notes from the Assabet Vol. XVII No. 2

Second Quarter, 2019

Pressing the Fed

Late in 2017, Donald Trump appointed Jerome Powell as Chairman of the Federal Reserve, to replace popular Chairperson Janet Yellen. Under Yellen's direction, and that of her predecessor Ben Bernanke, the U.S. economy had emerged from the financial crisis known as "the Great Recession." Powell was expected to bring continuity to Yellen's current policy of slowly normalizing interest rates while shrinking the balance sheet which had grown enormously as a part the of "Quantitative Easing" program. Not the typical model of Fed Chairman, he lacked a PhD in Economics. His background was more practical than academic as he had served as a lawyer in investment banking as well as in the Treasury. Yet broadly welcomed, he began to follow Yellen's lead of adjusting monetary policy. Interest rates were hiked 5 times under Yellen, and 4 times in 2018, under Powell's watch.

Trump has been known to skirmish with his own appointees, but a power struggle with the Fed Chair raises some unique issues. Within a year, as the S&P 500 stock index experienced some consecutive losses, and the market feared the consequences of trade wars, Trump expressed his regret at appointing Powell. He made clear the specific short-term moves he expected from the Fed, and his confidence that he was authorized to remove Powell from the Chairmanship. In the process, he conveyed his disdain for the man he had appointed:

"They're making a mistake because I have a gut and my gut tells me more sometime than anybody else's brain can ever tell me." or:

The Fed "doesn't know what it's doing," or: the Fed "blew it."

"The only problem our economy has is the Fed."

Powell has firmly held his own. Unlike Trump's shoot-from- the-hip Tweet messages, Powell's communication is akin to that of all Fed Chairs: measured and circumspect. For example, when asked to reduce the value of the dollar, he said:

"The Treasury Department, the *administration*, is responsible for exchange rate policy. full stop...We don't comment on the level of the dollar. We certainly don't target the level of the dollar. We target domestic economic and financial conditions as other central banks do."

The Trump/Powell altercation, which has lingered into 2019, involves opposing concepts of the Fed's purpose, and how it should operate. Contd p. 2

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Fed continued

Not an authority on governmental organization, Mr. Trump thinks that the Fed should impose policies, of various lengths of time, that quickly impact economic results. He also believes that the president should influence those decisions. Powell's view, which is in stern contradiction, was something he emphasized when appointed: that the Fed is an independent government agency, insulated from political pressure. The lines are drawn!

Powell's understanding is consistent with the Fed's role as laid out in the Federal Reserve Act, 1913. Although the Fed Chairman is appointed by the president, approved by the Congress, and the Fed is subject to Congressional oversight, the Fed was never intended to be controlled or directed by either the White House or Congress. Created in response to highly disruptive monetary panics, most recently the Panic of 1907, the Fed was meant to manage long term monetary policy which could maintain economic stability. Reflecting American's distrust of national banks, the Federal Reserve Act established a decentralized banking reserve system. When the Great Depression demonstrated a need for additional control of monetary policy, the Fed was granted more independence within the government. In 1977, the Federal Reserve Reform Act included economic growth, price stability, and maximum employment among the Fed's responsibilities.

> **We're human, we make mistakes, but we won't make mistakes of character or integrity.**
>
> *Jerome Power*

The Fed's independence includes the freedom to set monetary policy without needing ratification from the Executive branch of government. The Fed is not funded by Congress. And the 14 year terms of the Fed Board of Governors do not coincide with presidential terms. This autonomous structure exists to discourage political influence on decisions of the Fed. For years, this was a relatively solemn imperative. (Powell's somewhat righteous statement, here quoted, implies that his disagreement with Trump can be weighed by measures of personal honor.)

Obviously, both the members of Congress and of the administration might be tempted to influence the Fed's decisions. Moves to positively impact the short-term economic environment, instead of to provide longer term stability, may be expected to benefit the party in power. Yet they may cause economic problems later on. For those reason,s discretion about political pressure is most fervently applied as an election approaches. Although not a formal rule, hikes made to decrease interest rates within 2 months of an election are quite rare, if only to avoid the perception of political pressure. While there may have been instances of presidents exerting pressure on the Fed, independence has remained a widely held value.

However, this became more complex when the nature and size of the Fed's activities expanded in response to the financial crisis of 2008. Feeling the need to provide an extreme amount of emergency money in order to revive the economy, the Fed employed "Quantitative Easing (QE)." With short-term interest rates already near 0%, the normal practice of growing or reducing interest rates could no longer adequately impact economic growth or inflation. Through QE, the Fed significantly grew its balance sheet through purchase of mortgage backed securities, as well as long-term Treasury securities. Starting in 2008, the Fed increased the money supply by a staggering $4 trillion. The Fed hoped to greatly increase the money supply, thus lowering interest rates, increasing lending and growing the economy. Banks held on to more of the available money in excess reserves than expected, but many economists credit the Fed and QE with saving the U.S. economy.

Nonetheless, the actions of the Fed, "the lender of last resort" now taking credit risk to greatly expand the balance sheet, were beyond their traditional range. As a result, many in Congress questioned the Fed's independence. Some argued that the line between fiscal policy and monetary policy was blurred when the Fed could engage in government funding. Of course the Treasury, responsible for fiscal policy, operates under considerably greater direction than the Fed. Even Massachusetts Democrat Barney Frank expressed concerns: "There is a problem with too much power going to an entity that is not subject to democratic powers." (Note that he was arguing for more transparency and accountability to the Congress, representing the American citizenry, not for submission to the President.) Fed Chair Ben Bernanke's and successor Janet Yellen's intent to "normalize" monetary policy by shrinking the balance sheet while raising short-term interest rates, demonstrated their agreement. Powell followed suit. A normalized policy, presumably, would serve to defend that traditional independence of the Fed.

Recently, two things hinder the return to that tradition. One is precedence, the deviation from tradition during the financial crisis. The other is a President without a strong commitment to legal structure, especially when it challenges his own authority. Powell is burdened by both. He continues to assert that he will serve his 4 year term, regardless of Trump's insistence that he can fire him. Yet he also appears ready to cut interest rates, consistent with Trump's wishes, yet not in accordance with them. Rather, Mr. Powell obliquely blames the President for the Fed's new retreat from normalization: escalating trade tensions which deteriorate the economic outlook.

Governmental stories include history, political pressures and personalities, suspenseful at the moment, fun with hindsight.

Economic and Financial Overview

Move, continued

For those of our readers who are unfamiliar with central Massachusetts, Holden is a suburban home of approximately t g west of Worcester

Pleasure or Profit?

There's a very wide band separating those who collect art simply for enjoyment or satisfaction, and those for whom art is purely an investment. On one end of the continuum is the collector who loves owning certain artworks for their aesthetic beauty, for how they move them emotionally, or even because their history is so fascinating. Having these creations in their own possession may bring this collector true satisfaction. These all are forms of pleasure derived from seeking, studying, purchasing and finally owning artworks, which don't need to be expensive or even likely to increase in value. In fact, the pleasure-seeking art collector may prize his child's kindergarten painting above all the rest.

At the opposite end is the collector whose goal is to realize a substantial return from investing in artwork. As with most investment in individual assets, this requires time and attention, acute knowledge of the shifting market, and exceptional skill at making sound purchases. To be fully engaged by the profit motive, this collector needs to enjoy treasure hunting. An innovative eye for things other art collectors overlook, also is a strength. Finally, the art investor should not be nostalgic. That child's painting never was the best, after all, and for the right price, any object in the collection is for sale.

Obviously these are extremes, and the band between them is occupied by various mixtures of profit and pleasure, which can change over time for individuals. The pleasure-oriented art collector may get caught up in the quest. As knowledge of art and market grows, her interest might be redirected towards the current tastes of the market more than what excites her aesthetic preferences. The individual procurer may not have started out as a collector. The thrill of the hunt and the delight in the art itself may develop a passion.

The continuum of pleasure to profit was lengthened recently by the practice of securitizing art works. Satisfying the ultimate "profit" motive, art collectors can buy shares in expensive works with purchases as low as $20. Masterworks, a leading source, reviews the long sales experience of "blue chip paintings," and tries to purchase them for less than market price by leveraging their auction house relationships. Monet's "Coup de Vent" and Warhol's "1 Colored Marilyn" will be available for collector participation once the SEC has qualified the offering circular, and FINRA also approves the application. Masterworks offers insights about the art market in order to assist shareholders to keep track of their investment. The goal is to create a system by which investors can trade shares through brokers.

Meanwhile, Masterworks hopes to own each artwork for 5 to 10 years. If an outside collector makes a serious bid, the shareholders vote the decision jointly, based on the size of their holdings, none of which can exceed 10%. This opportunity clearly is for the investor only. His art choices are confined to a small number of well known, extremely blue chip works, which he can never display at home. She can go view the work on display, however. Aesthetic appeal, or the delight of recognizing the talent of a starving artist, can have no part in this investment. He cannot control what is bought or sold, or the timing of a transaction. Finally, a limited stake in a single painting is an undiversified, and therefore high risk investment. Art was a top performer in 2018, but not all artworks excelled.

R. Ramsey, "This Company Lets You Invest in Fine Art for as Little as $20," https://finance.yahoo.com,5/31/19, https://www.masterworks, P.Silverstolpe, "The Art of Collecting,"www.telegraph.co.uk, 6/3/14, I. Cavric, "Art Collecting for Profit and Pleasure," www.articles factory, 2/6/02, A. Trinianow,"The New Art Economy," https://www.forbes.com, 8/16/18, O. Holland, "How Art Shares Could Make You a Warhol Collector,"https://www.cnn.com, 8/21/18

OUR SUMMER READING: Consult www.goodreads.com for reviews

Wayne: An Economist Walks Into a Brothel. Using unusual examples plus the lessons of finance and economics, Alison Shrager explains how to measure and manage risk.

Robert: The Causes of the Panic of 1893 by W. Jett Lauck. Like the Panic of 1873, this serious economic depression, was marked by the collapse of overbuilt railroads and shaky railroad financing. A series of bank failures resulted.

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