Investing in Ben Bernanke's World

By Jim Coleman

Extraordinary. History-making. Unprecedented. These are the words used over the course of the last few weeks to describe the steps taken by the Federal Reserve to stabilize financial markets and bolster the national economy. Significantly, in an effort to curtail the subprime mortgage and credit crises that have engulfed the financial system and now threaten a recession, Federal Reserve Chairman Ben Bernanke recently announced the broadest expansion of the Fed’s lending authority since the Great Depression.

For the first time, securities dealers will be permitted to borrow from the Fed on the same terms as commercial banks. The Fed also lowered the rate charged at its discount window by a quarter of a percentage point, to 3.25% and extended the maximum term from 30 to 90 days. The offer is good for at least the next six months. Additionally, at its March meeting, the Federal Open Markets Committee (FOMC) reduced its target for the federal funds rate by 75 basis points to 2.25 percent, a full 3 percentage points below last summer’s rate.

While Chairman Bernanke certainly mentioned those steps in his April 3 testimony before the Committee on Banking, Housing, and Urban Affairs in the U.S. Senate, his main focus was on a more sensational move -- the Fed’s recent $29 billion bail out of Bear Stearns. Acknowledging that saving the nation’s fifth largest brokerage firm from bankruptcy raised difficult questions of public policy, Bernanke stated, “Normally, the market sorts out which companies survive and which fail, and that is as it should be. However, the issues raised here extended well beyond the fate of one company.

Our financial system is extremely complex and interconnected, and Bear Stearns participated extensively in a range of critical markets. The sudden failure of Bear Stearns likely would have led to a chaotic unwinding of positions in those markets and could have severely shaken confidence.”

According to Chairman Bernanke, the company’s failure also could have “cast doubt on the financial positions of some of Bear Stearns’ thousands of counterparties and perhaps of companies with similar businesses,” making the damage caused by a default “severe and extremely difficult to contain.” Moreover, in the Chairman’s view, the damage would not have been confined to the financial system, but would have been “felt broadly in the real economy through its effects on asset values and credit availability.”

Bottom line: Because Bear was so inter-connected, the cost of letting the firm fail was greater than the cost of the bail out.

Source for Bernanke’s testimony:
http://fedreserves.gov/news event/testimony/bernanke/20080403.htm

While headlines fuel debate over the question of whether the Fed has made the right decision, there’s a more immediate concern for individual investors. That is, if the Fed’s traditional tools need re-tooling to fix the current financial crisis and restore market confidence; do investors need to make unprecedented moves of their own? Rather than match one extreme move for another, I suggest the following time-tested strategies to guide you through what is an extraordinary period in market history:

Seek real information. Remember as precedent-setting as the Fed’s moves may be, headlines are written to sell newspapers. In times of market volatility, it’s important to dig a little deeper and to put market events in context. That can be time-consuming, but it’s time well-spent and can often uncov- er surprises.

Control what you can. Market volatility, interest rate fluctuations, and inflation are largely out of your control. However, you can control how you save, what you spend, and when you retire. Interestingly, while headlines proclaim “Boomers Delaying Retirement”, may fuel economic worries, for some, putting retirement off for a year or two could be a prudent move, just as carpooling helps combat high gas prices. The point is, especially in periods of marked uncertainty volatility and unprecedented federal responses, it’s important to ensure you make decisions based on reason, not emotion.

Check your long term plan. If you’ve been living on a fixed income, evaluate your withdrawal rate to ensure that your current spending isn’t jeopardizing your long-term asset preservation. Ask for help. If you’re feeling overwhelmed by market events, you are not alone. Study after study reports waning consumer confidence and America’s general dissatisfaction with the economy. If you have a financial advisor, now might be a good time to touch base. If you’ve never worked with an advisor, now might be a good time to reach out Additional financial expertise and historical perspective could be just what you need to put your mind at ease.

[About Jim Coleman -- Jim Coleman has been in the financial services industry for over 20 years. He founded Coleman Financial Advisory Group, a Waterbury-based financial services firm, in 1990. He specializes in providing comprehensive financial planning, asset management and estate planning services. Investing: Your Guide to Surviving and Thriving in the Fast-Paced Global Markets of the 21st Century. Contact Jim Coleman at (203) 756-7526 or Jim@ColemanAdvisoryGroup.com]