First Trust
Monday Morning OUTLOOK

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Time To Drain The Fed Swamp

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The Panic of 2008 was damaging in more ways than people think. Yes, there were dramatic losses for investors and homeowners, but these markets have recovered. What hasn't gone back to normal is the size and scope of Washington DC, especially the Federal Reserve. It's time for that to change.

D.C. institutions got away with blaming the crisis on the private sector, and used this narrative to grow their influence, budgets, and size. They also created the narrative that government saved the US economy, but that is highly questionable.

Without going too much in depth, one thing no one talks about is that Fannie Mae and Freddie Mac, at the direction of HUD, were forced to buy subprime loans in order to meet politically-driven, social policy objectives. In 2007, they owned 76% of all subprime paper (See Peter Wallison: *Hidden in Plain Sight*).

At the same time, the real reason the crisis spread so rapidly and expanded so greatly was not derivatives, but mark-to-market accounting.

It wasn't government that saved the economy. Quantitative Easing was started in September 2008. TARP was passed on October 3, 2008. Yet, for the next five months markets continued to implode, the economy plummeted and private money did not flow to private banks.

On March 9, 2009, with the announcement that insanely rigid mark-to-market accounting rules would be changed, the markets stopped falling, the economy turned toward growth and private investors started investing in banks. All this happened immediately when the accounting rule was changed. No longer could these crazy rules wipe out bank capital by marking down asset values despite little to no change in cash flows. Changing this rule was the key to recovery, not QE, TARP or "stress tests."

The Fed, and supporters of government intervention, ignore all these facts. They never address them. Why? First, institutions protect themselves even if it's at the expense of the truth. Second, human nature doesn't like to admit mistakes. Third, Washington DC always uses crises to grow. Admitting that their policies haven't worked would lead to a smaller government with less power.

The Fed has become massive. Its balance sheet is nearly 25% of GDP. Never before has it been this large. And yet, the economy has grown relatively slowly. Back in the 1980s and 1990s, with a much smaller Fed balance sheet, the economy grew far more rapidly.

So how do you drain the Fed? By not appointing anyone that is already waiting in D.C.'s revolving door of career elites. We need someone willing to challenge Fed and D.C. orthodoxy. If we had our pick to fill the chair and vice chair positions (with Stanley Fischer announcing his departure) we would be focused on the likes of John Taylor, Peter Wallison, or Bill Isaac.

They would bring new blood to the Fed and hold it to account for its mistakes. It's time for the Fed to own up and stop defending the nonsensical story that government, and not entrepreneurs, saved the US economy. Ben Bernanke and Janet Yellen have never fracked a well or written an App. We need a government that is willing to support the private sector and stop acting as if the "swamp" itself creates wealth.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-13 / 7:30 am	PPI – Aug	+0.3%	**+0.3%**		-0.1%
7:30 am	"Core" PPI – Aug	+0.2%	**+0.2%**		-0.1%
9-14 / 7:30 am	Initial Claims – Sep 9	300K	**300K**		298K
7:30 am	CPI – Aug	+0.3%	**+0.3%**		+0.1%
7:30 am	"Core" CPI – Aug	+0.2%	**+0.1%**		+0.1%
9-15 / 7:30 am	Retail Sales – Aug	+0.1%	**+0.1%**		+0.6%
7:30 am	Retail Sales Ex-Auto – Aug	+0.5%	**+0.6%**		+0.5%
7:30 am	Empire State Mfg Survey – Sep	18.0	**10.5**		25.2
8:15 am	Industrial Production – Aug	+0.1%	**+0.1%**		+0.2%
8:15 am	Capacity Utilization – Aug	76.8%	**76.8%**		76.7%
9:00 am	Business Inventories – Jul	+0.2%	**+0.2%**		+0.5%
9:00 am	U. Mich Consumer Sentiment- Sep	95.0	**97.3**		96.8