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# DouglasBradley

Personal Financial Advisors

## DouglasBradley's MONEYWISE

Financial News and Insight from an Independent Advisor

December 2010

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### Personal Notes

#### **Doug -**

On the Friday after Thanksgiving, my wife and I headed up to New Jersey for my 20th high school reunion. I was a little apprehensive - I didn't grow up where I went to high school and my parents moved away soon after I graduated. So I haven't seen or talked to most of my my classmates in 20 years. But it turned out better than expected. I got to catch-up with a few old friends and hear what they've been up to. It was funny, everyone was essentially the same as I remember them, just a little older. And I was surprised at how many people still live in New Jersey considering how expensive it is to live there. But all-in-all it was a worth while trip.

#### **Brad -**

Another summer boating season has

*The Federal Reserve Board's policy of Quantitative Easing is the gift that keeps on giving (Part 3 of 3).*

This month's MoneyWise is the final installment in a three part series on the concepts and actual implementation of the government policy known as Quantitative Easing (QE). In October, we introduced you to QE and why it is being used by our government leaders. We timed our primer so you were educated and prepared when on November 3<sup>rd</sup> the Fed, under Chairman Ben Bernanke, announced its second round of QE (QE2) in the amount of \$600 billion. In November, we explained and illustrated in pictures the impact QE has had on the stock market since March 2009. To finish up the series, this month we'll discuss the future of QE and its long-term implications for the stock market and the economy at large. (If you haven't read the two previous editions of MoneyWise on QE, we encourage you to do so before moving forward.)

It has to be said that the effects of QE and QE2 had their desired impact. For those invested in stocks since the announcement of the first QE in March 2009, you are certainly richer today largely due to the Fed's pumping up of the stock markets. This is what is referred to as the "wealth effect" and it is a stated goal of our financial leaders. The "wealth effect" is the idea that making people "feel" richer will spill over and make them "act" richer (i.e., more apt to spend money). Therefore, by artificially inflating stock and house prices, consumers can be induced to spend more on goods and services - which in turn stimulates employment, taxes, new investment, etc.

Unfortunately, there are negative consequences to using QE, including:

- an exploding Federal deficit (that will ultimately lead to higher interest rates and inflation);
- currently artificially low interest rates/yields on bank accounts, CDs and money markets (that hurt retirees);
- higher future tax rates (to pay down aforementioned government debt);
- reduced government entitlements (e.g., Social Security and Medicare) and services (because they are no longer affordable);
- the declining value of the US dollar (making imports more expensive);
- the shifting of mortgage losses incurred by private banks onto the backs of US taxpayers;
- speculative investing in commodities (cotton, sugar, wheat, gasoline);
- trade tensions with important countries like China; and,
- extreme wealth inequality (as only people with investment assets have seen their net worth grow).

come to an end for me. It was a quick one as I got a very late start due to our workload. I did extend it as long as I could into the fall, however. I pulled my boat from its slip and spent a couple of days recently winterizing the engine and getting the boat shipshape so that it could be shrinkwrapped for the winter. I'm hoping I'll find the time to put the boat in the water before August next year and get more than 3 months of enjoyment from it.

#### **Mahesh -**

With cold weather fast approaching, my family and I headed back to Florida over the Thanksgiving holidays. For the first time, we visited the west coast - Ft. Myers and Naples. I still prefer the east coast - Miami and Ft. Lauderdale - but like the hot weather wherever it is. We hope to get back there soon.

Also, the rampant use of QE doesn't force the government, financial institutions or US citizens to directly solve the underlying causes that created our country's economic woes. Instead, at a significant long-term cost, they are merely "kicking the can down the road".

Considering the benefits in light of the consequences, will the Fed under Ben Bernanke stop at QE2? We doubt it. Bernanke's words, including his Sunday appearance on "60 Minutes", suggest he is prepared to institute QE3, QE4, and even QE5 if need be to keep the economy from dipping into a second recession (or worse).

There is the hope that just the threat of QE3 is enough of an impetus to keep asset prices artificially high and the wealth effect in force. It would be a positive outcome if only the talk of a QE3 could achieve the desired results without spending the money and increasing the US debt. Think "Pavlov's Dog." But either way, US stock market investors are now conditioned to invest based on promises of more US government stimulus versus on underlying business fundamentals - not a healthy situation for the long term.

Despite our dissatisfaction with the use of QE, we understand what the Fed and US Treasury are trying to accomplish. They have found that their only option is to knowingly build an unstable bridge to span the gap between today's poor economy and a better tomorrow. The rickety bridge is better than no bridge at all while waiting for a stronger bridge to be built. The strong economic bridge would be built on a solid foundation comprised of new technologies, new businesses, updated employee skill sets, growing income equality, rising home prices, lower household debt, etc. In the meantime, the Fed has to spend, spend, spend.

Fortunately, at DouglasBradley we've been expecting and planning for the outcomes of QE on the economy and our clients' portfolios for years. The primary goal of all investors should be to protect their investment portfolios from the intended and unintended outcomes of the Fed's policies. We have strenuously argued for large gold positions in every portfolio since early this decade and we still feel the same way. The run-up in gold prices over the past two years validates what we were saying back in 2001 and 2002. We fully expect the price of gold and the stock of gold mining companies to surge still higher as the global economy struggles to find a solid footing. That said, we are not one-trick ponies and have identified other opportunities for growing wealth in the years to come. Feel free to contact us if you'd like to discuss our thoughts on how you should plan for retirement in such an unfriendly economic environment.

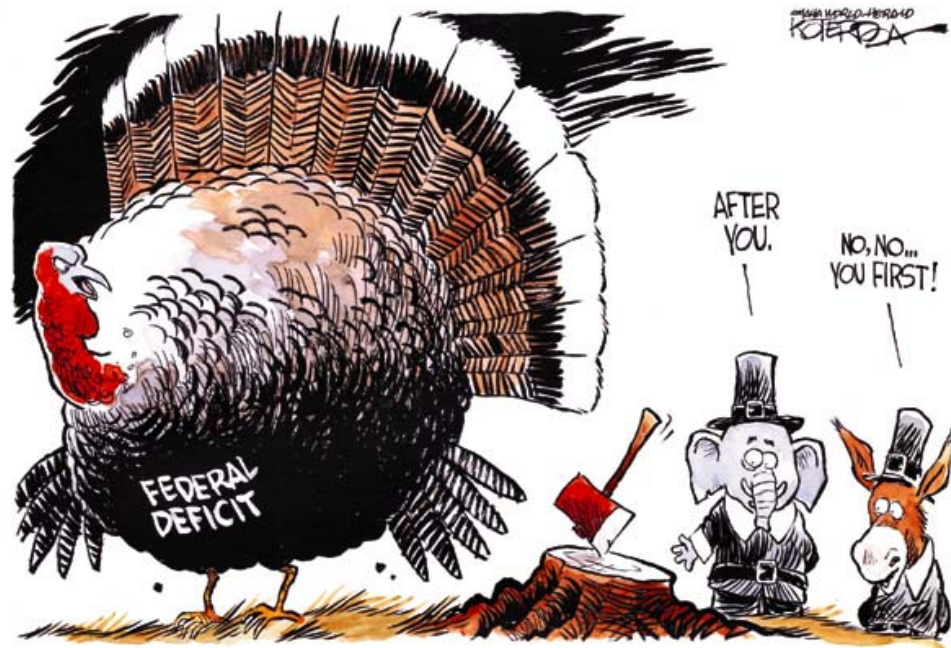
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## HAPPY HOLIDAYS!!

From everyone at DouglasBradley, we wish you and your family a very Happy Holiday and best wishes for a healthy, happy and prosperous 2011.

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