TrendMacrolytics

Donald Luskin, Chief Investment Officer
David Gitlitz, Chief Economist
Thomas Demas, Managing Director

MACROCOSM

Hope, Greed, Fear, Worry and the Fed

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Donald Luskin

Fed policy will help stocks climb the wall of worry, even if it is entirely absurd.

In a *Trend Macro Live!* note before the open on August 22, we speculated that **Intel's** improved guidance might be the "starter's pistol" to kick off widespread acceptance of accelerating economic recovery. Confidence has indeed improved and more good news from the tech sector has been forthcoming, but if there's a race going on here it's not a sprint. The gradual, grudging acceptance of the reality of accelerating growth is reflected in the fact that the S&P 500 has edged higher every single trading session since August 22, and could still make it nine in a row with an upside close today.

We are in an awkward stage in the evolution of market psychology. In the classic cycle of hope, greed and fear, we have certainly moved beyond fear but haven't gotten all the way to hope yet. Where we are is "worry" -- the thing that bull markets climb a wall of. In this stage the inevitably mixed signals that come from an economy in transition will tend to be interpreted publicly in ominous terms -- but stock prices will tend to speak louder, and more optimistically, than words.

So it is with this morning's job numbers. The talk is that a "jobless recovery" is no recovery at all. Yet in an important sense, from a corporate shareholder's perspective, a jobless productivity-driven recovery is the best profit-maximizing kind. And as we pointed out earlier this week, productivity growth is (and demonstrably always has been) the most powerful catalyst of future job growth (see "Labor, Capital, Confusion" September 2, 2003).

Another potentially stock-friendly factor at play here is **the Fed**. In a speech yesterday Fed **Governor Ben Bernanke** indicated that productivity-driven growth wouldn't necessarily mandate monetary tightening if job growth is lagging. Even granting the absurdity that growth should *ipso facto* determine tightening or ease, it is doubly absurd to draw a distinction between different types of growth. Yet in a world in which the Fed believes that there are no signs of inflationary risk, Bernanke's view seems to be that it is a "free option" to gun the economy with the most accommodative possible policy. Good news for stocks if real recovery is underway already, and the Fed is committed to putting frosting on the cake.

This is not the first time Bernanke has expressed this view. We've wondered before whether this option is really as free as he thinks (see "How Much Will These Free Options Cost?" June 25, 2003). Continued extreme ease in the face of recovery, jobless or otherwise, is playing with inflationary fire. And the Fed has a poor record of keeping its fingers from getting burnt.

But at least for the moment, even if this Fed policy approach is built on error, the potential consequences of that error haven't happened yet, and remain only risks. Right now, the Fed's stance is acting to ameliorate another signature concern of this "worry" phase -- that rising interest rates will choke off the very recovery they seem to be anticipating. That's very good for stocks. Bonds, on the other hand, being more sensitive to latent inflationary risk and still cautious after this year's Fed miscues, may not be able to sustain much of a recovery even in light of Bernanke's statements (see "Is This What They Had In Mind?" August 18, 2003). TM

http://www.trendmacro.com
don@trendmacro.com
dgitlitz@trendmacro.com
tdemas@trendmacro.com

Offices:
Menlo Park CA
Parsippany NJ
Stamford CT

Phone:
650 429 2112
973 335 5079
203 322 1924