, heathy pockets of 'creative destruction' are a political landmine and viewed as something to be avoided at all costs.

Central banks, led by the Fed, are destroying the global financial world order. Today's \$15 trillion of negatively yielding debt is lunacy. An investor taking interest rate risk should be compensated for it with added compensation for credit risk.

Further dangers have developed from income seekers fleeing negative yielding bonds and replacing them with dividend paying stocks, i.e., the other end of the capital structure. Old school portfolio construction like 60/40 portfolios no longer serve their proper function - I will save that topic for my next note.

It is unsustainable and impossible for central banks to try to perpetually prop up markets and maintain negative real yields. Currency wars are a race to the bottom in rates because the goal is to weaken the currency. However, an exchange rate is relative – it's a ratio. When both countries cut rates, the ratio for the most part remains stable.

Unfortunately, there are many other aggregating negative consequence. Much has already been written about some of them: financial repression, indebtedness, 'everything bubbles', and moral hazard.

I'd like to focus on the Fed's exit strategy. What is it? Do any central banks have one? If they don't have an exit strategy, then I believe that they don't have any strategy at all. Sports team don't celebrate at half time. Providing the stimulus is always the easy part, but only half the game

I believe at this point, the only way for central banks to not lose total control of markets is for the Fed to refrain from cutting again any time soon. Let the other central banks cut if they must, but the Fed must lead the way out of financial repression and on a path toward rate normalization. Only the country with the world's reserve currency can do this. And, after all, the Fed is the one who got us into this mess in the first place.

It will be a difficult road, but markets give the Fed too much credit anyway and it really doesn't have the proper tools to properly fix much of anything (except maybe the level of total indebtedness via the price of money). And, don't believe their hubris when FOMC members say, "we are the only game in town". They'd like to believe they are, but they are not.

The Fed is a central bank not a Finance Ministry, so it should stop acting like the latter.

Refraining from cutting again will likely mean a period of hardship brought on by a stronger dollar and weaker equity market. FOMC members should talk less and stop offering the 'market put' that market participants readily expect at the first sign of any market or economic weakness.

In short, the FOMC has to stop trying to make everything better today, because imbalances and debt are aggregating and Fed actions are mortgaging the world of tomorrow and damaging the economic world order.