"The Fed Has Spent the Last 15-20 Years Manipulating the Stock Market"

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Jeremy Grantham: "The Fed Has Spent Most of the Last 15, 20 Years Manipulating the Stock Market"

Legendary investor Jeremy Grantham – Chief Investment Strategist of Grantham, Mayo, Van Otterloo- told CNBC last week:

> What I worry about most is the Fed's activity and — QE2 is just the latest demonstration of this. The Fed has spent most of the last 15, 20 years—manipulating the stock market whenever they feel the economy needs a bit of a kick. I think they know very well that what they do has no direct effect on the economy. The only weapon they have is the so-called wealth effect. If you can drive the market up 50 percent, people feel richer.
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> This is what the Fed wants by the way.
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> It wants us to go out there and buy stocks, which are overpriced because bonds they have manipulated into being even less attractive. So, we're being forced to choose between two overpriced assets.
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> And what the Fed is trying to do is to make cash so ugly that it will force you to take it out and basically speculate. And in that, it's very successful, of course, with the hedge funds. They're out there speculating. Finally, the ordinary individuals are beginning to get so fed up with having no return on their cash that they're beginning to do a little bit more purchasing of equities. And that's what the Fed wants.
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> It wants to have the stocks go up, to make you feel a bit richer so that you'll spend a little more and give a short-term kick to the economy. But, it— it's a pretty circular argument. For every dollar of wealth effect you get here, as stocks go from overpriced to worse, you will give back in a year or two. And you'll give it back like it— like it happened in— in '08 at the very worse time.
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> All of the kicker that Greenspan had engineered for the '02, '03, '04 recovery and so on was all given back with interest. The market overcorrected through fair value. The housing market that was a huge driver of economic strength and a— actually masked structural unemployment with all those extra, unnecessary houses being built. All of that was given back similarly at the same time. It couldn't have been worse.

Grantham also slams the Fed for blowing bubbles and for encouraging moral hazard:

> [Question:] So, what should the federal government be doing then? I mean, the housing industry, for example, missing in action. What is it going to take to get housing moving again? What is it gonna take to get businesses hiring again? If it's not the job of the Federal Reserve, what policy should we be seeing coming out of the government?
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> [Grantham:] I think the Federal Reserve has— is in a very strong position to move against bubbles. Bubbles are the most dangerous thing— asset-class bubbles that come along. They're the most dangerous to investors. They're also the most dangerous to the economies of— as we have seen in Japan and in 1929 and now here. You've got to stop them.
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> The Fed has enormous power to move markets. And it— not necessarily immediately, but give them a year and they could bury a bull market. They could have headed off the great tech bubble. They could have headed off the housing bubble. They have other responsibilities— powers. They— they could have interfered with the quantity and quality of the sub-prime event. They chose not to.
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> In fact, Greenspan led the charge to deregulate this, deregulate that, deregulate everything, which was most— ill advised, and for which we have paid an enormous price. So, they can— they can stop bubbles, and— and they should. It's easy. It's a huge service. What you do now is— is— I like to say it's a bit like the Irish problem.
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> I wouldn't start the journey from here if I were you when you ask— the way. You— you really shouldn't allow the— situation to get into this shape. You should not have allowed the bubbles to form and to break. Digging out from a great bubble that has broken is so much harder than preventing it in the first place.
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> And unless we're lucky, we will have yet another crisis without being able to lower the rates 'cause they'll still be low, without being able to issue too much moral hazard promises from the Fed because people will begin to find it pretty hollow. Cycle after cycle, the Fed is making basically— is flagging the same intention. Don't worry, guys. Speculate. We'll help you if something goes wrong. And each time something does go wrong and it gets more and more painful.

Finally, Grantham slams low interest rates and quantitative easing:

> Let me point out that the Fed's actions are taking money away from retirees.
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> They're the guys, and near retirees, who want to part their money on something safe as they near retirement. And they're offered minus after-inflation adjustment. There's no return at all. And where does that money go? It goes to relate the banks so that they're well capitalized again. Even though they were the people who exacerbated our problems.
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> I— I think, therefore, under these conditions, low rates is actually hurting the economy. It's taking more money away from people who would have spent it

> —retirees — than are being spent by passing it on to financial enterprises and being distributed as bonuses to people who are rich and, therefore, save more.
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> So, I think it’s a— a— bad idea at any time and a particularly bad idea now.

Here’s the interview:

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