



Serenity Now

By Emilio Vargas

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I have been hopeful but now I am becoming fearful. Not about making money but about the prospect of another bubble. The recent statements and actions of the Federal Reserve Bank may be laying the groundwork for a third massive asset mispricing in ten years.

A much larger QE1 and fiscal stimulus failed to create organic growth in the economy. A smaller QE2 is unlikely to produce the desired growth in jobs and the economy. Expectations of QE2 have fueled a double-digit decline in the dollar and mirror rise in real assets. Although most people consider common stock to be financial assets, I count them as real assets because they represent a claim on the underlying real property.

The failure of QE2 to have the desired effect on the economy and future easing will likely form the basis of another bubble. QE2 and the expectations of more QE have engendered the Anything But Dollars trade. Those assets (commodities, currencies, junk bonds, domestic and foreign equities) would normally decline in value due to a weak economy. As the Federal Reserve Board is wont to do, they are likely to create a bubble in these assets in a misguided effort to stimulate growth.

The unintended consequences of these actions are manifold. All bubbles break; only the timing is uncertain. When that happens policy options and their effectiveness will be limited, the dominant position of the U.S. dollar will be permanently damaged, and the power of the Federal Reserve will be damaged as well. World trade will be affected negatively. The dollar decline engendered by the expectation of QE2 is already wreaking harm on foreign economies. It is slowing growth in developed nations while helping to fuel inflation in developing economies.

The wealth "created" in the symbol economy of money and credit will be ephemeral. It cannot be otherwise unless it is matched by a similar growth of wealth in the real economy. When the process ends, as it inevitably must, the bust will likely be worse than the one we are trying to escape.



To quote Lloyd Braun, "[Serenity now, insanity later.](#)"

Emilio Vargas is a pseudonym. The author is a former money manager.

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