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Behind the Smoke Screen: The Federal Reserve

Policy makers are blurring the lines between borrowing the money they need and simply creating it. Essentially, Congress has made the Federal Reserve a virtual unlimited bank, and they have been, and will continue to pour new cash into the money supply. This inflates asset values, such as stocks, and eventually other hard assets as more cash in the system looks for places to invest. All of us, including our children and grandchildren, are going to pay a big price for this somewhere down the road. When COVID-19 became a pandemic, the Fed had no choice but to step in to avoid an economic collapse. The Fed has intervened in order to prevent the absolute certainty of a deflationary depression. The large-scale purchases of U.S. treasury securities are stretching the boundaries of what a central bank will do to finance soaring federal debt.

Our government (more precisely the Federal Reserve) **for the first time in its history** has begun buying bonds of U.S. corporations directly in the open markets since March. This is a practice that has NEVER occurred in the history of the Fed. Not only is such action beyond the Fed's original purpose, it's also a serious commingling of the federal government's involvement in the private sector. By purchasing corporate bonds, the Fed assumes the perilous role of determining corporate winners and losers. The Fed is now the third largest holder of the biggest corporate bond ETF (exchange-traded fund), and it owns big positions in 15 other corporate bond ETFs -including junk bonds.

If investors want to know why the stock and junk bond markets continue to rise despite new and grave economic reports every week, it's because of the Fed's commitment to inject massive amounts of new money into the capital markets through its aggressive monetary policies, including its new program of expanded quantitative easing (QE). The Fed has been inflating asset bubbles (stocks and bonds) by offering free money and buying all kinds of debt. The Fed has stated it will continue to buy about $120 billion in bonds each month going forward into the second half of this year.

Prolonged low interest rates induce the accumulation of so much wasteful government and private debt that raising interest rates would lead to a catastrophic financial and fiscal crisis. As much as central bankers worry about government debt financing, they will strenuously deny it if it means avoiding financial devastation. Unfortunately, the path of least resistance is to keep rates low, in turn encouraging more debt.

Federal Reserve Chair Jerome Powell is on record as saying "interest rates are going to remain at these historically low levels for a very, very long time." That's because asset prices (stocks and bonds) have been so egregiously inflated that any nominal increase in interest rates right now would equate to economic meltdown.
Beyond keeping interest rates so low, the Fed has become sort of a super lender. Through its quantitative bond purchase program, it's responsible for the ever-growing corporate insolvency storm that is intensifying. Indeed, one out of every 5 U.S. companies are considered "zombies." Meaning, they don't make enough profits to cover the interest expense on existing debt. The number of these "zombies" is surging because they feed off of the Fed's falsification of credit markets.

The U.S. finds itself stuck in a debt trap, alongside the rest of the developed world. The U.S. government experienced an $864 billion budget deficit in **June alone**. Compare that with a budget deficit of $984 billion for the **entire 2019 fiscal year**. Congress is currently negotiating another stimulus package that will more than likely be enacted by early August with a price tag between $1 trillion and $2 trillion. That should put the budget deficit for fiscal year 2020 close to the **$6 trillion** range. Federal and state governments are now essentially running the American economy.

What the Fed is doing right now is not going to increase a company's cash flow that's needed to meet their obligations. The Fed can't print earnings needed to pay interest expenses. More importantly, they can't print jobs (52.7 million jobless claims have been filed from the beginning of the pandemic through 7/23/20).

In closing, with the aforementioned information and real economic data, we recommend continuing our conservative approach during these unchartered times.

As always, we at Kapusta Financial Group, would like to thank you for the trust and confidence you place in our team. Please don't hesitate to contact us with any questions or comments.