Taking into account the extent of federal fiscal retrenchment since the inception of its current asset purchase program, the Committee sees the improvement in economic activity and labor market conditions over that period as consistent with growing underlying strength in the broader economy. **In light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions, the Committee decided to modestly reduce the pace of its asset purchases**. Beginning in January, the Committee will add to its holdings of agency mortgage-backed securities at a pace of $35 billion per month rather than $40 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of $40 billion per month rather than $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. The Committee's sizable and still-increasing holdings of longer-term securities should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative, which in turn should promote a stronger economic recovery and help to ensure that inflation, over time, is at the rate most consistent with the Committee's dual mandate.

Federal Reserve Press Release, *December 18, 2013,*
Announcing the "tapering" of its monthly bond purchases (aka QE3).

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I am little embarrassed to say it, but I cannot believe how excited I got when the Federal Reserve actually started tapering its monthly bond purchases. Seriously. At first I was just relieved that the Fed could actually begin to wean itself off its purchasing addiction, but then I began to feel an exhilarating combination of anticipation and joy. A sense that something wonderful was unfolding right before my eyes. A hope that I was finally going home to some familiar and joyful world. Wow! What has happened to me?

I think it is fair to say that participating in the financial markets for over 25 years leads to a certain amount of emotional distance, or what I would prefer to call a pragmatic skepticism, bred by the innumerable misjudgments that participants make in the natural course of investment management. From personal experience, I long ago came to the humbling conclusion that I will often be wrong no matter what I feel or how much I think I know. Add to that the fact that a decision in the financial markets can be both right and wrong, as prices vary up and down over days and months and years, and you can see how a healthy dose of emotional reserve is necessary. And yet, here I am using "excited" and "Federal Reserve" in the same sentence.

In part, I think I am letting down my guard, opening myself to naïve optimism and disappointment, because of how deeply contradictory current Fed policies are to the foundational building blocks of capitalism. I have written many times praising the actions of the Federal Reserve as our financial system teetered on the edge of collapse in the fall of 2008, particularly about its taking on the role of financing overnight commercial paper and forthrightly acting as the bank of last resort.[1] I thought its

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[1] On the flip side, I have also written that the Federal Reserve started becoming too reactive to the financial markets under Alan Greenspan's reign as Fed Chief, increasingly trying to manage stability in place of allowing the markets to cleanse themselves of their natural excesses, creating moral hazard, unrealistic expectations of stability, skewed risk assessments, poorly formed resource allocation decisions and ever more need for intervention to manage ever larger excesses.

ratcheting down of the Federal Funds interest rate in response to the crisis was appropriate. I even felt its first experiment in the realm of quantitative easing, in which it began to purchase mortgage backed securities in December of 2008 to promote liquidity in the damaged epicenter of the crisis, was reasonable under the circumstances. By last year, however, I had to question the fact that the Federal Reserve maintained its "crisis" policies even as the US stock market rose to an all-time high. The incongruities strained my veteran composure. The stock market's enthusiasm may or may not be misplaced, but a policy of starving conservative savers and investors of yield by actively suppressing interest rates while the stock market is at an all-time high is not only unseemly and unjust, it is distorting market signals for risk and reward and, consequently, is leading to irrational allocations of capital and stunting future growth. I have said before that the Fed must be really worried about the structural underpinnings of our economy (and the global economy) to be risking its credibility in this way – and maybe it still is – but now, with the first few steps of tapering begun, with the Fed decelerating its bond purchases, we have finally started down the path that I have been waiting for. While we are still a long way from a "normal" Fed policy, and the Fed or the economy could easily falter along the way, just the idea of restoring a more market based rationality and finding out where the economy stands without the Fed policy distortions makes me excited! Seriously.

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I have read plenty of commentary over the last few years suggesting the aggressive Federal Reserve policy has enabled our federal government to avoid making decisions on issues that are critical to our long-term economic success. The perception is that the Federal Reserve has done the heavy lifting in supporting our economy while the politicians have been squabbling amongst themselves. Obvious examples of issues that have the potential to greatly impact the long-term trajectory of our economy but remain unresolved include tax reform (corporate and individual), Social Security and Medicare reform and immigration reform. It is hard to say whether the Fed has indeed provided cover for our federal government's inaction, but it is clear to me that many politicians have little appetite for bipartisan compromise in the current polarized environment (and primaries in gerrymandered districts certainly don't offer much incentive for Democrats and Republicans to meet in the middle). Our portfolio manager Terry Robinette recently went to a forum presented by a member of the Committee for a Responsible Federal Budget (CRFB) that addressed aspects of these issues and presented a refreshingly frank perspective. The group incorporates the work that was done by the bipartisan National Commission on Fiscal Responsibility and Reform (aka the Simpson-Bowles Commission) in moving to a sustainable budget and taxation framework. There is a wealth of information and non-partisan evaluations on their website, CRFB.org. Given our economy's structural issues, such as an aging demographic, I vote for solutions. Is that too emotional?

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We appreciate your business. We are working hard to help all of our clients meet their individual financial needs and goals. Please contact us if you have a friend or family member that would like to talk with us about our services.

John McCorvie, CFA