First Trust
Monday Morning **OUTLOOK**

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Money Misperceptions

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1 – The Panic of 2008 was not caused by tight monetary policy. 2 – Zero percent interest rate policy (ZIRP) and Quantitative Easing (QE) did not save the US or global economies. 3 – Monetary policy in the US is getting looser as the Fed hikes rates, and, 4 – negative interest rates in Japan and Europe are not working.

How's that for four consecutive statements that are 180 degrees different than Conventional Wisdom? Most leaders in charge of the commanding heights of government believe the conventional wisdom, and cling to it like religion. But then, they all have a vested interest in it.

Many in the money management business, find it easy to believe as well. If central banks are all running very loose monetary policies, buy stocks, or bonds! And for short-sellers, and those who sell online newsletters and books about the end of the world, it's easy to say all this easy money is just a "currency war" that will end with hyper-inflation, trade wars and an economic catastrophe.

So, which is it? What's really going on? How does an investor decide? The best we can do is explain our more nuanced analysis. It's not really all that complicated, just different.

So first (1), it is important to understand that a 1% federal funds rate in 2003 helped fuel the Fannie and Freddie surge in sub-prime lending. It is also true that Fed rate hikes in 2004-06, with the funds rate moving above 5%, took away the super-easy credit and undermined those who had bought overpriced houses with adjustable-rate, sub-prime debt. Nonetheless, those rate hikes did not lead to a contraction in liquidity. No measure of money actually declined in 2007 or 2008.

It was mark-to-market accounting that created solvency issues, not liquidity issues. Questions about accounting created the crisis, not a lack of liquidity.

Second (2), QE was started in September 2008, TARP was passed 10/3/2008 and ZIRP soon after. Yet the market fell considerably more after these policy attempts to save the US. It wasn't until mark-to-market accounting was changed in March/April 2009 that stocks and the economy bottomed - the Panic was finally over. Since then, the US has had a slow, but normal (meaning driven by entrepreneurship) recovery.

Third (3), even though the Fed bought $3.5 trillion of bonds during its QE operations, banks sat on most of this cash holding it as excess reserves. Even though the monetary base was rising at a 25% annualized clip, M2 (all deposits in all banks) kept growing at a 6% annual rate. This is why the dollar never collapsed and the US did not experience hyper-inflation.

In fact, the December Fed rate hike was the first rate hike in history where bank reserves were not contracted. There are still $2 trillion in excess reserves in the system. Money is not tight at all, and the M2 money supply has accelerated to a near 8% growth pace. The US money supply is accelerating as rates move higher and it is more profitable to lend.

Finally (4), negative interest rates encourage cash hoarding. Why not hold cash and get a zero percent rate, especially when deposits potentially face negative rates? M2 money supply growth in Europe during Q4-2015 was just 5.3% and loans are growing slowly. In Japan, M2 declined in February from January and is only up 3.1% in the past year.

In other words, the M2 money supply is growing faster in the US than it is in Japan and Europe. No wonder the dollar is weaker today versus the yen and the euro than it was a year ago.

It's so easy to say that the US is raising rates, while Europe and Japan are cutting, so the dollar will get strong, but this has it backward because the experimental policies of global central banks are not working.

The only way to get faster growth in any country is to use the fiscal policy levers - tax cuts, spending cuts, and regulatory relief - what the PC-crowd calls "structural reforms" in order to shield politicians behind rhetoric. But the real story is that growth in the US is accelerating and that bodes well for investors who can cut through the clutter, believe in entrepreneurship and tune out the government's "press agents."

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-21 / 9:00 am	Existing Home Sales – Feb	5.310 Mil	**5.240 Mil**	5.080 Mil	5.470 Mil
3-23 / 9:00 am	New Home Sales – Feb	0.510 Mil	**0.511 Mil**		0.494 Mil
3-24 / 7:30 am	Initial Claims Mar 21	268K	**268K**		265K
7:30 am	Durable Goods – Feb	-3.0%	**-3.4%**		+4.7%
7:30 am	Durable Goods (Ex-Trans) – Feb	-0.3%	**-0.2%**		+1.7%
3-25 / 7:30 am	Q4 GDP Final Report	1.0%	**1.0%**		1.0%
7:30 am	Q4 GDP Chain Price Index	0.9%	**0.9%**		0.9%