StockTwits®

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MACRO WEEKLY

A periodical of the StockTwits Investment Community

MOUNT ST. FED

The Unleashing of Fed Fury May Exceed Market Expectations

Recent Photo of Mount St. Helens | Edited by Gregor Macdonald

FEATURED CONTENT

ALSO INSIDE:

This week on StockTwits.TV:

Howard Lindzon
Gets the Inside View
From Ivaylo Ivanhoff
On the new StockTwits 50

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MOUNT ST FED

As global markets head towards their reckoning in the first week of November, some jitters have arisen that the FED might disappoint on its overly well-signalled QE 2.0. However, if we pay close attention to the full breadth of FED commentary, and also to the actions of key investors like Bill Gross of PIMCO, everything suggests the FED will do at least as much as foreshadowed, if not more. Prepare for a blast.

FEATURES

A NOTE FROM THE EDITOR

Welcome to StockTwits Macro Weekly, the weekly magazine of the StockTwits investment community. Each issue features a core essay, written by the Editor. Around this, we build in the key news events and observations, from the past week. To have each issue sent to you, sign up here.

You will also find StockTwits Macro Weekly functions as a live document, that is eminently clickable and is therefore a helpful launching pad to other relevant content. Feedback from readership is welcome, and we are always on the lookout for written contributions from the community: gregor@stocktwits.com

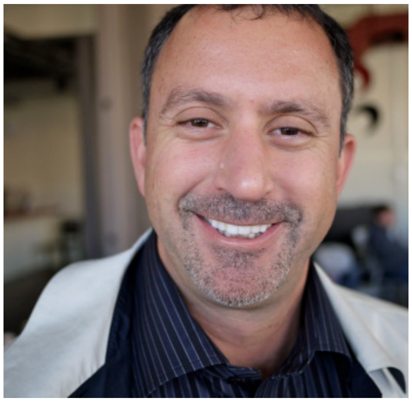
MOUNT ST. FED—When FED chairman Bernanke spoke in Boston on Friday, both stock and commodity markets were less than jubilant over what they heard. The reaction is a tell on the current juncture: price levels in everything from the SP500 to the CRB index have quickly ascended in recent months in anticipation of further quantitative easing. The upcoming FED meeting in the first week of November promises to unleash a new flood of liquidity into the US financial system. With regards to market action, this begs a question: have prices risen to discount a recovery in economic growth? Hardly. While the developing world is back on its volatile, upward growth path, the developed world is almost uniformly moribund. Most economies from Japan to the US to Europe continue to sag under a heavy weight of debt. As countries like Spain, Greece, and Ireland get ready to lurch downward once again, the bigger nations like Japan, the US, and the UK are set to embark on new rounds of stimulus. Perhaps stock markets and commodity markets are less afraid the FED will wimp out on November 3, and are more concerned that price levels already reflect the pending QE. This would assume, however, that the FED annoucement will merely intersect quitely with current market expectations. But what if the FED emerges with an upside surprise?

This weekend for example, just one day after the Bernanke appearance, Chicago FED President Charles Evans emerged with a hot-button speech, laced with the phraseology of more aggressive monetary action. Evans used the term *liquidity trap*, a concept that calls to mind the twin lost decades in Japan. Evans also echoed previous FED commentary that targeting a desired level of inflation may be desirable. But he seemed to go one step further, explaining that the economy and the marketplace--in order to fully experience the breadth of such reflationary

Indexes

INDU 11062	TNX 2.58	GOLD 1368.26	VIX 19.03	SPX 1176.19	DXY 76.973

StockTwits.TV:
Howard Lindzon chats with Ivaylo Ivanhoff



The StockTwits Blog Network has a new entry, The StockTwits 50, which has a great helmer by the name of Ivanhoff. This week, Howard talks with Ivanhoff about the possibility that the US stock market is very close now, to a top.

The StockTwits 50 is a handpicked list of equities that "represent the stocks with the strongest fundamental and technical characteristics." The theme here is that these are the names with the best setups. The list is rebalanced weekly.

Ivanhoff sees in last week's action some signs that the long rally is coming to an end, as hot leaders in such sectors as the cloud computing space fell hard. As Howard points out, while momentum is a tough dynamic to play, it cannot be ignored and the StockTwits 50 is simply one of the best lists out there for the active trader, looking to capture strong moves. Watch the show here.

StockTwits.TV can also be taken as an iTunes subscription.

policy--should be made to understand clearly that the FED will keep *pressing, pressing, pressing* until new inflationary targets are achieved. Language and theories such as these are confirmation that the FED is not only prepared to meet market expectations, but exceed them.

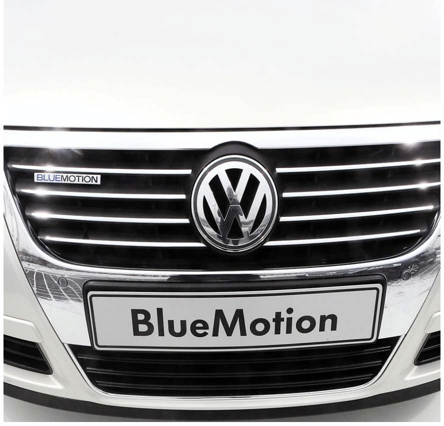
It's useful to remember that the Federal Reserve Open Market Committee likes to fly in a kind of V-formation with the Chairman in the lead, as various members and governors vocalize a broad spectrum of ideas that distributes itself off the tail of each wing. It's helpful to the FED's cause, for example, that Kansas City FED President Hoenig continues to dig away at inflation-fighting themes as this provides the FED with cover. This "dissension", which is largely symbolic, gives the impression that the FED is sweating over every decision, and is a robustly deliberative body. Usually, however, as each large policy decision approaches there is a tilt in one direction and we're seeing that now with just two weeks to go. The question is: how could the FED surprise the market?

For hints around the edges of this question, let's consider that Bill Gross's PIMCO is back to buying mortgages again and by a considerable amount. Bloomberg reported Friday that the Total Return Fund cut exposure to Treasuries from 36% to 33% of assets, yet *increased exposure to mortgages from 21% to 28% of assets*. Why is PIMCO dialing back its weighting to Treasuries, just as the FED is about to announce a 100 billion dollar per month buying program, of Treasuries? Perhaps the answer lies in the price levels US Treasuries have already attained, and, PIMCO's view (or insider knowledge) that the FED will re-start its MBS (mortgage backed securities) purchasing operation. As mentioned in an article in StockTwits Macro Weekly of 3 October, *Re Fi Me*, there is little doubt that the FED's intention is to significantly lower rates, and to trigger a refinancing of wave of mammoth proportions. Getting the nation's homeowners into new, fixed-rate loans at 100-200 basis points lower than current levels would be a way to improve household cash flow. The PIMCO bet may be a call on *flows* through Treasuries to the mortgage market, therefore, even if the price of Treasuries are roughly at their upper bound already. While there are ancillary issues surrounding the callable features of any MBS that PIMCO is buying, the signal is clear: something major this way comes (or is intended to come) in the US mortgage market.

Let's also consider that a new development, the impairment of residential real estate Titles as uncovered by the foreclosure wave, may also act as an incentive for the FED to surprise markets with more forceful action. The mainstream financial press for the most part has once again misdiagnosed the seriousness of the foreclosure mess. Don Coxe for example, in his Friday podcast, was brutal in his assessment of the Wall Street Journal's coverage of the fiasco, which incorrectly dismissed the matter as a mere *problem of paperwork*. Clearly the WSJ does not understand that Land Use and Real Estate Law operates with far more "letter" and much less "spirit" for obvious reasons: you simply cannot run such systems on *intent*. And while it's true that mistakes can and have been remedied in real estate law, it's not easy to do even on a case by case basis. Now, how about a remedy for (potentially) trillions of dollars of improperly recorded Promissory Notes? That will be hard, to put it mildly.

Despite the well deserved criticism of the FED's approach to the burst credit bubble, let's leave aside for a moment the fact that QE cannot possibly revive the economy or trigger job growth and consider the risk-reward proposition for the FED--at least to their own way of thinking. For the FED, which is now sitting on trillions of dollars of assets, the

Hyper Mileage VW

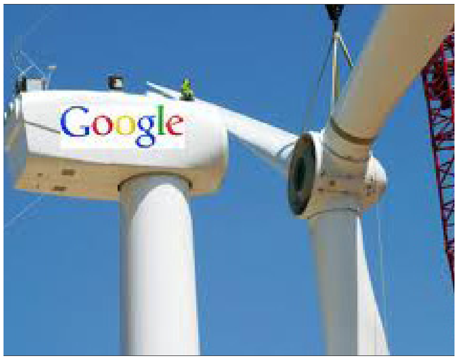


Volkswagon is making a compelling contribution now to the high mileage vehicle market, and it should enliven the debate between EVs (electric vehicles) and more efficient ICE (internal combustion engine) vehicles. The Passat Blue Motion has just broken records after going 1,527 miles without refueling; that's 74.8 mpg, in a single trip from the UK to Southern France, and back. How was this possible?

The short answer: diesel. As any engineer knows, the ICE engine can reach its greatest potential through a design of very high compression, using diesel. At 75-80 miles per gallon, this also starts to call into question the efficacy of EVs, which have their own set of problems relating to cost, and power density.

Consider this possibility: EVs, which struggle to find the optimal balance between on-board battery weight and range, continue to top out at 125 miles of range. Meanwhile, what happens to the EV market if a new wave of high-mileage diesel autos comes onto the market at lower price-tag, and which also hedge the owner against escalating oil prices?

Search for Power



Nearly three years ago now Google announced a very large project of Google.org titled RE<C. The intention of that project was to discover, produce, or develop Renewable Energy that cost less than Coal. And ambitious goal to be sure, and most people in the energy community wished Google well, and eagerly looked forward to results. Unsurprisingly, several years later, there have been no results. This is in no large part due to the fact clean technologies like solar and wind capture diffuse energy, while coal is fairly dense energy and is cheap. Emphasis on *cheap*.

So what's Google up to now? The search company wants to own more power grid infrastructure. This time, they've decided to invest in both the production (wind) and the underwater grid to carry that power along the East Coast of the United States. The project is initially projected to cost 5 billion, though one assumes this is just for starters. Google has a keen self-interest in power generation, as the energy-cost of running the company's servers explodes higher. For a sense of this scale, look at $GOOG's huge new data center in the Dalles, Oregon.

possibility that they will have to fight inflation rather than deflation in the future is a far more attractive--and realistic--outcome. This is precisely what the FED's Eric Rosengren was trying to say at this weekend's Boston conference. But to quote him directly: *Insuring against the risk of deflation may be much cheaper than waiting until it has occurred and then trying to address it*. Indeed. The FED is probably confident, if not overconfident, that with a balance sheet already in the trillions they have more than enough material to soak up excess liquidity in the system, should we actually "get there." To undershoot expectations two weeks from now would merely undo all the reflationary work the FED has "accomplished" over the past several months. The chances the FED makes this mistake is therefore low. Prepare for a big, upward blast.

--Gregor Macdonald, 17 October—Amherst, MA

~Chart of the Week~