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…Let's just state the obvious: the world remains a risky place despite the all-time low levels recorded lately on the volatility index. The worrisome items facing investors (and society) never seem to get more benign, do they? One day it is the impending blow-out of interest rates, the next is an imminent attack on a middle-eastern country. Yet strangely the market has continued to rise to all-time highs and seemingly masks anything and everything that historically has imperiled confidence and earnings potential.

Why? We think that the answer is fairly intuitive. Of course, the perceived inability of the Federal Reserve to tighten credit, or retreat from its accommodation, is ostensibly the primary factor underlying the current global investment thesis. The Fed is all in, keeping rates far lower than they would otherwise be without intervention, and speculation in liquid larger-capitalization stocks has surged. Lofty valuations are of little importance under this scenario, so long as banks' trading desks have large reserves over deposits, and mutual funds have continued capital inflows. I suppose, in the banks' case, they figure it is much easier (and less risky) to flip a 100+ times earnings stock than it is to loan the money into the real economy assuming a multi-decade payback in a rising-rate environment. As we all know, increasing loan activity is the backbone of a constructive economy and a bright future, but it can simultaneously light the fuse of inflation (because lending money exponentially increases the supply of money in the economy.) So, given the choice between creating price inflation in the economy, or fomenting financial-asset inflation, the banks (and the market in general) have chosen the latter. Not surprisingly, since that is the path of least resistance, years of purchasing long-term treasuries and mortgage-backed securities at $85-billion per month has yet to meaningfully increase output or employment. All we have to show for our tax dollars at work thus far is an amped up price-to-earnings multiple on the S&P. Since, the "means" have not yet accomplished the Fed's "end" of spurring economic growth, it looks like the game will continue.

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