BY RICHARD SKEPPSTROM
JUNE 2015

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Betwixt and between

The easy money's been made. That's not gloomy talk. It's not controversial. It's not a recommendation to do anything. It's a fact. You can expect high returns from stocks when margins are depressed, valuations are low, interest rates can be slashed and the U.S. Federal Reserve is about to juice the system. But that's simply not where we are now. We are in a new market where the returns will be lower, fewer things will work and volatility will be higher. We will be in this environment for the foreseeable future. This is sort of like getting older. As they say, it's better than the alternative. Cheer up.

Byron Wien, the legendary strategist, says the market can go higher from here even without the Fed's help. Of course it can. In fact, I suspect it will slowly grind higher. What's been working so far this year is growth. High-growth names in healthcare, technology and consumer cyclicals have led. Michael Goldstein of Empirical Research Partners has identified a group he calls the 75 "Big Growers." They have the most "unimpeachable (growth) credentials" and they've done exceptionally well. That isn't surprising. Economic growth has disappointed, compelling investors to seek growth that's unmistakably independent of the economic backdrop. They're expensive at about 33 times earnings but not stupidly so. They'll likely lead until economic growth turns decisively in either direction. As unhelpful as this is, I suspect the next leadership change will be easier to spot in hindsight. We're betwixt and between.

The Fed: friend forever

It's certainly appropriate for Mr. Wien to consider markets post-Fed rate increases but I doubt the Fed can ever again take its hands off the markets. As I see it, it's let too much debt build in the system at too-low rates to ever disengage. And this is the state of things pretty much everywhere in the world. We gorged on debt over the last few decades to keep growth going and when the inevitable retching began in 2008, the central banks conjured the most powerful medicine imaginable (0 percent interest rates and Fed asset purchases) and the symptoms subsided. But the disease (debt) is still there; the therapy assured it. Is that unfair? Perhaps there was nothing else they could do; we'll never know. Easier credit is the traditional remedy for a recession and I have no doubt that a less-robust response would have been more painful, and likely much more. But debt was clearly THE problem and more of it didn't sound like a cure. In any case, the Fed chose the experimental "nuclear version" of easy credit and the results are, regrettably, resoundingly lackluster. No doubt they counted on better. But the fact is we're left with a mountain of debt – probably unserviceable at normal rates – and central banks have left themselves with only one option in the event of a problem: more asset purchases. That is both insurance policy and moral hazard. One must conclude that the Fed will keep a firm grip on the markets and bail us out until it can't.

And "can't" isn't going to happen this year or next or even the year after that. I don't even know how to conceptualize a limit to the Fed's ability to purchase financial assets. They've already bought more than $4 trillion, which in technical terms is a $&%#load. It could probably do much more. The relative value of the dollar would suffer and there'd be some commodity inflation but it's simply not been as inflationary as some had feared or at least it hasn't been. Nor has it been very stimulative. That has a lot to do with demand for credit, which has been weak. Fed asset purchases push interest rates lower and create bank reserves but there's been little demand for credit given that's what got us into this mess in the first place. But there is an interesting wrinkle to all of this. When the Fed buys a Treasury note, the government owes itself. It could simply cancel the debt. If you use your imagination, you can almost (wink-wink) see how this could get abused but we're not even close to being there. But Japan is. Government debt there is more than 200 percent of gross domestic product (GDP); they borrow nearly 40 percent of their government spending every year and still their interest rates (0.4 percent) and inflation remain remarkably low. You can bet we're studying their methods closely.

Thank you for taking the time to read this month's Market Perspective. I hope you found it helpful.

Strategic Return Portfolio	
Equities	68%
Bonds	13%
Gold	2%
Cash & similar	17%
Total	**100%**

as of May 26, 2015

Richard, an investment professional with more than two decades of experience, manages Eagle's Strategic Return Portfolio. His views are his own and may not reflect those of other Eagle portfolio managers.

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