

Weekly Commentary

October 11, 2010

The Markets

Investors seem to be putting a lot of faith in the Federal Reserve right now.

Since the financial crisis began in 2008, the Federal Reserve and other branches of government have engaged in creative and somewhat unorthodox ways to try and shock the economy back to good health. While reasonable people disagree on the effectiveness of the government's intervention, it's fair to say that, so far, we avoided a repeat of the Great Depression. Whether that avoidance was due to, or in spite of, the government's intervention will be debated by academics for years.

One thing that we can say with confidence is that government intervention has distorted the financial markets to some degree. For example, over the past couple years, the Federal Reserve bought about \$1.75 trillion of agency debt, agency mortgage-backed securities, and longer-term Treasury securities. These purchases helped reduce government bond yields. In turn, these low interest rates have put pressure on the value of the U.S. dollar, helped boost oil and commodity prices, and helped send gold to record highs.

Last Friday, another distortion became clear when the Department of Labor released the payrolls report, which showed a loss of 95,000 jobs in September. That was worse than the expected loss of 5,000 jobs, according to Bloomberg. This "bad" news didn't phase the stock market as it rose for the day. The logic behind this "bad news is good news" idea is that with the job market still quite soft, this makes it even more likely that the Fed will step in with another round of quantitative easing. So, investors put their faith in the Fed thinking that it will swoop in to the rescue and flood the system with cheap money, which, in theory, could help the economy.

Federal Reserve and U.S. government intervention in the financial markets is not new. However, the degree to which it is occurring is rather stunning. While it may keep the economy and the financial markets propped up, the question becomes, for how long? If the juice from the government runs out, will the economy run out, too? Or, will the juice last long enough for the patient to get well and lead us into a vibrant economic expansion?

Data as of 10/8/10	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	1.7%	4.4%	8.7%	-9.2%	-0.4%	-1.8%
DJ Global ex US (Foreign Stocks)	2.3	6.0	7.8	-9.0	3.3	2.8
10-year Treasury Note (Yield Only)	2.4	N/A	3.3	4.6	4.4	5.8
Gold (per ounce)	1.9	21.5	28.4	22.3	23.2	17.4
DJ-UBS Commodity Index	3.8	3.7	10.7	-5.7	-3.6	3.0
DJ Equity All REIT TR Index	2.3	22.3	35.3	-6.4	3.8	11.2

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

HOW LONG IS THE LONG-TERM? Financial advisors commonly tell their clients to “invest for the long-term,” but how long is that? Well, how about 100 years?

Mexico, of all places, issued a government bond on October 6 that yields 6.1% and matures in 100 years, according to *Financial Times*. That’s longer than the average life expectancy for a baby born today. Despite the extremely long maturity, there is a legitimate reason for this type of bond.

The greatest demand for these bonds came from U.S. insurance companies, which makes sense. Insurance companies have a very long time-horizon because they insure people’s lives. And, while 100 years is longer than the average term of a life insurance policy, it gives insurance companies a little more predictability on the source of income that they can use to fund death claims.

Jeffrey Rosenberg, global credit strategist for Bank of America Merrill Lynch, pointed out in a CNBC article that issuing a 100-year bond is also a side-effect of the Federal Reserve’s easy money policy. Rosenberg said, “Lack of yield in risk-free alternatives forces investors out the risk spectrum -- either down in quality or out in maturity -- in search for yield.” In this case, investors were doing both, i.e., dropping down in quality and extending their maturity.

While a 100-year bond might work for an insurance company, the general public seems to prefer shorter-term bonds that have more liquidity. After all, in this day and age, you never know when you might need access to your investments on short notice.

Weekly Focus – Think About It

“There is a time for departure even when there's no certain place to go.” --*Tennessee Williams*

Best regards,

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