INVESTMENT FOR WEALTH

General report

Comments for June 2014

Innocence lost

At the beginning of the year we wrote: "2014 the year when central bankers lose their innocence". Have a look at the following excerpt from the July 2, Janet Yellen, Fed chairman speech before the IMF.

If monetary policy is not to play a central role in addressing financial stability issues, this task must rely on macroprudential policies… If macroprudential tools are to play the primary role in the pursuit of financial stability, questions remain on which macroprudential tools are likely to be most effective, what the limits of such tools may be, and when, because of such limits, it may be appropriate to adjust monetary policy to 'get in the cracks' that persist in the macroprudential framework… At *this point, it should be clear that I think efforts to build resilience in the financial system are critical to minimizing the chance of financial instability and the potential damage from it.*

This focus on resilience differs from much of the public discussion, which often concerns whether some particular asset class is experiencing a 'bubble' and whether policymakers should attempt to pop the bubble. Because a resilient financial system can withstand unexpected developments, identification of bubbles is less critical… (1)

So the Fed is not in the business of "popping bubbles" and takes no responsibility for excesses caused by its monetary policy. Zero! Nada! You have our back (our = from the Fed) to speculate with leverage in a reach for yield, as we will always lower and maintain zero percent interest rates when needed. We don't care if our monetary policies cause distortions in all markets. It is justified that the Fed kills the "moral hazard".

Mister Draghi, ECB president, has gone even further. After he crossed the Rubicon, going from ZIRP (zero interest rates) to NIRP (negative interest rates), he said on July 3 : "The first line of defense should be the macroprudential tools. I don't think people would agree with raising interest rates now."

So the ECB doesn't even need to try justifying its monetary policy, let alone act with preemption against bubbles in formation. Members of the ECB just have to ask … the people if they want higher rates : "*I don't think people would agree with raising interest rates now.*"

So no more claims of being independent and not being influenced by political pressures! Continuously pretending such a posture makes a pitiful clown out of you and you will be seen as an ugly liar.

No, no and no, you central bankers are not innocent, you central bankers are guilty as hell.

After your interventionism, your Keynesian monetary policies have created significant financial distortions and economic imbalances, you then excuse yourselves, saying interest rates are a blunt tool for addressing financial instability.

Post Lehman default, you went "all in" on a never seen scale. You called it unconventional.

You have created massive illusions of wealth, massive perceptions of "moneyness" for all types of risk assets, seemingly endless pools of cheap liquidity and have stimulated all financial market participants to form gigantic bubbles compulsively. For you, DEBT and LEVERAGE have no boundaries.

Macroprudential tools are your predelicted line of defense against bubbles and financial instability. But a mere observation of human history shows all too clear that regulators are always and everywhere found asleep at the wheel. They are always and everywhere fighting the last war after the facts.

Correct central bank policies should in our view address financial stability by killing bubbles before they become a problem. Be just a lender of last resort and let the "invisible hand" set interest rates and asset values, not central planning with hidden agendas like addressing inequality and social justice. Clearly the Piketty hype did not come from Mars.

In the same commentary at the beginning of 2014, we have also said that any surprise in the gold market was to be expected to the upside. With a year to day return surpassing 50%, our iW Alternative Gold Commodity Fund is indeed a nice surprise so far in 2014. We really believe that even better years are still coming, when central bankers will not only have lost their innocence but also their control on the markets.(2)

INVESTMENT FOR WEALTH

Performances and trading

iW Alternativ SIF – Low Risk
The fund has increased by 11,2% in June, NAV 9.711,03 EUR.

iW Alternativ SIF – Commodities
The fund has increased by 32,2% in June, NAV 444,60 EUR.

iW Alternativ SIF – Real Value Growth
The fund has increased by 17,3% in June, NAV 72,56 EUR (I), NAV 71,19 EUR (P)

Best regards,
The fund manager

(1) full transcript of Yellen's speech

In my remarks, I will argue that monetary policy faces significant limitations as a tool to promote financial stability: Its effects on financial vulnerabilities, such as excessive leverage and maturity transformation, are not well understood and are less direct than a regulatory or supervisory approach; in addition, efforts to promote financial stability through adjustments in interest rates would increase the volatility of inflation and employment. As a result, I believe a macroprudential approach to supervision and regulation needs to play the primary role. Such an approach should focus on "through the cycle" standards that increase the resilience of the financial system to adverse shocks and on efforts to ensure that the regulatory umbrella will cover previously uncovered systemically important institutions and activities. These efforts should be complemented by the use of countercyclical macroprudential tools, a few of which I will describe. But experience with such tools remains limited, and we have much to learn to use these measures effectively.

I am also mindful of the potential for low interest rates to heighten the incentives of financial market participants to reach for yield and take on risk, and of the limits of macroprudential measures to address these and other financial stability concerns. Accordingly, there may be times when an adjustment in monetary policy may be appropriate to ameliorate emerging risks to financial stability. Because of this possibility, and because transparency enhances the effectiveness of monetary policy, it is crucial that policymakers communicate their views clearly on the risks to financial stability and how such risks influence the appropriate monetary policy stance. I will conclude by briefly laying out how financial stability concerns affect my current assessment of the appropriate stance of monetary policy…

When considering the connections between financial stability, price stability, and full employment, the discussion often focuses on the potential for conflicts among these objectives. Such situations are important, since it is only when conflicts arise that policymakers need to weigh the tradeoffs among multiple objectives. But it is important to note that, in many ways, the pursuit of financial stability is complementary to the goals of price stability and full employment. A smoothly operating financial system promotes the efficient allocation of saving and investment, facilitating economic growth and employment…

Despite these complementarities, monetary policy has powerful effects on risk taking. Indeed, the accommodative policy stance of recent years has supported the recovery, in part, by providing increased incentives for households and businesses to take on the risk of potentially productive investments. But such risk-taking can go too far, thereby contributing to fragility in the financial system. This possibility does not obviate the need for monetary policy to focus primarily on price stability and full employment--the costs to society in terms of deviations from price stability and full employment that would arise would likely be significant…

Although it was not recognized at the time, risks to financial stability within the United States escalated to a dangerous level in the mid-2000s. During that period, policymakers--myself included--were aware that homes seemed overvalued by a number of sensible metrics and that home prices might decline, although there was disagreement about how likely such a decline was and how large it might be. What was not appreciated was how serious the fallout from such a decline would be for the financial sector and the macroeconomy. Policymakers failed to anticipate that the reversal of the house price bubble would trigger the most significant financial crisis in the United States since the Great Depression because that reversal interacted with critical vulnerabilities in the financial system and in government regulation…

It is not uncommon to hear it suggested that the crisis could have been prevented or significantly mitigated by substantially tighter monetary policy in the mid-2000s. At the very least, however, such an approach would have been insufficient to address the full range of critical vulnerabilities I have just described. A tighter monetary policy would not have closed the gaps in the regulatory structure that allowed some SIFIs and markets to escape comprehensive supervision; a tighter monetary policy would not have shifted supervisory attention to a macroprudential perspective; and a tighter monetary policy would not have increased the transparency of exotic financial instruments or ameliorated deficiencies in risk measurement and risk management within the private sector…

A review of the empirical evidence suggests that the level of interest rates does influence house prices, leverage, and maturity transformation, but it is also clear that a tighter monetary policy would have been a very blunt tool: Substantially mitigating the emerging financial vulnerabilities through higher interest rates would have had sizable adverse effects in terms of higher unemployment. In particular, a range of studies conclude that tighter monetary policy during the mid-2000s might have contributed to a slower rate of house price appreciation. But the *magnitude of this effect would likely have been modest relative to the substantial momentum in these prices over the period; hence, a very significant tightening, with large increases in unemployment, would have been necessary to halt the housing bubble. Such a slowing in the housing market might have constrained the rise in household leverage, as mortgage debt growth would have been slower. But the job losses and higher interest payments associated with higher interest rates would have directly weakened households' ability to repay previous debts, suggesting that a sizable tightening may have mitigated vulnerabilities in household balance sheets only modestly…*

Furthermore, vulnerabilities from excessive leverage and reliance on short-term funding in the financial sector grew rapidly through the middle of 2007, well after monetary policy had already tightened significantly relative to the accommodative policy stance of 2003 and early 2004. In my assessment, macroprudential policies, such as regulatory limits on leverage and short-term funding, as well as stronger underwriting standards, represent far more direct and likely more effective methods to address these vulnerabilities…

If monetary policy is not to play a central role in addressing financial stability issues, this task must rely on macroprudential policies… If macroprudential tools are to play the primary role in the pursuit of financial stability, questions remain on which macroprudential tools are likely to be most effective, what the limits of such tools may be, and when, because of such limits, it may be appropriate to adjust monetary policy to 'get in the cracks' that persist in the macroprudential framework…

At this point, it should be clear that I think efforts to build resilience in the financial system are critical to minimizing the chance of financial instability and the potential damage from it. This focus on resilience differs from much of the public discussion, which often concerns whether some particular asset class is experiencing a 'bubble' and whether policymakers should attempt to pop the bubble. Because a resilient financial system can withstand unexpected developments, identification of bubbles is less critical…

First, it is critical for regulators to complete their efforts at implementing a macroprudential approach to enhance resilience within the financial system, which will minimize the likelihood that monetary policy will need to focus on financial stability issues rather than on price stability and full employment…

Second, policymakers must carefully monitor evolving risks to the financial system and be realistic about the ability of macroprudential tools to influence these developments…

In recent years, accommodative monetary policy has contributed to low interest rates, a flat yield curve, improved financial conditions more broadly, and a stronger labor market. These effects have contributed to balance sheet repair among households, improved financial conditions among businesses, and hence a strengthening in the health of the financial sector…

Taking all of these factors into consideration, I do not presently see a need for monetary policy to deviate from a primary focus on attaining price stability and maximum employment, in order to address financial stability concerns. That said, I do see pockets of increased risk-taking across the financial system, and an acceleration or broadening of these concerns could necessitate a more robust macroprudential approach…

Conclusion: In closing, the policy approach to promoting financial stability has changed dramatically in the wake of the global financial crisis. We have made considerable progress in implementing a macroprudential approach in the United States, and these changes have also had a significant effect on our monetary policy discussions. An important contributor to the progress made in the United States has been the lessons we learned from the experience gained by central banks and regulatory authorities all around the world…"

(2) for our readers one of the best critical articles we have recently read on actual central bank policy: The Delusion of Perpetual Motion by John P. Hussman http://www.hussmanfunds.com/wmc/wmc140630.htm