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## **Bernanke, Equities and the November Election**

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By Kerry Pechter    *Tue, Sep 4, 2012*

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If Mitt Romney's and Paul Ryan's punches have failed to KO a vulnerable president, the reason may be no farther than your Bloomberg terminal, where you can see that the S&P 500 has more than doubled since the earliest days of the Obama administration.

Credit for the rally—or blame, if you're an angry bear—arguably goes to Fed chairman Ben Bernanke, who as arbiter of U.S. central bank policy has suppressed prevailing interest rates and somehow—despite a strong undertow of risk aversion among mass investors—managed to buoy up stock prices.

Last Friday, at the annual symposium sponsored by the Kansas City Fed at the foot of the Grand Tetons—the Olympus of the banking gods—Bernanke reiterated his commitment to keep rates low for as long as another two years; by mid-afternoon on August 31, the S&P hit 1409, up from 680 on March 9, 2009.

In the course of his address, whose meaning was as usual camouflaged in Fed-jargon and stippled with acronyms, Bernanke more or less assured the markets that his motto remains, "Easy does it." Hence the equities outlook, as well as Obama's, is pretty good, at least for the moment.

### **It could be worse**

Regarding the stock market, Bernanke specifically said, "It is probably not a coincidence that the sustained recovery in U.S. equity prices began in March 2009, shortly after the FOMC's decision to greatly expand securities purchases. This effect is potentially important because stock values affect both consumption and investment decisions."

The first stage of the Fed's asset-buying policy also put a floor under prices of mortgage-backed securities and lowered retail mortgage rates, he said. Lower mortgage rates helped people refinance, if they qualified, and support higher home prices.

Once the forces of deflation were muzzled, in Bernanke's view, the economy could begin to recover, and did. "As of 2012, the first two rounds of LSAPs [large-scale asset purchases] may have raised the level of output by almost 3 percent and increased private payroll employment by more than 2 million jobs, relative to what otherwise would have occurred," Bernanke said in his speech.

"As of July," he added, "the unemployment rate had fallen to 8.3% from its cyclical peak of 10% and payrolls had risen by 4 million jobs from their low point... Inflation (except for temporary deviations caused primarily by swings in commodity prices) has remained near the [Federal Open Market] Committee's 2% objective and inflation expectations have remained stable." Manufacturing, housing, and international

trade have strengthened, and investment in equipment and software has rebounded, he said.

### **Four dangers**

Four things could still go wrong, Bernanke conceded. First, the Fed's policy could backfire if it buys too many U.S. government agency and Treasury bonds, reduces the liquidity of the market for U.S. debt, and compels private buyers to demand higher yields in return. Second, the Fed could eventually own so many assets that, when the economy revives, it couldn't sell them fast enough to suck excess cash out of the economy and prevent inflation. Third, the Fed's rate-suppression policy could compel investors to take bigger risks in hopes of higher yields, and thereby de-stabilize the financial system again. Finally, a sudden spike in rates could cause the assets on the Fed's balance sheet to fall in value and the Fed might lose hundreds of billions of dollars. But the potential dangers of his policies, the central banker said, were outweighed by their positive effects.

A number of "headwinds" are preventing the economy from recovering faster than it has, Bernanke added. He cited the facts that new construction remains at low levels, that hiring and purchasing by governmental entities is down because of depressed tax receipts, that uncertainty and anxiety persists regarding the so-called "fiscal cliff" at the end of 2012, that many homeowners and small businesses still find it difficult to borrow, and that uncertainty about the Eurozone economy is weighing on Americans.

### **Rates will stay low**

In conclusion, Bernanke was fairly clear that interest rates aren't going up soon, at least not if the Fed can help it. "A number of considerations," he said, "...argue for planning to keep rates low for a longer time than implied by policy rules developed during more normal periods."

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