THE National Investor

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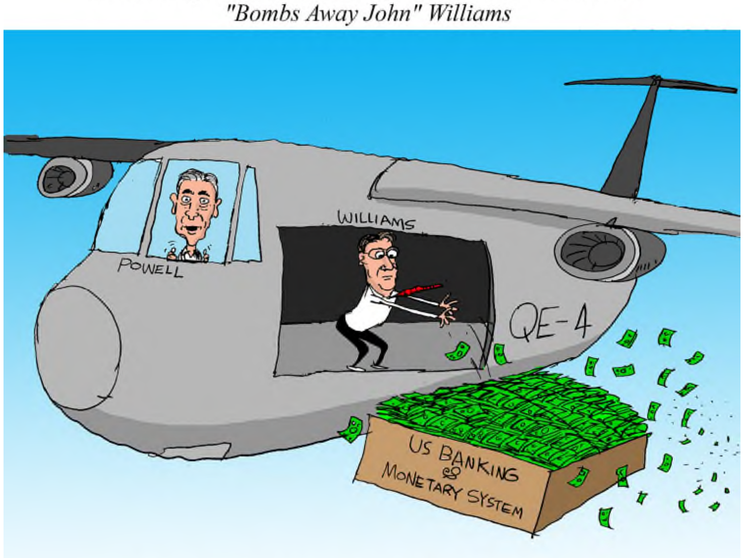
EVEN MORE "DRANO"; JUST HOW BAD IS THIS MESS, ANYHOW?

Introducing... "Cargo Plane Jay" Powell and his sidekick "Bombs Away John" Williams



"I just need to fix a little plumbing problem."

Prior to discussing the **uranium** (ever closer to a VERY bullish turn) and **broader energy sectors** (BIG trouble ahead) on Thursday's podcast (check it all out at http://www.kereport.com/2019/10/24/a-look-at-some-of-the-weaker-markets-energy-and-uranium/) I discussed **the Fed's latest announcement that it is adding yet more "Drano" to apparently *illiquid* markets.** That's a euphemism, of course, that Fed Chairman Powell himself invited, by his largely dismissing the "plumbing" problems in the markets he described at the Fed's last meeting in mid-September.

In case you haven't been keeping track, this past Wednesday's latest announcement from Powell's Fed was but the most recent *in a string of them* telling us that the "plumbing problem" is WELL beyond what we were first told. As I mused the other day, whether that is due to 1. A frightened Fed lying to us, not wanting to fess up to the real extent of the problem for fear of spooking the markets or 2. Powell and Company simply *not knowing themselves* how bad things are, **it doesn't change the fact that something is amiss.**

Lest you've lost track of the progression of things, here's a quick recap:

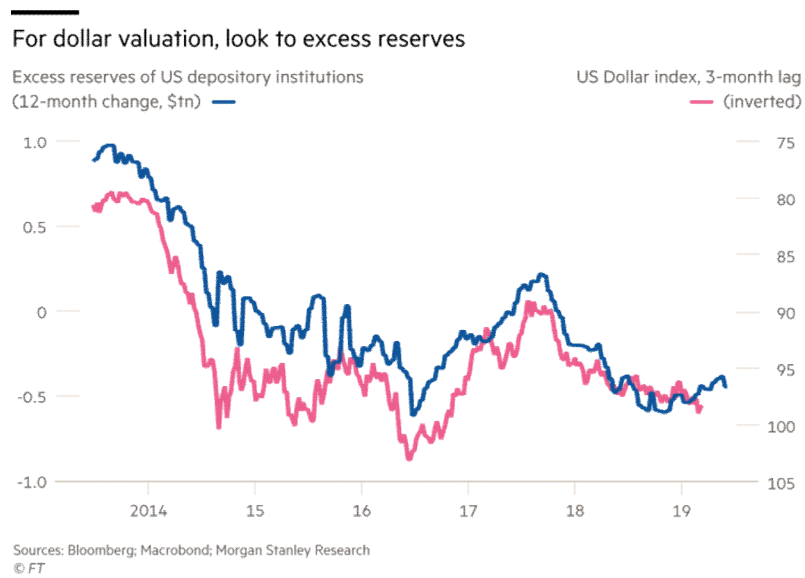
* **September 17 –** News of the Fed beginning to intervene in the overnight system having already leaked out, Powell admits that there are short-term "plumbing" issues requiring that the Fed pony up some overnight dough to smooth things out. The "plumbing fix" will last but *a couple days.*

* **September 19** – On second thought, the liquidity issues aren't only to do with end-of-quarter cash shortages. So, the Fed says, it will extend the repo operations *through to mid-October,* targeting as much as $75 billion daily in overnight repo market injections AND $30 billion in longer-term financing.

* **October 4** – Ummm…we're extending all this further *until November*.

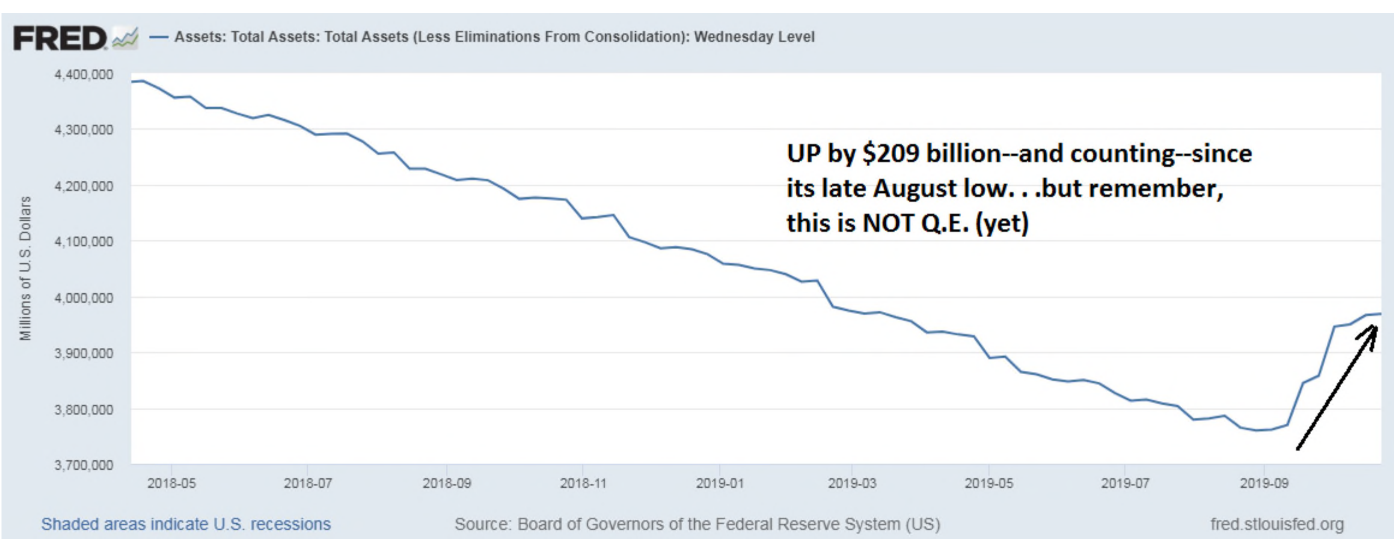
* **October 11** – We're now extending all of this into *as late as Q2 of 2020*. And we're ADDING further to our operations (Did we remember to remind you, though, that this is NOT Quantitative Easing??) by planning to buy $60 billion/month in Treasury bills.

* **October 23** – *Break out more Drano*! We're increasing the overnight repo offerings (HEY, we said this is NOT Q.E. !!) to $120 billion and "term" repo operations to $45 billion.



Now, as I said near the outset of the Fed's latest campiagn (*whatever* one wants to call it) the trouble the central bank is addressing is akin to a farmer or business that is asset rich but VERY cash poor. But this predicament is seemingly befalling a large swath of companies and financial institutions.

And it's one largely of policy makers' own creation: between measures that Washington put in place to make the system "safer" post-2008 AND the mechanics of the Fed's own policies, **the level of excess reserves in the system has been falling sharply,** as I have discussed in more detail elsewhere recently. I'll grant that, *technically*, Powell and the crew aren't being totally disingenuous when they insist these growing plumbing fixes are *not* the same thing as Q.E. But again, that doesn't change the problem: That being, issues of illiquidity *in markets*—now made more intractable as the economy slows to boot—are *growing*.



As the *Financial Times'* Colby Smith and Joe Rennison wrote on Wednesday after the latest missive from the Fed on its growing operations, "The flood of cash entering the repo market from the Federal Reserve has served to dampen concerns that a repeat of the bout of (September's) volatility could occur at the end of the year, when banks typically retreat from the market and shrink their balance sheets for December 31 regulatory calculations. . ." As I said on Thursday, in this regard, at least, **we see a difference between the Powell Fed today and the Bernanke Fed of 2007**: **Powell is at least trying to get *ahead* of events.**

The paralells between the present time and the 2007 environment where cracks started appearing in "the plumbing" (initially, back then, in the subprime mortgage markets and associated derivatives and securitized inventions) are uncanny, as many have been pointing out of late; see https://www.marketwatch.com/story/stock-markets-eerie-parallels-to-september-2007-should-raise-recession-fears-2019-09-18?link=sfmw_tw for an especially good take on this from Sven Henrich, published in *MarketWatch* late last month. Here again, we can all quibble over terminology. But *the problem* the Fed is facing is what matters, together with whether its actions are going to be sufficient to prevent a credit/markets crisis.

That problem—as in that 2006-2008 time frame, as cracks appeared ahead of the markets' implosion—is simply one of **the over-stretched fractional reserve system being at the point *again* where it cannot be stretched any further.** For over a decade, the Fed and the other central banks blew and re-blew all manner of bubbles to "rescue" us from the 2008 crisis, etc. But now, as I said this past week, not only is all this easing no longer doing anything for economic growth, but now *even markets* are STILL starving for oxygen despite all that the central banks have been doing. As the carnival performer, the Fed and the others have no choice but to keep putting more plates up. They can't stop. *But the more they have put up over the recent years, the less able they are to avoid the plates all falling off the sticks and to the ground*.

The next test for the Fed is ahead of us this coming week, when the F.O.M.C. gathers once more. By and large, Powell and several other Fed heads have attempted to get the markets to understand that—given the aggressive repo market and related operations—this all more than mitigates any need for further cuts to short-term interest rates *right now*.

But the trouble is, markets *still* have priced in a greater chance than not of another cut this week. And in what I personally see as one sign that the "plumbing problem" is more severe than the Fed is letting on, the bank seems more scared than usual of doing *anything* to upset market expectations.

They don't want to be "turned on" as Dr. Frankenstein's creation turned on him. So yet again, the upcoming F.O.M.C. meeting's Priority One will be to soothe the markets' fears. . .*and avoid a market rebellion*.

While Powell will lead the effort to keep spoiled and vulnerable markets more or less mollified, the *mechanics* of things demonstrating how successful the central bank is right now in its Drano-injecting efforts will STILL chiefly include the level of the U.S. Dollar Index. As I suggested, the greenback was due its recent bounce, if for no other reason than it had become technically oversold in the short term. **The trick now for the Fed, to the extent it can still control the situation, is to somehow break the back of the dollar's steady increase of the last 18 months or so for good.**

Between the Fed's increasing "Not Q.E." and its *probably* ongoing "mid-cycle adjustment" that could manifest itself in another rate cut come Wednesday, **the hope is that the dollar's long run is at an end** . We'll know more—and I'll likely have more to say, if not advocate as far as our portfolio and sector allocations—by or before week's end, I suspect.

As I want to get on to several more company updates as well as some thoughts on our current portfolio positioning, **I'm going to refer you to this past week's podcasts for more goodies**. Friday especially, I wrapped up the week's news (at http://www.kereport.com/2019/10/25/wrapping-up-the-week-with-amazon-earnings-results-the-balance-between-us-markets-and-gold-and-an-update-on-brexit/) discussing SEVERAL subjects:

* Stocks at their all-time highs, *despite Amazon's sobering news*.

* China trade – "skinny deal" still coming, or just more talk?

* Why—unlike 2008—a financial/credit crisis will NOT hurt the gold price, but more likely help it.

* The political "Game of Chicken" over Brexit

*** The preceding is excerpted from the fourth regular issue of *The National Investor* for October, 2019**

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