

JAPAN & QE3

WEB BUZZ 2011.03.21

We would imagine that many business analysts will be putting their spin on the Japanese misfortune. We can hear the brokers now calling their list of prospects, drumming up all the stocks that will benefit from the rebuilding of Japan. They did it for Katrina and this event should be even larger.

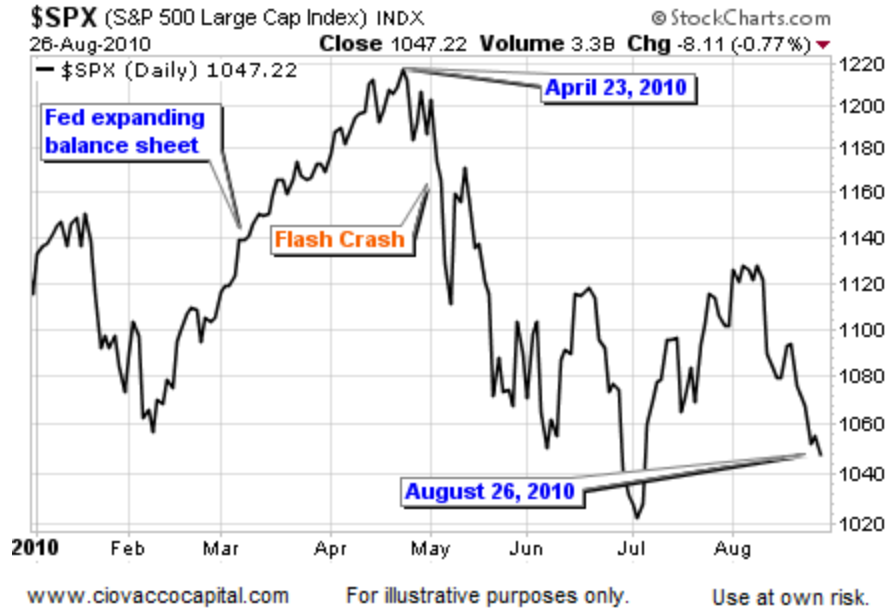
Yes there will be some isolated areas that will benefit from the misfortune of others; however, if having an event like that in Japan is good for economies, why not just blow up the entire country along with China and Korea? The answer, of course, is that there is a huge net loss that will be gone forever. You cannot create wealth by destroying it. A lesson not learned by many in the financial business.

Things will only get worse if the Fed continues its current atrocious policy. QE3 may be coming, but we are hopeful they will stand aside. If they don't, things will only get worse - it's the rule of unintended consequences. Monetary and fiscal policy have become this country's own worst enemies. As indicated above, what seems good turns bad and what seems bad can become good, e.g. in the latter case letting the economy complete its recessionary tendencies by not artificially propping it up hurts in the short-term, but has positive long-term consequences.

Now on to other things. The following charts reveal the market action of the S&P 500 after the announcement and implementation of QE1 and QE2.

Stocks Dropped As The Fed Wrapped Up QE1

From April 23 to August 27, the Fed allowed its balance sheet to shrink from \$1.207 trillion to \$1.057 trillion for a 12% contraction as QE1 drew to a close.



Adapted from seekingalpha.com

Bernanke Signals QE2 Is On The Way



Adapted from seekingalpha.com

There is no question that risk-takers love this type of Fed intervention. It signals that they are ready and willing to make funds available for speculation. The downside of this, of course, is the huge increase in the price of stocks and commodities, which have caused food and gasoline prices to rise. The riots we have seen in the Middle East and North Africa are primarily a result of this intervention in our opinion. It also is having a major impact on the U.S. economy, which has millions of unemployed and underemployed people struggling to make ends meet and in which a recent study indicates that 35% of personal income is government transfers.