



B O N N E R P R I V A T E R E S E A R C H

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Federal Reserve Governor Jerome Powell gave a speech on Monday, March 21st. Powell said the Fed would quickly raise interest rates. And not just to a neutral level, but to a “restrictive” level, until he’d eradicated inflation. If he’s serious about this, Americans are about to lose trillions of dollars off their stock, bond and property investments. Yikes.

Could Powell be bluffing?

It’s possible Powell is bluffing, trying to ‘talk’ inflation down without actually doing anything. This seems likely to me. I don’t trust Powell to fight inflation. The Fed lost its inflation-fighting credibility years ago. I have a hard time imagining Powell purposefully sending the economy into a recession, which he surely will have to do if he wants to put an end to inflation.

The markets seem to think Powell is bluffing too. The major averages have been soaring. The S&P is up 5.6% since last Wednesday at 2.36pm, about six minutes into Powell’s opening statements following the March FOMC meeting. (The S&P is now only down 6% year-to-date.)

One of history’s great economic crimes

Saving is built into the DNA of mankind. You prepare for future (and unknown) economic risks by setting aside some of your surplus now. You delay consumption and gratification because you might need it later. Saving is the basis of capital formation and investment.

Central banks, and especially the Fed, went against human nature by lowering interest rates to zero. By trying to avoid a recession and trying to eliminate the business cycle, they've tried to change human nature. Instead, they've distorted it.

My own conviction is that the Fed committed one of the great crimes of economic history by pushing interest rates negative and then stoking inflation. It robbed savers of their purchasing power. It also undermined the delicate balance between savers, investors and consumers and inflated the greatest speculative bubble of all time, in all things.

You should be thrilled—as I am—at the prospect that bank accounts could pay 5% again, bonds could pay 10%, great stocks trade at fair values and pay attractive dividends... and there's no inflation. We'll see. In the meantime....

Why are markets rising?

I'm wondering something. Why does the stock market seem to surge higher every time Powell tells us he's going to aggressively raise interest rates? It's not the reaction I would have expected. Higher interest rates should draw capital away from the stock, bond and property markets and into savings products.

But maybe something else is going on? Could Powell be acting as a beacon to foreign investors and his hawkish speeches are drawing savings from around the world into the USA and into dollar-denominated assets?

I haven't seen this theory anywhere else and I've got no way to corroborate it. But I'm watching this carefully. If this is the case, it suggests raising interest rates won't tighten financial conditions and won't eradicate inflation.