Victoria Capital Management, Inc.

Market Musings

A newsletter brought to you by Victoria Capital Management, Inc.

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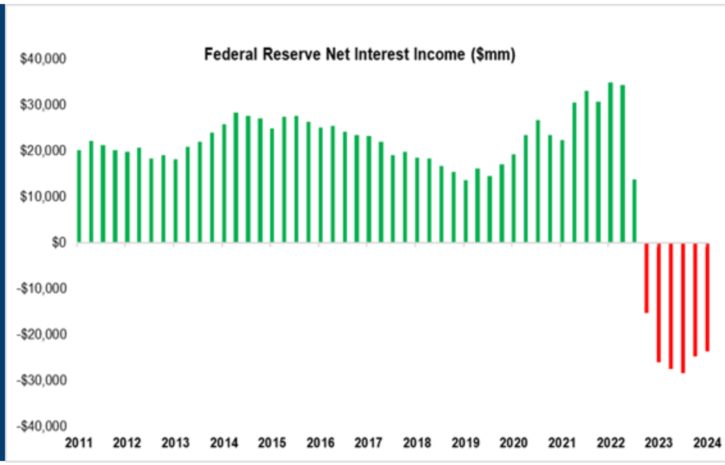
The green bars represent the net interest income that the Federal Reserve received during their quantitative easing policies from March 2011 to September 2022. The red bars represent the absence of net interest income during quantitative tightening that began in late 2022.

(data source: Federal Reserve Board of Governors)



Another Perspective on Monetary Policy

One definition of “Musing” or “Musings” is paraphrased in the following: “My musing and writings on this issue do not come from the groves of academe.” (Herbert S. White) So our perspective on the impact of monetary policy is musing for us.

Ever since the financial crisis of 2008, the Federal Reserve embarked on quantitative easing, “a form of monetary policy in which a central bank purchases securities on the open market to achieve a desired outcome.” This program, known for short as “QE” is to lower interest rates, and increase money supply and lending. When we examine this action, we come to a different conclusion. The Federal Reserve buys securities (such as mortgages) exchanging low-yielding reserves for higher-yielding securities. In the process, the Fed takes money out of the economy via the excess interest the Fed receives on these transactions and then turns this money over to the Treasury. For the ten years ending 2022, the Fed gave the Treasury almost $1 trillion from the excess interest earned from the bonds purchased from the private sector. Did QE provide liquidity to the economy when such a large wealth transfer took place during these years? Then, when the Fed began to “tighten” by raising interest rates to slow inflation and the economy, the Fed sold securities to the private market and took back reserves. This transaction resulted in the private sector receiving interest payments and the Fed giving up those receipts. The Fed began to lose that interest income because of these transactions and the private sector had much more money to spend.

If economists were to look at this wealth transfer from the public to the private sector, they may begin to understand why the economy continued to do well why there was no surge in unemployment, and why there are reduced expectations of an imminent recession. The higher interest rates that were supposed to slow the economy provided greater growth instead because the demographics favored savers vs. borrowers by giving them a major surge in income that they spent to maintain or improve their standard of living. There may be other explanations that contradict the traditional wisdom of quantitative easing or tightening but we do not think that they would provide a reasonable explanation of why the consensus of economic forecasters missed this outcome.

“Never let the fear of striking out keep you from playing the game.”

- Babe Ruth

Market Commentary

April’s showers brought May’s flowers. U.S. large-cap equities posted their best monthly performance since February, with the S&P 500 up 5%. Even mid and small-caps fared well with gains of 4% and 5%, respectively. All sectors, except for energy, were positive. Across the pond, the S&P Europe 350 soared 3.5% to extend its year-to-date gain to 10.9%. Mid and small-caps did even better, returning 3.9% and 6.0%, respectively. All 16 countries contributed positively to returns. In Asia, Taiwan is still the leader with a return of more than 18% so far this year. Japan came in as a close second. Across the globe, bonds declined as investors worried that inflation was returning. The U.S. dollar was relatively strong, but the Japanese yen continued to remain weak.

In March, the Bank of Japan became the last central bank to exit from its negative interest rate policy. At the peak of the global zero-interest rate policy regime, more than $18 trillion in global debt traded at a negative interest rate.

source: Bloomberg