
REVIEWING CAMP KOTOK DISCUSSIONS

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David Kotok, chairman of Cumberland Advisors, organizes an annual fishing retreat and economic conference at Leen's Lodge in Grand Lake, Maine. This was the first year I attended, and I came back with a number of great takeaways.

Perhaps most importantly on the personal side—I learned I am a fish whisperer, and the fishing was amazing: Our guide knew exactly where all the bass and perch were hanging out, and we caught approximately 60 fish in two days. My canoe partner, Mike Drury, chief economist at McVean Trading, can attest to the uncanny experience. If you want a suggestion on a fishing trip, I know who you should call.

Secondarily, Grand Lake, Maine, was a beautiful backdrop to train for Wesley Gray's March for the Fallen trip that I plan to attend in five weeks. After spending a weekend with new friends in Maine, I'm really looking forward to another intense bonding experience in Pennsylvania with Wes and his quant finance crew. If you are a hiker and want an insane challenge in five weeks, you can contact alpha architect directly at their website.

Kotok Review

This year, one of the weekend's events was a panel discussion on [monetary policy](#) moderated by Martin Barnes, chief economist at BCA Research. Participants on the panel included two Fed "insiders"—Danielle DiMartino Booth, former advisor to Dallas Fed President Richard Fisher, and Bob Eisenbeis, former research director at the Atlanta Fed—and two Fed observers—Jim Bianco of Bianco Research (who does great [macro](#) research with a fixed income bent) and Megan Greene, chief economist at Manulife.

We did a preview of this panel on our "Behind the Markets" podcast to take the discussion out to a broader population. Barnes and Bianco were on for the hour. Notes included:

- On who will be next Fed president:
 - Barnes discusses how Janet Yellen's West Coast liberal background may lead her to not want to serve as Fed chair again, but also that Donald Trump's economic advisers have included Larry Kudlow and David Malpass and more "hard money"-oriented thinkers. The others who have been floated as potential replacements have been more rules-based thinkers who would have implied higher interest rates than we've experienced recently; that seems inconsistent with Trump's desires.
 - Bianco believes he's settled on one thing: The next Fed president will not be Yellen; it will be a business-oriented person. Bianco points to the odds implied on the PredictIt.org website that showed at the time of our conversation Gary Cohn (former head of Goldman Sachs) as the favorite with a 47% chance, Kevin Warsh (former Fed governor and now at the Hoover Institution) as second most likely with a 12% chance, and Yellen only as the third most likely candidate (11%). Bianco thinks the 1,000 economics PhDs at the Fed should be getting their resumes ready and looking for new jobs, as priorities and focus could change soon.

- On [balance sheet](#) run-off:
 - Barnes is skeptical of the [quantitative easing \(QE\)](#) program's impact on the markets and that, if it did not really have a large impact on the markets during the buying phase, perhaps QT, or quantitative [tightening](#), will not have a large impact on the run-off. In any event, Barnes sees the Fed moving extremely slowly.
 - Bianco believes the [Fed](#) has a tradition of making tough decisions before new leadership comes in (i.e., when Ben Bernanke started tapering purchases before Yellen came in). This means the run-off likely will start soon.
- On the dollar:
 - Barnes says that if the only things that mattered were relative monetary policy and relative [fiscal policy](#), you'd have a stronger dollar— but U.S. fundamentals do not suggest an overly strong currency. Only when you look at the alternatives do you see the strong dollar environment. But he points out that no one wants a strong currency in the world, so he sees range-bound currencies going forward.
- Getting More Defensive Out of Equities: Barnes notes that one of the big questions facing asset allocators is whether they should hop off the equity/risk asset train and give up on the last 10% to 15% upside in the market. He talks about the strong case for diversifying into foreign markets given valuations. But while BCA Research still favors equities over bonds, he personally is starting to lower equity allocations to get more defensive with valuations and the Fed hiking rates.
- Fed Fear: Bianco believes the Fed is captive to the market and is actually scared of the market—that it does not want to create panic. Right now, the market expects 1.5 rate hikes for 2018, and the Fed seems to deliver on what markets expect. Bianco doesn't think rates would be much higher if the Fed were not captive to the market—but he does think the balance sheet would be much lower. If there is a business/markets-oriented person coming in, an accelerated balance sheet wind-down could be in the cards.
- Global QE Matters More: Bianco shows that global central banks have been the main driver of declines in yields. Bianco does not think the Fed's wind-down will be a big deal—but thinks the Fed is a leading indicator. Later in 2018–2019, when the Bank of England, the European Central Bank and maybe even the Bank of Japan follow the Fed in reducing balance sheet, that's when we could see greater rises in rates.

We'll be bringing more of the conversations from Camp Kotok to our podcast in the coming weeks and months, as the group of participants was incredibly insightful and strong. I'm looking forward to sharing more soon, and you can listen to my full discussion with Barnes and Bianco here:

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DEFINITIONS

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Macro : Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

Quantitative Easing (QE) : A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.

Monetary tightening : A course of action undertaken by the Federal Reserve to constrict spending in an economy that is seen to be growing too quickly or to curb inflation when it is rising too fast.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Fiscal Policy : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.