Is the Fed Juicing the Stock Market?

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Is the Fed manipulating the stock market? TrimTabs CEO Charles Biderman seems to think so, and he makes a strong case for his theory in an article at zerohedge.com.

Biderman focuses his attention on the mystery surrounding the stock market's 9-month rally and asks, "Where is the money coming from?" After all, the market cap has increased by more than $6 trillion since March 9. That amount of money should be fairly easy to trace; right?

Wrong.

Biderman: "The most positive economic development in 2009 was the stock market rally. (But) We cannot identify the source of the new money that pushed stock prices up so far so fast. For the most part, the money did not from the traditional players that provided money in the past."

Huh? So, this vast infusion of liquidity–which helped the banks to avoid painful deleveraging–did not come from the usual suspects?

That's right. According to Biderman, the money did not come from (a) companies ("which were a huge net seller") (b) retail investor funds, (c) retail investors, (d) foreign investors, or (e) pension funds.

What about the hedge funds?

Biderman: "We have no way to track in real time what hedge funds do, and they may well have shifted some assets into U.S. equities. But we doubt their buying power was enormous because they posted an outflow of $12 billion from April through November."

Okay; so we're back to Square One. Where did the money come from?

Biderman again: "As far as we know, it is not illegal for the Federal Reserve or the U.S. Treasury to buy S&P 500 futures. Moreover, several officials have suggested the government should support stock prices. For example, former Fed board member Robert Heller opined in the Wall Street Journal in 1989, "Instead of flooding the entire economy with liquidity, and thereby increasing the danger of inflation, the Fed could support the stock market directly by buying market averages in the futures market, thereby stabilizing the market as a whole." In a Financial Times article in 2002, an unidentified Fed official was quoted as acknowledging that policymakers had considered buying U.S. equities directly, not just futures. The official mentioned that the Fed could "theoretically buy anything to pump money into the system."

Biderman is referring to the Plunge Protection Team. Here's a clip from an article I wrote in 2007 which helps to clarify the PPT's origins:

"The Working Group on Financial Markets, also know as the Plunge Protection Team, was created by Ronald Reagan to prevent a repeat of the Wall Street meltdown of October 1987. Its members include the Secretary of the Treasury, the Chairman of the Federal Reserve, the Chairman of the SEC and the Chairman of the Commodity Futures Trading Commission. Recently, (2007) the team has been put on high alert because of increased market volatility and, what Hank Paulson calls, the systemic risk posed by hedge funds and derivatives….

Ambrose Evans-Pritchard of the UK Telegraph notes, "Secretary of the Treasury Hank Paulson has called for the PPT to meet with greater frequency and set up a command centre at the US Treasury that will track global markets and serve as an operations base in the next crisis. The top brass will meet every six weeks, combining the heads of Treasury, Federal Reserve, Securities and Exchange Commission (SEC), and key exchanges."

This suggests that the PPT could, in fact, be the driving-force behind the ongoing stock market rally.

Biderman: "This type of intervention could explain some of the unusual market action in recent months, with stock prices grinding higher on low volume even as companies sold huge amounts of new shares and retail investors stayed on the sidelines. For example, Tyler Durden of ZeroHedge has pointed out that virtually all of the market's upside since mid-September has come from after-hours S&P 500 futures activity."

True. The market has been behaving erratically for some time now. Could it be the "invisible hand" of Fed chair Ben Bernanke nudging equities ever-higher?

Consider the comments of former Clinton advisor George Stephanopoulos who verified the existence of the PPT in an appearance on Good Morning America on Sept 17, 2000. He said:

"What I wanted to talk about for a few minutes is the various efforts that are going on in public and behind the scenes by the Fed and other government officials to guard against a free-fall in the markets . . . perhaps the most important the Fed in 1989 created what is called the Plunge Protection Team, which is the Federal Reserve, big major banks, representatives of the New York Stock Exchange and the other exchanges and they have been meeting informally so far, and they have a kind of an informal agreement among major banks to come in and start to buy stock if there appears to be a problem. They have in the past acted more formally . . . I don't know if you remember but in 1998, there was a crisis called the Long term Capital Crisis. It was a major currency trader and there was a global currency crisis. And they, with the guidance of the Fed, all of the banks got together when it started to collapse and propped up the currency markets. And, they have plans in place to consider that if the markets start to fall."

If there was ever a time that warranted government intervention, it was right after Lehman Bros blew up and global markets went into freefall. The whole system was teetering and about to collapse. It's likely that the Fed recognized the danger and made a last-ditch effort to avoid another Great Depression. That means that Bernanke probably used his surrogates at the banks and brokerages to strategically purchase futures and equities that had the best chance of reversing the downward trend. What else could he do—sit on his hands and wait for Armageddon?

The problem is, no steps have been taken to prevent a similar catastrophe from occurring in the future. The same lethal debt-instruments that triggered the crisis are in play today; over $1 trillion in toxic assets still remain on the banks balance sheets, and nothing has been done to reduce financial sector debt. In fact, according to the Fed, total debt for the financial sector was $16.5 trillion in the second quarter 2009, the same as it was a year earlier. Nothing has changed.

Financial institutions are re-levering and taking on greater risks knowing that the government will bail them out if they get into trouble. At the same time, the Fed's lending programs have kept markets from fully-correcting by keeping asset prices artificially high. This has helped the banks to conceal their losses and appear healthier than they really are. The question is; how long can the charade go on before something gives?

Policymakers seem to believe that blanket government guarantees and stock market manipulation are enough to forestall another disaster. But critics think that a day of reckoning is fast approaching.

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