



## Half Time at the Financial Super Bowl

by William W. Priest, CEO & Co-CIO

February 2, 2010

Welcome back, sports fans. It’s half time here at the Financial Super Bowl, and the battle between the “Power of Zero Interest Rates” (Team Zero) and “Deleveraging and its Consequences” (the Deleveragers) has already taken some spectacular turns. Despite a promising ground game by the Deleveragers (see Figure 1), Team Zero’s air game – led by Ben Bernanke, the QB – has completely dominated the field. The first quarter (i.e. the summer of 2007 through the fourth quarter of 2008), saw one interception after another by Bernanke, followed by a second quarter (i.e. the past twelve months) of non-stop completions. And now, at the beginning of the second half, it looks like Bernanke has brought Team Zero back from the brink of what looked like a truly catastrophic rout. Just look at Figure 1: the BFCI has come back ALL THE WAY, to paraphrase Chris Berman. Since Spring, the MSCI World has gained over 70%, and pass protection for Bernanke has been holding strong, with earnings exceeding expectations for eight consecutive months.

Figure 1: BFCI<sup>1</sup>



<sup>1</sup> The Bloomberg Financial Conditions Index combines yield spreads and indices from the money markets, equity markets, and bond markets into a normalized index. The values of this index are presented as z-scores, which represent the number of standard deviations from which current financial conditions surpass or lag the average of the 1992-June 2008 period.

It makes you wonder what's going on in the Deleveragers' locker room. What devilish defensive strategies have they cooked up to put the brakes on Team Zero? Will Team Zero's novel pass formation (i.e. "quantitative easing") be as unstoppable in the second half as it was in the first half? One thing's for sure: Team Zero's biggest fans – spread investors and equity owners – already think they smell victory.

But there's still a lot of game left to play. Let's take a look at how the second half could pan out.

Based on what we've seen from Team Zero so far, I think there might be some chinks in the armor. The QB's commitment to "quantitative easing" combined with the running backs' "inventory rebuild" and "fiscal stimulus" strategies are unlikely to last the whole game. Those running backs look good for one more quarter at best. And remember, the Fed's mastermind behind "quantitative easing" is a rookie to the big game: impressive so far but rumor has it he's been juicing.

Here come the Deleveragers entering the stadium for the second half... and I am stunned by the looks on their faces! Look at that swagger! That determination! If I were a betting man, I would say Team Zero better be prepared for one tough fight. After all, those unemployment numbers are not coming down very quickly and, after adjusting for transfer payments, wage gains are de minimis. If Team Zero's running backs cannot move the ball, and if their wide receivers – "rising employment" and "more income per worker" – are shut down, then the Deleveragers will start to control the line of scrimmage and the aftermath will be felt both on and off the field. Those talking heads on CNBC, once defined by William Safire as a "bunch of nattering nabobs of negativity," will be back in force. David Rosenberg, Joe Stiglitz, and Nouriel Roubini will have the floor. And those cheerleaders for Team Zero: Ed Yardeni, Ed Hyman, and Joe LaVorgna will no longer look so attractive to their fans.

And the plot continues to thicken! I'm just now getting word from our weather desk that storm clouds are headed for the stadium. And the skies don't seem likely to clear up anytime soon: geopolitical events on the terrorist front, a quagmire in Afghanistan, a looming confrontation in Iran, sovereign risk concerns in Greece and other Euro states, domestic political gridlock, bankrupt state governments, and rising forms of economic protectionism all spell trouble ahead.

Finally, let's not forget that the Deleveragers have a deep bench: much deeper than Team Zero's. No steroid rumors here, just a lot of history. In modern economic times, no significant financial crisis has ever escaped deleveraging. And with Reinhart and Rogoff<sup>2</sup> playing the roles of assistant coaches on the Deleveragers' sideline, this team should be miles ahead in terms of insight and perspective.

My guess is the Deleveragers will carry the second half and overcome Team Zero's lead. It will be a tight one, and the referee – Random Event – will likely make the call that

---

<sup>2</sup> This Time is Different, Eight Centuries of Financial Folly, Carmen M. Reinhart & Kenneth S. Rogoff, Princeton University Press, 2009

determines the outcome or, instead, sends the game into overtime just like the ref in the commercial for Buffalo Wild Wings.

The only thing we know for sure is that the team with the best system will win. And this, believe it or not, depends on the equipment manager: Jobs. If he rises to the occasion, Bernanke and Team Zero will triumph. But if the equipment is old, outdated, and unable to be reassembled in a functioning fashion, the Deleveragers will win.

So stay tuned for what is shaping up to be the financial showdown of the century. It's kick-off time!