Mitchell's Musings 6-8-15: Buy Low/Sell High and Bet on the Winning Horse

Daniel J.B. Mitchell

An item in the news caught my eye dealing with the Federal Reserve and "transparency." Specifically, a column appeared in the *Los Angeles Times* – apparently reflecting a similar column in the *Wall Street Journal* – indicating that you shouldn't rely on Federal Reserve chairs for stock market advice.[1] The column noted that after former Fed chair Alan Greenspan made his famous "irrational exuberance" warning, you could have lost a lot of money if you had pulled your investments at that time from the stock market, even taking account of subsequent events. One such event was the dot-com bust and another was the later housing bust. Nonetheless, timing is everything; if you sold at the bottom you might have lost but if you held on to your shares you would have come out ahead.

The column goes on to note that current Fed chair Janet Yellen has noted high valuations of some techy sectors of the stock market but those shares also went up after she sounded a cautionary note. Pay no attention to the Fed chair seems to be the lesson to be drawn. But is that so?

There is the old bit of (useless) advice that you should "buy low" and "sell high" to make money. Indeed, a quick Google search failed to reveal even an attribution of that quote – because it is so commonly used to illustrate how it really tells you nothing. The advice is useless since it fails to tell you about timing – when exactly is the market low and when is it high? By itself, it is as unhelpful as advising you that when betting on a horse race, you should always bet on the winning horse.

Useless though they are, both buy low/sell high and bet-on-the-winning horse are bits of *micro* advice. They may be useless but they are aimed at individual investors or betters. Fed chairs don't purport to be micro advisors who are competing with stock brokers or race track tip sheets. They <u>do</u> have *macro* concerns, however. Sometimes bubbles and the bursting of those bubbles can be costly to the overall economy. The dot-com/boom/bust provoked a mild recession. On a regional basis in my home state of California, its impact was greater than in the U.S. as a whole, leading to – among other effects – a state budget crisis and the recalling of a governor.

The housing bubble/burst, on the other hand, produced the Great Recession. By many measures, particularly in the labor market, we are still not fully recovered from that recession. So surely, Fed chairs

[1] http://www.latimes.com/business/hiltzik/la-fi-mh-want-to-make-money-in-the-stock-market-dont-listen-to-the-fed-chair-20150602-column.html

have legitimate concerns about such episodes. Their concerns are not whether you as an individual could make money by a long-term buy-and-hold stock strategy but what happens to the general economy when there are panics and market collapses.

It may well be that making statements about irrational exuberance is not especially effective at avoiding such exuberance and that it has no effect on financial busts. It may be – in fact it likely is – the case that statements by Fed chairs are no more useful at telling you at the micro level how to time investments than telling you to buy low/sell high. But it seems wrong to imply that Fed chairs shouldn't openly share their macro policy concerns in public forums. Surely, those folks who call for more "transparency" at the Fed would be unhappy with such a position. What could be more transparent than a Fed chair sharing her policy concerns?

If Janet Yellen is expressing nervousness about stock market valuations, she could be telling you that she is leaning toward raising interest rates to cool things down. It's likely that she is not alone in such leanings among Fed policy makers. She might be wrong in her evaluation about the market. But now you know how she – a significant player in monetary policy – feels. Whether you want to sell your stocks on hearing what she has to say is your business. Whether your investment choices should be made on that basis is your affair. But whether the Fed raises interest rates is everyone's business because of the macro effects, even the business of those who have no stock market investments and are just doing such real world things as seeking employment.