# The Carnegie Counselor

THE CARNEGIE INVESTMENT COUNSEL NEWSLETTER FIRST QUARTER 2016

## N.I.R.P.

In the midst of the last recession of 2008-2009, the Federal Reserve was very proactive attempting to kick-start the economy. They worked to strengthen weak banks by delivering TARP dollars to any and all banks, pumped billions into the economy through the quantitative easing programs known as QE1, QE2 and QE3, saved weak firms that made bad bets (AIG, Merrill Lynch) and let others fall into the scrapheap of history (Bear Stearns, Lehman Brothers).

With a weak economy, low inflation and rising unemployment, the Federal Reserve also moved aggressively to provide "credit-easing" by lowering interest rates. From September 2007 to April 2008 they dropped the Federal Funds rate from 5.25% to 2%. By the end of December 2008, the Federal Funds rate was lowered to essentially 0% and remained there until December 2015.

Although the Federal Reserve signaled since mid-2014 their desire to increase the interest rate member banks pay to each other, the moribund economy didn't offer sufficient evidence that it was able to handle a money-tightening policy. Since they committed to raising the rate in 2015, the expectation of a rate rise hung over the economy all of last year. June was the first target, then September came and passed, and finally two weeks before the year ended, the Federal Funds rate was set at 0.25%. The snowbirds had barely settled in Florida in early January when the pressure from the markets started to reign down on the Fed. The bond market didn't move as the Fed hoped, and bond yields for long-term treasuries actually fell with fears the economy would slide into a recession. High-yield bond prices cratered and pressure mounted on the Fed that they had moved hastily in raising rates and would choke the economy. The stock market reacted sympathetically by dropping 10.5% out of the gate, the worst opening for stocks in 100+ years.

With this backdrop, the Central Bank of Japan, after two decades of a dreadful economy and zero interest rates, did the unthinkable in January and moved to a Negative Interest Rate Policy (NIRP). Taking the idea from a few minor European banks that have had no positive results from the experiment, the policy essentially charges customers to keep assets in

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## Carnegie Adds Retirement Group

**Kim Gannis**

**Keith Warmbein**

Kim Gannis and Keith Warmbein joined Carnegie recently, leading our efforts to better service retirement plan sponsors. We have found that many plans are paying unnecessarily high fees and/or receiving poor service. Recent Department of Labor changes are forcing employers to address these issues or possibly face personal liability. Call us today if you would like us to review a 401(k) plan close to you.

banks.  The goal is to stimulate savers to pull money out of banks to invest or buy products which will accelerate the economy.  Central planning at its finest, if you can't borrow and spend at 0%, then we'll force you to take unwanted risk.

Immediately the Federal Reserve Bank in the US initiated stress tests to determine how a NIRP policy might impact various industries.  Imagine a prolonged period of zero or negative interest rates on banks, insurance companies, foundations, pensions or your own retirement.  In 2008, we moved to a policy of building short-duration bond portfolios expecting interest rates to eventually move higher.  We thought a laddered bond portfolio would build a bridge to a period of higher income for clients.  Eight years later, the possibility of higher interest rates doesn't appear to be on the horizon.  We have recently extended the longest term bonds purchased from 7 years to 8-10 years.

Low interest rates have little impact on those who never saved or with no assets.  For anyone who made sacrifices and put money away for the future, not earning a yield for the risk taken is essentially a tax on those with means.

The impact of the Federal Reserve's policy to hold interest rates at zero has had a very real impact on client performance.  While the impact is most noticeable for clients in the withdrawal phase of their investing lifecycle, it also has made a powerful impression on all investors.

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The bonds and cash we place into the capital markets for the benefit of clients exceed over $400 million.  This capital is being used by corporations, municipalities, government agencies and banks to fund their operations.  In a normal interest rate environment we might expect to earn 4-8% for the risk of lending these funds.  In the current market we are struggling to produce 2-4% yields.  This is half the returns for the same risk taken, yet there is no great public outcry because nobody cries for the rich.

The good news is we are not tipping into a recession.  With auto sales moving at an annual clip of over 17 million units, housing values rising and consumer spending strong, this economy can handle a slight rise in interest rates.  If you can afford a home paying 2.9% interest, you can afford the same home at 3.9%.  A Negative Interest Rate Policy would likely have harmful unintended consequences for the economy.  This recalls the pejorative characterization of opposition by residents to a proposal for a new development as N.I.M.B.Y or Not In My Back Yard.  Considering the deleterious effect negative interest rates would have on client assets, we suggest NIMBY for NIRP.


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