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The Fed's goal: Press the massive re-set button so we can start borrowing and spending again

September 10, 2012 - Long Island

The Federal Reserve's near zero interest rate policy is extraordinary in two main ways. First is the actual low rates themselves. Second is in terms of the length of time, rates have been tamped down in the last few years and remaining low for the next few years. But what's the goal?

The Fed's goal is to press what I describe as a sort of massive re-set button in order to bring the levels of debt, assets, and income of consumers and businesses back into a sustainable level. This is so we as members of the same economy can begin borrowing and spending again, but from a lower level than that of 2007. An economy cannot grow if spending doesn't grow. Borrowing and spending combined creates a multiplier effect-Dollars enter monetary circulation and from there, split into wages, taxes, and investment. The opposite is deleveraging. Ultimately, the Fed sees debt refinancing as the best way to achieve sustainability and rightfully so-reduced spending on debt without the negative effects of deleveraging.

This massive re-set button has been very successfully pressed by large American corporations. These corporations have been able to refinance debt (both bank debt and bond debt) in record fashion. Additionally, they masterfully cut costs and built hefty cash cushions. But the average consumer and small business are not even close to pressing the re-set button. Neither has been able to refinance debts nor cut costs nearly to the extent that the large corporations have. This is why I currently continue to focus my attention on large cap stocks and avoid investing in small cap stocks.

This brings us to a more poignant question that I often hear: "How can you be bullish on stocks when I see so many economic problems all around me?" From the average consumer's view, unemployed neighbors, local foreclosures, and empty store fronts, the situation hasn't yet recovered enough to make him or her confident about the economy. Well, the consumer is right to feel this way. Things don't look very good, certainly not nearly as good as what this year's stock market performance would indicate.

Then again, this year's stock market performance has been mainly on the back of large cap stocks. In addition to successfully pressing the re-set button, they show historically average, if not low, valuations. So, even in the event that profit margins decline and return to lower historical levels, large cap stock valuations are such that if stock prices were to just grow into historical valuations, the trend could still be on course for continued positive investment performance. You may not like this explanation, but this is how investors reconcile the consumers' nervous view of the economy with stock market bullishness.

To tie it all together, the Fed has a long way to go before reaching the full capacity of pressing the re-set button for consumers and small businesses. This is why the Fed plans on maintaining its current interest rate policy for a few more years. Large American corporations have been the only party so far that has been able to take full advantage of the re-set button and for this. I believe shareholders of big companies should continue to earn returns with relative outperformance versus other equity asset classes.

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