First Trust
Monday Morning OUTLOOK
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# Panic, Punts and Reality

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The biggest single college football play of 2015 happened in Ann Arbor, MI, on October 17th. The ball was at mid-field, it was fourth down with two yards to go and there were only 10 seconds left in the game. The Michigan Wolverines were beating the Michigan State Spartans, 23-21.

Michigan chose to punt the ball – a typically boring, and very safe play. In 2015, college teams punted, on average, about five times per game. Less than 2% of these punts were blocked; even fewer were returned for touchdowns.

The Michigan punter bobbled the snap and it bounced into the hands of a State player, who ran it in for a touchdown. The Spartans won the game (27-23) and will soon play Alabama in the first round of the college football playoffs. Huge play!

So, the question is, does this fluke play change how coaches manage future football games? The answer: No way!

We ask, and answer, this question because the ghost of 2008 (a once-in-a-century economic panic caused by mark-to-market accounting) is influencing many analysts, journalists, money managers, and policy-makers, who still don't really understand what happened.

As a result, with the Federal Reserve on the verge of lifting interest rates by ¼ of 1%, these pouting pundits of pessimism are freaking out because it's the first rate hike in a decade and junk bond yields are soaring in a way reminiscent of the Lehman Brothers failure in September 2008.

Today's *Wall Street Journal* has a story written by the well-connected John Hilsenrath saying, many economists believe the Fed will lift rates now only to cut them back to zero in the future. This argument is based on some relatively obscure historical data and fears that something bad "might happen."

But these arguments are just forecasts based on fear, and a misguided narrative that economic growth and rising stock prices since 2009 have been a "sugar high," caused by the Fed's easy money policy. We don't believe that. Yes, the Fed bought a lot of bonds, but the banks hold a vast majority of that money in excess reserves. That's why inflation remains low.

Growth has been powered by new technology, not Fed policy. Oil prices are down because of new supply, not a "potential" set of rate hikes sometime in the future. In addition, regulatory over-reach, otherwise known as Dodd-Frank, has limited the depth and breadth of bond markets as banks fear being labeled proprietary traders.

Three small funds are in various stages of shutting down due to a lack of liquidity combined with redemption requests. They include Third Avenue Management's $788 million mutual fund, Stone Lion Capital Partners $400 million hedge fund and Lucidus Capital Partners $900 million high-yield credit fund. Other funds face redemptions as well, leading many to argue that there is a lack of liquidity in the high-yield bond market.

Is this Lehman Brothers all over again? We highly doubt it. A Fed rate hike has been a long time coming and any investor or fund that wasn't prepared for this is highly suspect. Moreover, now that overly strict mark-to-market accounting rules have been fixed, any systemic problems are highly unlikely.

In 2008, Tier One capital ratios at the four largest banks were just 7.5%. Today, these banks have 12.1% capital ratios. Moreover, after the Fed does tighten on Wednesday, the banking system will still have over $2.5 trillion in excess reserves. In other words, raising rates will not reduce available liquidity in any significant way.

In the past year, the M2 money supply is up 5.8%, commercial and industrial loans have grown 11.4% and corporations have record amounts of cash on their books. There is no evidence of tight money or liquidity constraints. Any business, individual, fund, or institution that needs zero percent interest rates to survive should not exist.

In 2013, when Ben Bernanke said he would like to end Quantitative Easing, the markets had a "taper tantrum." Today's market turmoil is the equivalent of that emotional upheaval. In the end, tapering happened, the economy kept growing and the stock market moved to new highs. The same will be true for this rate hike as well.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 12-15 / 7:30 am | CPI – Novs | 0.0% | **0.0%** | | +0.2% |
| 7:30 am | "Core" CPI – Nov | +0.2% | **+0.2%** | | +0.2% |
| 7:30 am | Empire State Mfg Index – Dec | -7.0 | **-5.5** | | -10.7 |
| 12-16 / 7:30 am | Housing Starts – Nov | 1.130 Mil | **1.135 Mil** | | 1.060 Mil |
| 8:15 am | Industrial Production – Nov | -0.2% | **-0.2%** | | -0.2% |
| 8:15 am | Capacity Utilization – Nov | 77.4% | **77.3%** | | 77.5% |
| 12-17 / 7:30 am | Initial Claims – Dec 12 | 275K | **273K** | | 276K |