Economic Update

Broadleaf Partners, LLC

Chain Gangs & Pipe Dreams

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While I've always known that football was a rough sport, running chains and marking yards for my son's freshman team has me rethinking that assessment. Brutal is probably a far better description. I'd even venture to say that the game may be the modern day equivalent of the Roman Gladiator contests, with the only difference being that death is unusual or at least not immediate.

On the first play of last week's game, a kick returner on the opposing team caught the ball, spun around and ran towards me on the sidelines. I can distinctly recall the whooshing sounds of his legs, the focused efforts of his breathing, and the cracking of football pads colliding as blockers and tacklers introduced themselves to each other for the very first time.

Whenever I watch football, I can't keep the equation for force from popping into my head, sometimes annoyingly so. Force equals mass times acceleration…mass times acceleration. Rainman always gets his boxers from Kmart…Kmart in Cincinnati. You get the idea. Give me mass and I'll give you a lineman. Give me acceleration, and I'll give you a wide receiver. Give me both, and a running back is born.

Well, this kid was fast, darn fast. As he ran toward me, kicking fresh grass clumps into the air with each powerful stride, I instinctively grabbed my yard marker a little harder, and braced for an out of bounds collision. Fortunately, he cut quickly towards the middle as he approached me and then to the sidelines once again about thirty yards downfield. I was convinced that our team wouldn't catch him and that he would score a demoralizing touchdown on the very first play of the game. Much to my surprise, one of our fastest players finally tripped him up near the two yard line.

As we rushed the chains to the other end of the field, I was surprised to see the player holding his leg on the ground, screaming for his coach and, in the universal sign of distress, crying for his mother. He had likely broken his tibia, dislocated his knee, or quite possibly both of the above, according to the attending parent/ER physician. A half hour later, the ambulance rushed him off to the hospital and the game resumed.

While I didn't see any other injuries, I did witness several other questionable events, including a parent who was nearly ejected after getting into it with the refs. (I must be missing this gene.) On another occasion, one of our own players hit his own teammate violently after the other team scored and then screamed through his locked facemask, "I'm gonna f****** kill you if we lose the game!". Fortunately for him and the raised eyebrows on the Chain Gang, we won by a point.

As someone who spends a lot of time drawing parallels between work life and life in general, it strikes me that football may be a lot like capitalism and investing, whether you realize it or not. It can be a fast and exciting game to watch and for some may even be a fun game to play. It can also at times be unbearably brutal and in spite of a few basic, time honored rules, perfectly dishonorable at others.

On Friday of last week, CNBC held a rare interview with billionaire David Tepper, who runs a very successful hedge fund and has given large sums to his alma mater, Carnegie Mellon in Pittsburgh. Like many highly successful individuals, Mr. Tepper commands attention even when his opinions grace the edges of arrogance, simply because he has such a long and stellar track record. Questioning the logic of an apparent master of nearly any discipline takes an extreme level of courage and perhaps even a certain level of arrogance itself, as by definition, almost anyone doing so would likely be a relative novice in comparison.

In the interview, Mr. Tepper made a convincing no lose case for stocks. On the one hand, he argued that if the economy improves from here, earnings should do well, leading stocks higher. On the other hand, if the economy falters, then the Fed will engage in quantitative easing (QE) by buying up all types of debt and forcing interest rates even lower. In the short run, such a move would not only be a positive for stocks, but all assets in general.

When pushed to elaborate on his views, Tepper argued that the Fed could push mortgage rates as low as 2% by buying debt and that most folks would refinance, put a few dollars in their pocket and then spend the rest, boosting the economy. Historically, this has been the mechanism through which the Greenspan era used monetary policy to influence economic prospects.

As much as I like Tepper's arguments and in particular his decision to never utilize leverage at his hedge fund, I always get a little leery about no lose situations, particularly when it comes to the stock market. While he may very well be correct in the short run (this may quite frankly be all he is claiming), just because QE has worked in the past is no guarantee that it will always work in the future. So far, lower rates haven't created real spending in the economy; on the contrary, it has only led individuals to deleverage. This isn't to say that even lower rates might not do the trick, only that it may not be the certainty to which it appears, even when coming from a long time star.

In some senses, the Fed may have given the go ahead to Tepper's line of thinking last week by explicitly stating that inflation may be too low with respect to what it considers to be an environment of stable pricing. As we've mentioned repeatedly in the past, the Fed has a dual mandate to set policy that encourages both price stability and full employment. While we've known for quite sometime that unemployment levels remain far above those deemed acceptable in the current environment, the risk of inflation has almost always been a countervailing force to completely unbridled, stimulative Fed policy.

By setting a tone where inflation may now be viewed as too low and unemployment too high, it is easy to conclude as Mr. Tepper may be that the Fed is giving the outright nod to asset speculation and in particular a no lose outcome for equities. The Greenspan Put which some argue socialized the markets losses while privatizing its gains, may in effect be giving way to the Bernanke Call which hopes to accomplish more of the same, but by giving others the chance to front run its purchases by buying all manners of asset classes.

Back to the subject of football, last year I remember reading a Wall Street Journal article which theorized that barring helmets from games might help reduce injuries as players would be less likely to hit each other as hard. While the theory has some intellectual merit and perhaps some actual lab data to support it in the form of early football and modern day rugby, it also seems to be lacking something in the common sense department.

As I've said before, anytime winning seems easy, especially in the stock market, it has usually been a decent signal that you might be treading in dangerous territory. At times like that, it has usually paid to increase rather than decrease one's aversion to risk.

Equities could indeed move higher from here and in our opinion, likely will, but buying under the influence of a pipe dream predicated on the view that they are a no lose proposition would be as foolhardy as football without helmets or an offense with no defense.

What fun would that be?

Kindest Regards,

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