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The Big Screw Up Part 1

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Yesterday, Fed Chair Jerome Powell gave a speech at the Economic Club of New York in which he suggested the rates are currently *"just below"* neutral and that no major asset class is *"far in excess"* of historic valuations.

Those five words represent the single biggest admission of Fed policy failure by a Fed Chair in the last 30 years.

The previous three Fed Chairs, Alan Greenspan, Ben Bernanke, and Janet Yellen were all deeply flawed, and misguided individuals. However, as terrible as their thinking and the monetary policy that resulted from it was, ALL of them understood how to maintain a narrative in order to provide financial stability.

Put simply, these individuals were terrible Central Bankers, but competent politicians.

Jerome Powell was meant to represent a change from this. And during the first 11 months of his tenure he was. From the date of his appointment until yesterday, Powell had pushed the Fed towards a more "economic-centric" approach, away from an obsession with the financial markets.

He also:

1) Ended the era of non-stop verbal intervention in the markets by Fed officials.

2) Pushed the Fed to abandon its reliance on clearly flawed data.

3) Shifted Fed policy focus away from targeting asset price levels to targeting the

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SHORT-TERM ISSUES

- The Fed screwed up… the next crisis is here.
- Stocks to hold up into the G20.
- After that, the next leg down.

INTERMEDIATE-TERM ISSUES

- A bear market bringing the S&P 500 to the low 2,000s.
- China to enter a crisis.
- The EU to break apart.

LONG-TERM ISSUES

- A Crisis worse than 2008.
- Eventual market collapse of 50%+ in real terms.
- A scramble for high-end collateral to bring about derivatives collapse/ implosion of big banks.

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"neutral rate" or the level at which rates matched GDP growth and inflation.

These were not minor changes.

Regarding #1, during the Bernanke and Yellen years, it was commonplace to see one if not two Fed officials issuing statements to the financial media every week. Under Jerome Powell, this practice ended with Fed officials *rarely* issuing public statements outside of official Fed events.

Regarding #2, from 1987 until 2018, economic data in the US became increasingly unreliable as the political class leaned on the Fed and BLS to overstate growth and downplay structural issues in the economy. As a result of this, key economic data points (particularly GDP growth, inflation, and the unemployment rate) became complete fiction. Under Jerome Powell, this practice ended, with the Fed openly and officially seeking new methods for measuring REAL economic levels.

And finally, regarding #3, while the Fed never explicitly admitted it, it was clear to anyone paying attention that the Fed had become increasingly obsessed with stock levels during the last three Fed Chair's tenures.

Under Alan Greenspan, the Fed began ignoring clear and evident froth in the financial markets allowing the Tech Bubble to metastasize. His successor, Ben Bernanke, even went so far as to claim that Fed policy was a success **because** the stock markets were up. And *his* successor, Janet Yellen, was so obsessed with stock levels that she was lampooned in cartoons as being "married" to a bull.

It was here that Jerome Powell made the biggest change. As soon as he was appointed Fed Chair, Powell made it clear that his only focus was on reaching the "neutral rate." As a result of this, the Fed embarked on the single most hawkish monetary policy in history, with eight intended rate hikes planned for 2018-2019 as well as a Quantitative Tightening program through which the Fed would shrink its balance sheet by over half a TRILLION dollars per year.

This, in of itself, was extraordinary. But what made Jerome Powell a true revolutionary as far as Fed Chairs go was the fact that he maintained this strategy even when it began to blow up the financial markets.

Between January 2018 and November 2018, Fed policy blew up the emerging market space with China's stock market dropping 28%, India's dropped 23%, Mexico 21%, Brazil 22% and so on.

Jerome Powell didn't even acknowledge this.

Even more incredibly, Powell maintained the Fed's hawkish strategy when economically sensitive asset classes began to implode. During the first 11 months of his tenure as Fed Chair, Copper entered a bear market.

Gasoline fell nearly 30% from peak to trough.

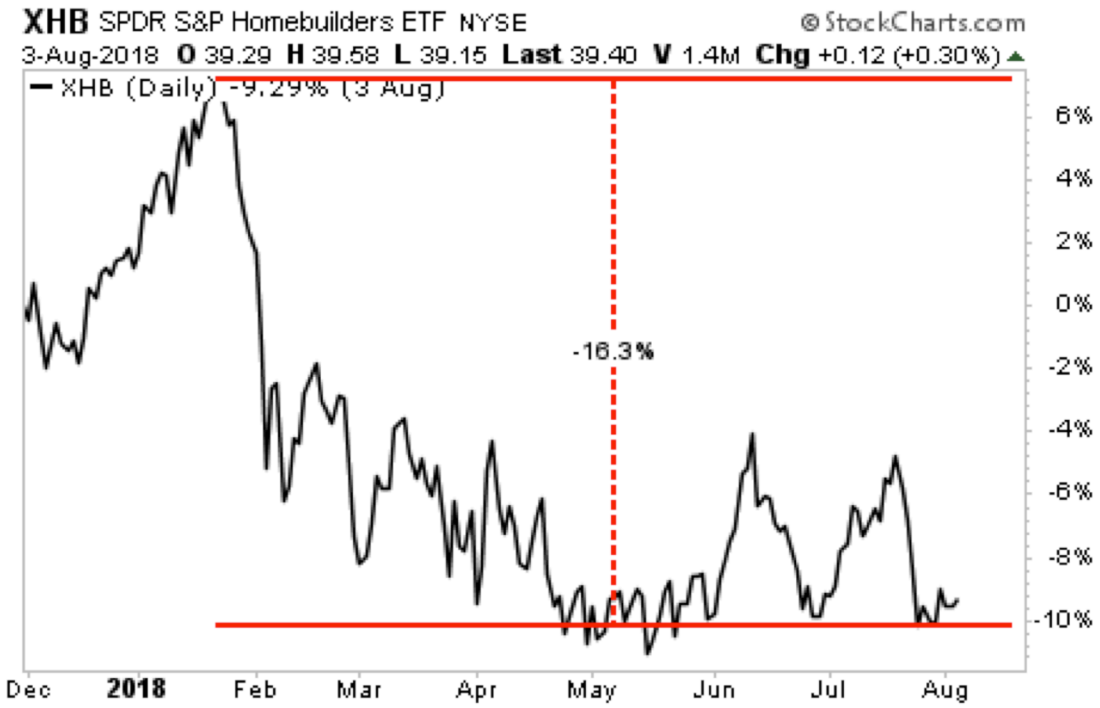
And Lumber went apocalyptic, falling more than 70% from peak to trough.

To top it off, it became clear to anyone watching that this was not just about commodities. As early as June 2018 it was clear that global growth was GONE.

Industrial giant and the world largest producer of large machinery, Caterpillar (CAT) entered a bear market in late June.

Over the same time period, General Electric (GE), which is often closely linked to economy growth, collapsed over 30%.

And finally, US Homebuilder stocks (XHB) collapsed over 16%.



Again, it was clear as early as June/July 2018 that the markets were sensing a completely slowdown in global economic growth.

And yet, here again Jerome Powell didn't waver from his hawkishness.

From January 2018 until yesterday, Jerome Powell didn't mention the large sell offs in economically sensitive assets once. Instead, throughout this time period, Powell repeatedly and emphatically stated that the Fed was focused exclusively on hiking rates until the Fed reached the "neutral rate": the point at which interest rates are equal to GDP growth while inflation is stable.

Indeed, a mere six weeks ago, Powell stated that the Fed was a "long ways" from the neutral rate, emphasizing that the Fed expected to hike rates again in December, and another 3-4 times in 2019.

Again, at the time Powell stated this, he had already ignored:

1) Bear markets in emerging market stocks.
2) Major drops, if not outright bear markets in economically sensitive commodities.

3) Major drops, if not outright bear markets in economically sensitive US stocks.

Which is why yesterday's admission was so astonishing. After 11 months of pushing the most hawkish Fed policy in history, yesterday Jerome Powell did a complete 180 and suddenly suggested that interest rates are already "just below" the neutral rate.

Even more astonishing, Powell suddenly became interested in risk assets, stating point blank that the Fed doesn't see a bubble in ANY major asset class.

> *We see no major asset class, however,* ***where valuations appear far in excess of standard benchmarks as some did, for example, in the late 1990s dot-com boom or the pre-crisis credit boom.***
>
> https://www.federalreserve.gov/newsevents/speech/powell20181128a.htm

Again, a mere six weeks ago, Jerome Powell was pushing for at least THREE rate hikes in 2019, which would mean rates at 3%-3.25% or even possibly 3.5%.

Then yesterday he says rates are "just below" the Fed's goal: a vague term but one that suggests **at most** two more rate hikes are coming (and this includes December, so only ONE rate hikes in 2019).

We're talking about a complete and total reversal in Fed Policy. And what's truly staggering is Powell didn't hint at or build up to this change in advance; he simply walked out and made this announcement as if it was expected!

The implications of this are vast, but the single most important one is that the Fed has implicitly admitted it screwed up.

For Jerome Powell to suddenly suggest the Fed is on the verge of completing its rate hike cycle after pushing the single most hawkish Fed policy in history NON-STOP and without the slightest hint of self-doubt for 11 months **is akin to him admitting he has no idea what he is doing.**

Imagine if you worked for a company at which the CEO pushed for an aggressive strategy to break into a new market for a year straight, all the while ignoring any criticism or differences of opinion on this strategy… only to walk into the office one day and say, "*scratch that, we're not going to break into this market at all. Let's do something else instead.*"

Imagine the impact that would have on marketing, R&D, and other departments in that company. Imagine trying to work under these conditions.

What Jerome Powell did was even worse than this.

Powell isn't a CEO of a corporation; he's the single most powerful Central Banker in the world, who controls the cost of money in the US baking system as well as the value of the reserve currency of the world, the $USD.

Never, not once in my entire career have I see a Central Banker do anything like this. Central Bankers are typically EXCELLENT at PR efforts no matter how incompetent their forecasting might be.

There's a reason for this: **the Fed is in charge of maintaining financial stability.**

Capriciousness and surprises do NOT bode well for financial stability.

Moreover, the secondary implications of Jerome Powell's statements are that:

1) The Fed has no clue what's going on in the economy (hence the sudden need to shift policy).

2) The Fed has no clue what the actual neutral rate is (ditto).

3) The Fed's goals are not actual goals but just nebulous concepts it promotes based on the whims of the Fed Chair (RIP forward guidance).

4) The Fed made a MAJOR policy mistake.

NONE of these are good things. In fact all of them are very, VERY bad.

However, perhaps the single most disturbing item is the fact that Powell must have realized something truly horrific is going on in the financial system to suddenly "stop on a dime" and drop his hawkishness.

Remember, this is the same man who stated that the only reason the Fed would even *CONSIDER* slowing the pace of its rate hikes would be if something so terrible occurred in the system that it resulted in a slowdown in consumer spending i.e. a SIGNIFICANT economic deterioration.

And yesterday Powell didn't state that the Fed was *considering* slowing the pace of its rate hikes… he said that the Fed was just about DONE!

Why?

Because the next crisis is here. And it's going to be BAD.

At this point I'd like to stop this issue. Please take some time to digest this. We are now in uncharted territory: a time in which the Fed has openly admitted it has no clue what is going on.

I'll have the second portion of this issue to your tomorrow. That portion will be devoted entirely to what's coming, along with detailed market analysis.

Until Then…

Best Regards,

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