
The Fed Stays in 'No Man's Land'

By Kerry Pechter Tue, Feb 24, 2015

My nightmare scenario is that when rates go up, equity prices will fall, and millions of Boomers will wish they'd sold their stocks at the peak and bought income annuities with the proceeds.



Based on the newly-published [minutes](#) of the Federal Reserve Board of Governors January 27-28 Open Market Committee meeting, the Fed “is not sounding like an institution that is ready to raise its benchmark interest rate in June,” a New York Times article said today.

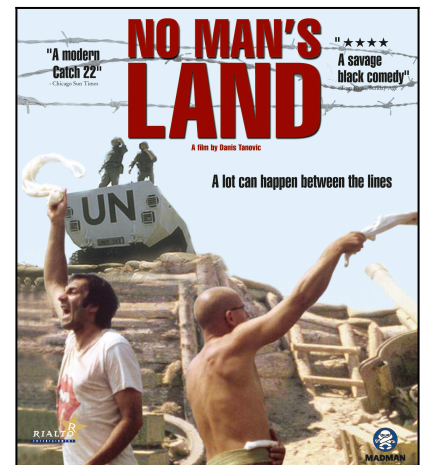
Which means that the Fed’s policy of keeping prevailing interest rates very low by buying securities—a policy that in 2009 one insurance executive told RIJ his company could tolerate for about five years—will move into its seventh year.

Here are a few relevant excerpts from the minutes:

- “Many participants indicated that their assessment of the balance of risks associated with the timing of the beginning of policy normalization had inclined them toward keeping the federal funds rate at its effective lower bound for a longer time.”
- “Many participants regarded dropping the “patient” language in the statement... as risking a shift in market expectations for the beginning of policy firming toward an unduly narrow range of dates. ... Some expressed the concern that financial markets might overreact, resulting in undesirably tight financial conditions.”
- “The Committee agreed to maintain the target range for the federal funds rate at 0 to 1/4 percent and to reaffirm the indication in the statement that the Committee’s decision about how long to maintain the current target range for the federal funds rate would depend on its assessment of actual and expected progress toward its objectives of maximum employment and 2 percent inflation.”
- “The Committee also decided to reiterate its expectation that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.”

The Fed’s policy has buoyed the stock market by allowing investors to borrow cheaply to invest in equities and by assuring investors that any change in rate policy will be gradual and telegraphed in advance. It has helped bondholders by keeping the prices of existing bonds of questionable value high.

But it has also driven up the cost of retirement dramatically. It has been a disaster for near-retirees and retirees who were hoping to get decent yields from safe investments in certificates of deposit, fixed-rate annuities, municipal bonds, Treasury bonds and income annuities. It has also been fatal for some pension funds, hiking their degree of underfunding overnight. j



The silver lining in the Fed's playbook, for Baby Boomers on the verge of retirement, is that the low-interest policy has helped maintain the value of the equity investments that represent a large chunk of their savings. But that's arguably cold comfort. There's a lot of risk implicit in the stock market these days and, in the opinion of some, not much risk premium left.

If the Fed raises rates, will the stock market move down? Will a small downward movement in the stock market trigger margin calls, distressed sales and even lower prices? To me, those are the important questions. Some experts say this isn't how the equity prices and interest rates interact. If not, why does The Street get conniptions when the Fed hints at an end to quantitative easing?

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In 2001, a tense anti-war movie about the Bosnian conflict, called "No Man's Land," presented a lose-lose situation where the combatants on one side have booby-trapped the body of a fallen enemy soldier with a powerful land mine. The mine is set to explode when the soldier's comrades, having retreated, return and attend to his body.

But the booby-trapped soldier was merely unconscious, not dead. When his comrades come back, they can't help him, because moving him will trip the mine and kill the rescuers. A TV

crew films the scene, and the media falsely reports that the soldier has been saved. The movie ends with the fully conscious soldier alone and abandoned with a land mine on his chest.

The Fed's dilemma—our dilemma—somehow recalls that movie.

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