Weekly Market Review

C.F. WHITTELSEY HOLDINGS

January 19 2015 — January 23, 2015

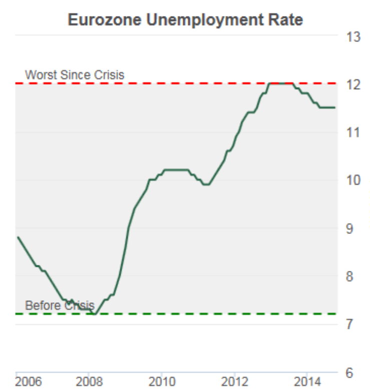
"The price of money depends on the supply and demand of that money. And if the European central Bank is engaged now in quantitative easing, in a more dramatic way than what it was before, it means it is increasing the quantity of euros and as a result we will see reduced value of the euro in the market place….. Europe needs to grow, in order to grow in needs to gain competitiveness, in order to gain competitiveness, the depreciation of the euro is a plus…. I see the role of the central bank in this case to provide space and time for other (fiscal) policy measures to take place." - Jacob Frankel—International Economics Advisor at JPM and former Bank of Israel Governor.

1.14 Trillion Euro QE Plan - What it means for Europe

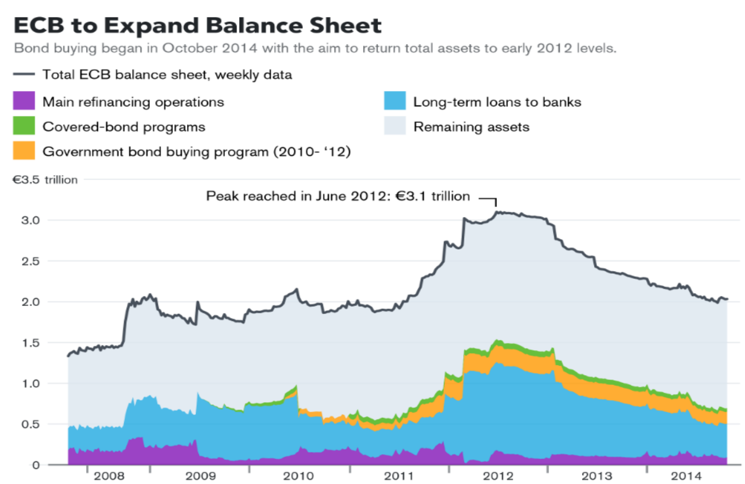
Mario Draghi announced a 1.14 trillion euro (1.3 trillion dollar) QE plan on Thursday, aimed to prop up the European economy. There will be 60 bil euros in monthly purchases through September 2016 split 45 bil in investment grade sovereign bonds, 5 bil in euro denominated public agency debt, and 10 bil under the existing ABS and covered bond program. This plan is largely resembles other major central bank programs to take yields down, and attempt to move allocations toward riskier assets, prop up inflation, and reduce the cyclical stress still weighing on the continents economy.

The committee left it very open-ended and cites inflation targets as a primary indicator of the monetary policy initiative (note that Dec consumer prices were just .2% annually). Draghi continues to try and pressure governments to 'do their part' in reviving the European economies. "Draghi is only too aware that whatever the ECB does on the monetary policy side in an attempt to meet its mandate will not be successful unless governments do their bit…. Fiscal policy is still needed to boost aggregate demand to prevent a further drop in inflation" - Janet Henry, Chief European Economist at HSBC.

Some skeptics think this is way too little way too late. "for inflation to reach close to a 2% threshold over the medium term, the potential amount of asset purchases needed is 2-3 trillion euros, not a mere 1 trillion." - Michael Martinez, Economist at Societe General. Others applaud the initiative, such as Bank of Japan Governor Haruhiko Kuroda.



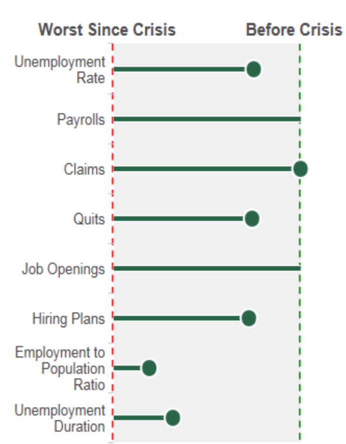
BlackRock Investment Institute, 12th January 2015



1.14 Trillion Euro QE Plan - What it means for the U.S.

The truth is, the US is in pretty good shape. Perhaps we should begin to head Larry Summer's secular stagnation thesis. Or maybe we just can't get over our own hubris (home sizes continue to grow while the family unit continues to decline). Outside of the employment to population ratio (and there is still a lot of debate on the structural v cyclical nature of this), we appear to be in a good place to begin normalization. So, what's the game plan?

Janet Yellen has made it pretty clear that they don't intend to move rates before April, so we can at least start from there. Standard Monetary Policy tools have been less useful over the years as rates have been floored and not moved about as some models might suggest.



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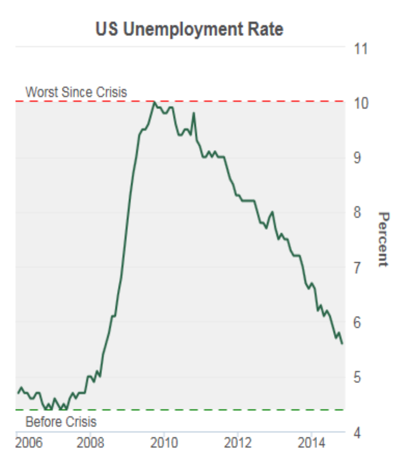
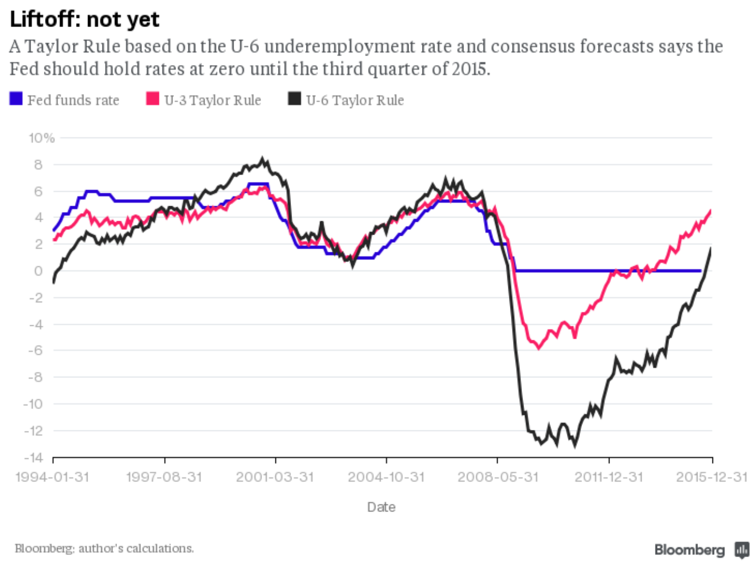


"Europe's economy was wrecked in the name of responsibility.. True, there have been times when being tough meant reducing deficits and resisting the temptation to print money. Ina depressed economy, however, a blaance3d budget fetish and a hard-money obsession are deeply irresponsible..... They were all too eager to ignore the evidence that they were wrong. And Europe will paying the price of their self-indulgence for years, perhaps decades to come" - Nobel Prize Winning Economist Paul Krugman on the ECB's handling of the European Economy.

1.14 Trillion Euro QE Plan - What it means for the U.S.

Furthermore, the global economic instability forces the Fed to take a larger role in discretionary decision making as opposed to one that is much more formulaically (Taylor Rule) prescribed. One last point, most of these older tools use the U3 unemployment rate as an input into their models. If we take the Taylor Rule, sub in the U-6 rate which includes discouraged workers and part time who want full time workers, and use a natural rate of 9% (this was suggested by Jan Hatzius—chief economist at Goldman Sachs) then you actually see a liftoff signal for 4Q2015, which is in-line (plus a few months) with the markets general read on the continuing softness in the Feds language and their move toward a more hawkish policy stance.



The initiatives on the other side of the Atlantic will hopefully boost inflation on the continent, which may allow for prices to move up here in the states. Its likely that the slowdown in Europe has kept prices slightly at bay. While the strong dollar may reduce the competitiveness of our exports, it certainly allows for US imports to amp up, dumping money into the European economy, and hopefully that reverberates back here. Furthermore, the long end of the curve is actually pretty pricey here in the states relative to the counterpart in the developed European countries. As a result, the move in Europe should actually pull long end yields down in the US or at least keep them relatively static, which supports the Fed's initiative to boost the housing market by keeping rates affordable.

To be sure, the treasury market is seeing some small signs of inflation. TIPS yields came down a bit in the latest 10yr issuance. The labor market data came in with unemployment at 5.6% which is a low during the since the recession. All in all, continue to look for a 2Q-4Q2015 liftoff (I'm a bit biased on the earlier side).