Gregory E. Cater CWS® CRC® AIF®
Certified Wealth Strategist®
Certified Retirement Counselor®
Accredited Investment Fiduciary®

32731 Egypt Lane, STE 801
Magnolia, Texas 77354
www.firstallied.com

936-321-1542
gcater@1stallied.com

Greg Cater Sr. and Greg Cater Jr.

QE, QE-Light or Definitely NOT QE

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On Monday of this week we posted a note explaining why we thought the Federal Reserve would start increasing their balance sheet (again) in the near future. You can get it here:

http://www.caterwealthmanagement.com/articles/QEvsStocks.pdf

Well it didn't take long, On Friday (today) the Fed announced a new program: buying $60 Billion per month of Treasury Bills. This is in addition to the overnight and term repurchase agreements announced earlier. Fed Chairman Powell stressed this is not a resumption of QE (ended in August). In his press conference he stressed this 7 times. I think he was trying to convince us. According to Wikipedia QE is:

> "**Quantitative** easing (**QE**), also known as large-scale asset purchases, is a monetary policy whereby a central bank buys predetermined amounts of government bonds or other financial assets in order to inject liquidity directly into the economy."

Sounds like QE to me.

He stated the new program is intended to increase liquidity, but don't think of it as QE. Some have opined in order for QE to be QE it must be "large-scale". Well QE3 purchased $40 billion per month; this Non-QE will purchase $60 billion per month.

Sounds "large-scale" to me.

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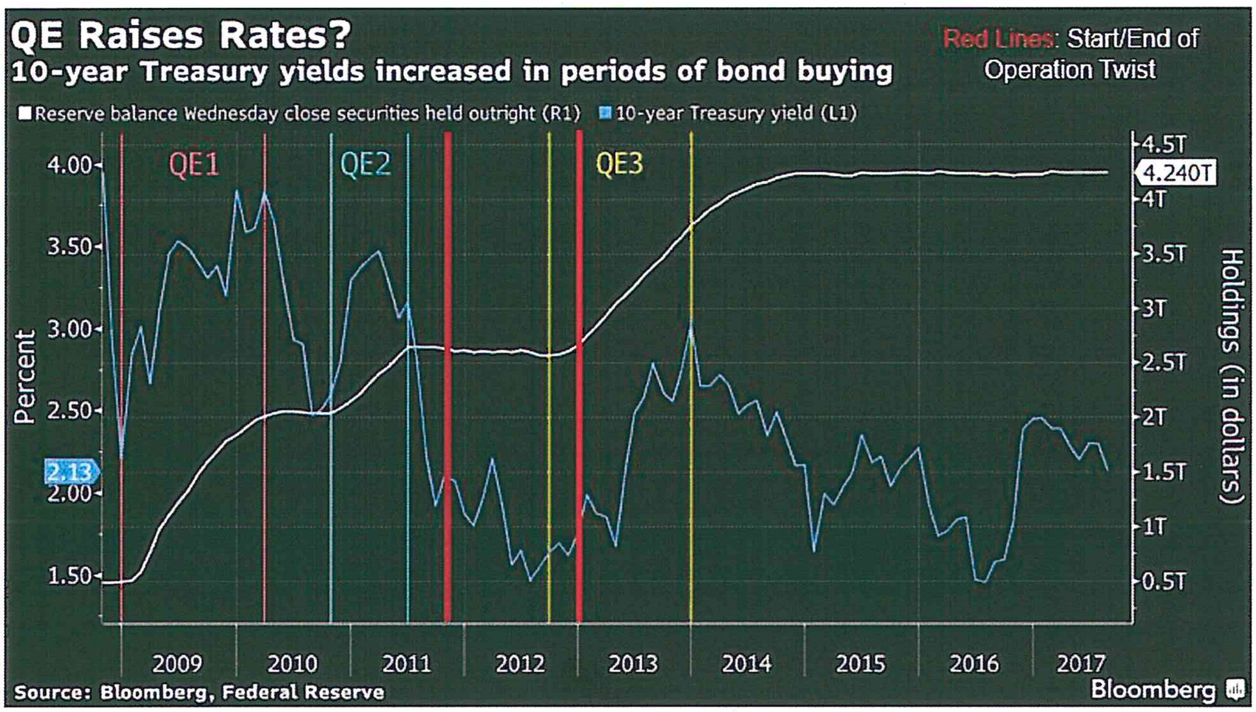
Originally QE was designed to provide banks with liquidity which would encourage lending to help the economy recover from the financial crisis. It was also supposed to lower interest rates. It failed on both counts, at least as far as bank lending and the yield on the 10 year Treasury bond are concerned. While the Fed was buying bonds (QE1, 2 and 3) rates rose; when QE stopped (1, 2 and 3) rates plummeted. The only Fed program during this time that actually did what it was supposed to do (lower rates) was "Operation Twist". In operation Twist the Fed sold short term bonds and bought long term bonds. It worked but they eventually ran out of short term bonds on their balance sheet and the program had to end. For the record "short term bonds" are Treasury Bills. So now they are buying Treasury Bills.



Fed purchases of Treasury Bills could serve two purposes. It will increase Bank Reserves, adding liquidity to the economy. It will also add short term bonds to the balance sheet to allow for new rounds of "Operation Twist" if needed. We believe it will be needed and this will lead to an ever increasing Fed balance sheet and lower interest rates.