Weekly Market Commentary
December 23, 2013

The Markets

To borrow a word from the legendary Gomer Pyle: G-O-L-L-Y!

In 1955, just five years before *The Andy Griffith Show* became a big hit, William McChesney Martin, Jr., then Chairman of the Board of Governors of the Federal Reserve System, made an often-quoted speech in which he said, "The Federal Reserve, as one writer put it, after the recent increase in the discount rate, is in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up."[1]

Last week, Fed Chairman Ben Bernanke didn't confiscate the punch. He simply modified the recipe by adding a lower proof of spirits when he announced the Fed would begin to taper its bond buying program. Starting in January, the Fed will spend $10 billion a month less on bonds (the amount will be evenly split between Treasuries and mortgage-backed securities). Taking away the punch bowl would have entailed ending all bond purchases and increasing the discount rate.[2] The Fed has indicated it will not change the discount rate for some time.[3]

After an initial dip on the news of impending tapering, many markets around the world moved higher. The Dow Jones Industrial Average and the Standard & Poor's 500 Indices pushed to record highs.[3] Britain's FTSE 100, Germany's Dax, and France's CAC indices all pushed higher on Wednesday, as did Japan's Nikkei 225 Index.[4] In the bond market, U.S. Treasury yields rose and then fell on the day of the announcement.[3]

The beginning of the end of quantitative easing wasn't the only news that drove markets higher last week. On Friday, the U.S. Commerce Department reported that U.S. gross domestic product (GDP) – a measure of our nation's productivity – accelerated faster than originally thought during the third quarter. The reasons for the upward revision were increased consumer and business spending.[5]

Life may have been simpler in fictional Mayberry R.F.D. – and they certainly had fewer choices as consumers – but economics and the responsibilities of the Federal Reserve weren't any less complicated.

Data as of 12/20/13	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	2.4%	27.5%	26.0%	13.4%	15.8%	5.2%
10-year Treasury Note (Yield Only)	2.9	NA	1.8	3.4	2.1	4.2
Gold (per ounce)	-3.0	-29.4	-27.6	-4.7	7.1	11.3
DJ-UBS Commodity Index	1.2	-8.3	-8.2	-6.7	2.9	-0.5
DJ Equity All REIT TR Index	1.9	2.5	2.6	10.7	18.0	8.6

Notes: S&P 500, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.
Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.
Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable.

IN THE EARLY DAYS OF BANKING IN THE WILD WEST, THERE WEREN'T too many rules about what banks could and couldn't do. According to *The New York Times*, in the early1900s:[6]

> "…Commercial banks established security affiliates that floated bond issues and underwrote corporate stock issues. (In underwriting, a bank guarantees to furnish a definite sum of money by a definite date to a business or government entity in return for an issue of bonds or stock.) The expansion of commercial banks into securities underwriting was substantial until the 1929 stock market crash and the subsequent Depression."

After the crash, thousands of banks failed.[6]

In 1933, Congress passed the Glass-Steagall Act (a.k.a. the Banking Act). The Act defined the difference between commercial and investment banking activities. Commercial banks primarily took deposits and made loans while investment banks helped companies issue stock and invested in securities.[7] The Act prohibited commercial banks from participating in investment banking activities. It also created the Federal Deposit Insurance Corporation (FDIC) whose job was to protect commercial banks' clients' deposits up to a certain amount.[8]

In 1999, after years of financial prosperity, Congress changed its mind and passed the Gramm-Leach-Bliley Act (GLBA) which effectively repealed the parts of Glass-Steagall that prevented commercial banks from participating in investment banking activities.[9] Some believe the change in rules played a significant role in the global credit crisis during which commercial banks suffered billions of dollars in losses because of their investment banking activities.[8]

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was passed in response to the global credit crisis and subsequent government bailout.[10] The 953-page Volcker Rule is part of the Act and was passed by regulators in December of this year. It establishes a set of rules that are intended to prevent FDIC-insured banks from making risky bets with customers' deposits. In particular, banks that rely on taxpayer guarantees are largely prohibited from proprietary trading and hedge fund investments. We'll know more when regulators decide how the rules will apply and who will enforce them.[11]

George Bernard Shaw said, "We are made wise not by the recollection of our past, but by the responsibility for our future."[12] Let's hope when it comes to U.S. banking law, he proves to be right.

Weekly Focus – Think About It

"As a child my family's menu consisted of two choices: take it or leave it."

--*Buddy Hackett, American comedian*[13]

Best regards,

Jim

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[1] http://fraser.stlouisfed.org/docs/historical/martin/martin55_1019.pdf (*page 12 of the document*)

[2] http://blogs.barrons.com/stockstowatchtoday/2013/12/18/markets-toast-taper-news-send-dow-sp-500-to-record-highs/?mod=BOL_hp_highlight_1

[3] http://online.barrons.com/article/SB50001424053111904399004579262371932942350.html#articleTabs_article%3D1 (*or go to* http://peakclassic.peakadvisoralliance.com/app/webroot/custom/editor/12-23-13_Barrons-How_the_Market_Learned_to_Love_the_Taper.pdf)

[4] http://www.bbc.co.uk/news/business-25442514

[5] http://blogs.barrons.com/incomeinvesting/2013/12/20/u-s-third-quarter-gdp-growth-accelerates-to-4-1/?mod=BOLBlog

[6] http://topics.nytimes.com/top/reference/timestopics/subjects/g/glass_steagall_act_1933/

[7] http://www.investopedia.com/articles/investing/062513/role-commercial-banks-economy.asp

[8] http://www.investopedia.com/terms/g/glass_steagall_act.asp

[9] http://www.investopedia.com/terms/g/glba.asp

[10] http://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp

[11] http://economix.blogs.nytimes.com/2013/12/13/a-modest-volcker-rule/

[12] http://www.brainyquote.com/quotes/authors/g/george_bernard_shaw.html

[13] http://www.brainyquote.com/quotes/topics/topic_funny.html#HPdj8ZiBwRJQmmxX.99