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I wish I wish with all my heart …FOMC Take Action

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In the early years of this 21st Century, my young daughter, Carrera, watched the show Dragon Tales on PBS daily. The series was about a brother and a sister who can enter into the magical dragon fantasy land by reciting a rhyme which started with "I wish, I wish with all my heart". According the PBS website under the Dragon Tale FAQs, there are three primary educational goals: 1) encourage children to take on new or difficult challenges in their lives, 2) help children recognize that there is more than one way to approach a challenge, and 3) help children understand that to try and not succeed fully is a valuable and natural part of learning.

Perhaps the Federal Reserve ("Fed") should apply these three goals as the Federal Open Market Committee (FOMC) prepares to meet this week to determine its interest rate policy. Over the past three years and with an increasing drum beat, investors, economists, prognosticators, and observers have been anticipating the end of the zero interest rate policy (ZIRP) and that one day the FOMC will begin normalizing interest rates ("Lift Off"). After experiencing the taper tantrum in the summer of 2013 and the end of large scale asset purchase program (a.k.a. Quantitative Easing) last November, the market has been even more sensitized to Lift Off. The thought that the punch bowl will be removed after 6 years and the liquidity saturated party will end is uncomfortable to say the least. Like a drug, the market has gotten used to a safety net that was cast during a much different set of circumstances. The unconventional monetary policies were initiated in 2009 as an attempt to avoid transforming the Great Recession into a financial depression. Although today the U.S. and the rest of the world are not back to normal (employment, inflation and economic growth), the U.S. is far from where it was at the depth of the Financial Crisis where we were facing a likely collapse of our financial system and our economy.

The Fed has two congressional mandates: full employment and price stability. Employment is one of the most important drivers in an economy. Even though a strong case can be made to suggest we have not reached the natural full employment rate, over the past six years we have watched a slow but meaningful drop in unemployment rate with a steady and material increase in job creation. The economy is healing progressively as we move further away from the Great Recession. Clearly, there are economic winners and losers in this economic cycle and millions of Americans remain underemployed and unemployed. The current 5.1% U3 rate does not represent the complete reality of American labor condition. It is this slack in the labor economy that can best explain the missing wage inflation. However, there are more people working today and thus more are earning an income. In the aggregate, this is good for the U.S. economy since two thirds of our GDP is made up of consumer consumption. Our banks and corporations are at their best financial conditions in years and are more able to absorb systemic shocks. Even the

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consumer balance sheets have significantly improved (albeit through defaults, bankruptcies and hard work). Although we are far from perfection, the economy is at a much improved place today than 2009. The QE and the ZIRP have done their jobs (to what extent remains unanswerable), and it is reasonable to say that the patient is out of intensive care and the unconventional methods should be removed. In fact, the application of unconventional procedures can do more harm than good when the patient is well on his way to health.

In an effort to normalize monetary policies, the Fed has moved to end QE as the economy stabilized, used forward guidance to guide the market regarding interest rate policy, and is now relying on data to make the Liftoff decision. The constant theme throughout has been transparency. The Fed has broadcast its thinking and decisions through governor speeches, post FOMC meeting Q&As, publishing meeting minutes, "plan talks", congressional testimonies, and writings. Nonetheless, this has been a case of the more disclosure the more the market needs to know. Actually, through constant communication, the Fed has painted itself into a corner with less freedom to act. I submit that the Fed has not succeeded in its guidance. Ever since the data dependency phase, the data, message and action appear to be inconsistent. All of this has contributed to uncertainty. In fact, the Fed's credibility is being challenged.

The current market volatility is rooted in the China led emerging market slowdown and the uncertainty of Liftoff. The Fed's decision this week is unknowable, and the odds of Liftoff change almost daily. If the Fed decides to wait, then the weight of uncertainty will linger until the Fed acts to begin rate normalization. However, if the Fed moves this week, it confirms that the U.S. economy can stand on its own and the negative effects and unintended consequences of ZIRP can begin to dissipate, which in the aggregate is good for the economy. In this case, the U.S. stock market should react very positively.

I wish, I wish, with all my heart that the Fed will: 1) take on the Liftoff challenge this week by raising rates; 2) make data dependent decisions but not backward looking ones; and 3) have courage to Liftoff. Zig Zigler, the great salesman, once said that if you wait until all the lights turn green, you will never get out of the house. Almost all decisions are made without a complete set of information, and career and reputational risks should not be part of the decision making process for the FMOC. There will be mistakes, errors, and unknown consequences that can only be obvious after the fact. A no action decision is not always the conservative or right option.

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