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# DouglasBradley

Personal Financial Advisors

## DouglasBradley's MONEYWISE

Financial News and Insight from an Independent Advisor

November 2010

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*An illustration of the impact of the Federal Reserve Board's policy of Quantitative Easing on the stock market (Part 2 of 3)*

#### QE2: The Sequel

#### Cartoon

### Personal Notes

#### **Doug -**

October is always a busy month for us. My youngest daughter's birthday is at the beginning of the month; the oldest's is at the end of the month; my in-laws come down for their annual October weekend visit; and of course we have Halloween. On our one free weekend, Patty and I went to Atlantic City with long-time friends of ours. We both celebrated 15 years of marital bliss this fall. It was a beautiful weekend, so we got to stroll the boardwalk. We enjoyed some very nice restaurants, and since we're not big gamblers we got our entertainment from "people watching". It's nice to get away every so often and remember that we're a "couple" and not just "parents".

This month's MoneyWise is the second in a three part series on the concepts and actual implementation of the government policy known as Quantitative Easing (QE). We've been talking about it for months, but now that it has entered the mainstream vernacular we thought it important to explain it in-depth. Last month we introduced you to QE and why it is being used by our government leaders. We timed our primer so that 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. (If you haven't read last month's introduction to QE, we encourage you to do so before moving forward.)

In this edition of MoneyWise we'll show you the impact the original round of QE had on the stock market over the ensuing 18 months. Our purpose is to give you an understanding of what the future might hold for us after QE2. To finish up the series, in December we'll discuss the future of QE and its long-term implications for the stock market and the economy at large.

The first round of Quantitative Easing was announced by Ben Bernanke on March 18, 2009. By this time the stock market had been falling for more than a year and it was close to six months after the financial collapse of Bear Stearns, Lehman Brothers, Merrill Lynch, AIG, etc. Most investors, both professional and individual, did not understand the implications and enormity of what the Fed was about to embark on. In fact, other than the Wall Street insiders who would ultimately profit the most from QE, no one would have believed that our own government would use more than a trillion dollars of debt and taxpayer money to manipulate the stock market higher by artificially stimulating/inflating asset prices. And, to a degree, it worked wonderfully - if you were a partner at Goldman Sacks or other large Wall Street investment firm. But what if you were unemployed or underemployed? Well ... you know the answer to that question.

As you can see in the chart below, the stock market took off in March 2009 - immediately after stock speculators and hedge funds got the word from the Fed that the government would go to any length to prop up the markets.

**Brad -**

Doug and I made a very productive trip to San Antonio, Texas in October. The purpose was to conduct Due Diligence meetings with a mutual fund company that manages a large portion of our assets under management. Over two days, we had the opportunity to speak directly to the portfolio managers who make the investment decisions on behalf of our clients. Because US Global Funds manages specialty mutual funds (vs. general funds), the managers have a deep understanding and expertise in their respective areas. For instance, the managers of the China fund were born and educated at elite universities in China. The same was true of the manager of the Eastern European fund who we had a chance to have dinner with the day after he returned from Russia where he met with company CEOs as well as his parents. We had a particularly good conversation with the manager of the gold mutual funds. He is a mining engineer with decades of experience who still takes the time to travel to even the remotest mines in the world. We did sneak in a little fun when we met delightful clients from Austin, Texas for lunch one day.

**Mahesh -**

I completed my soccer coaching season for both of my kids. I am looking forward to my four week break before I begin the basketball



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When the effects of the first QE failed to revive the economy (and, really, why would it have because it didn't really increase productivity or encourage investment), Bernanke decided he'd try the same failed strategy a second time. To be fair, the government and Fed have run out of any other options to revive the economy so they are forced to try to create the illusion they have the situation under control. Anyway, Bernanke first hinted about QE2 in a speech in Jackson Hole, Wyoming on August 27, 2010. After seeing what the first round of QE did to inflate stock prices, is it any wonder that the stock market took off after the 27<sup>th</sup>? Of course, betting on the effects of QE2 is not really investing. It is speculation and relying on government hand-outs instead of actual gains in employment and GDP growth.

Speculators got their hopes and wishes for QE2 fulfilled on November 3<sup>rd</sup> when Bernanke formally announced that another \$600 billion of taxpayer money would be pumped into the stock markets. By that time, of course, speculators had already "jumped the gun." Referring back to the chart, you can clearly see that the market again started to rise after just the idea of QE2 was mentioned in late August. Heck, why bother to wait for an actual announcement when a rumor will suffice. And to that point, why bother to actually pump the money into the economy when it appears speculative investors can be motivated to buy stocks by a mere mention of free money?

Next month we'll talk about the longer-term implications of all this stimulus and what the insatiable need for it really says about the state of our economy. Here's a teaser: we've seen one conclusive outcome of the stimulus and it is one we've been predicting for years. Namely, a meteoric rise in the prices of gold, silver and other commodities as the recipients of the QE and QE2 look for investments sure to increase the most as a result of the expansion of the money supply. Since November 2008 the price of gold bullion has nearly doubled and the index of gold mining stocks has gone up 240%. And, to be truthful, with the

season in the first week of December. For the Thanksgiving break, I will be taking my entire family down to Florida to vacation with my wife's parents. It will be my first visit to Fort Myers, although I visit Florida often. If you know me, I would gladly sit in the middle of a Florida swamp to absorb the sun versus staying in the North during the winter months!

Fed insistent of following this course of action we don't think gold has stopped its advance by any means.

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