ON ECB AND CURRENT MARKETS WITH JOSH BROWN AND PETER TCHIR

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Last week, Jeremy Siegel and I chatted with Peter Tchir from Brean Capital and Josh Brown, aka "The Reformed Broker," of Ritholtz Wealth Management to get their thoughts regarding the recent announcement from the European Central Bank (ECB) and its impact on the markets. **Draghi Overdelivers** Tchir thought that ECB president Mario Draghi had surprised to the upside at his March 10, 2016, policy meeting, and he was particularly impressed by the expansion of quantitative easing (QE)—indicating that corporate bonds now qualify for ECB's QE program. Draghi also hinted that more QE purchases could be directed to the sovereign debt of weaker peripheral countries, instead of Germany's continuing to get a disproportionately large allocation of QE efforts. Tchir also mentioned the long-term refinancing operation (LTRO) programs, which help banks create new assets such as loans and bonds with limited mark-to-market risk, as funding rates are locked in. This helps address capital issues that banks may be facing. Consequently, as of this writing, bond markets have reacted very well. Brown agreed that the QE efforts—at the ECB and the Bank of Japan (BOJ)—are in some ways advancing beyond what the Federal Reserve (Fed) did in the United States. Negative interest rates, the ECB's purchase of nonfinancial corporate debt and the buying of Japanese real estate investment trusts (J-REITs) and even equities by the BOJ are really pushing the envelope, according to Brown. **Is There a Point at Which the ECB Runs Out of Bullets?** Tchir made the point that monetary policy is not a panacea—fiscal policy will need to help boost the impact of monetary policy. The banking sector has gotten weaker in terms of its capability to provide capital. Brown agreed that QE alone doesn't inspire the "animal spirits" of entrepreneurs or aggregate demand within economies. It remains to be seen how much further QE and central banks can push economic activity forward, absent action from the fiscal side. The ECB is, in his view, attempting to charge banks for not making loans while also incentivizing certain types of loans, but what the ECB can't do is create the list of worthwhile endeavors for which the loans can be used. **How Financials Performed** With all the talk about the banks, I had to ask about the connection between how, in many corners of the world, Financials are among the worst-performing sectors, and yet they come up in every discussion about QE as an essential transmission mechanism between central banks and economic activity. Tchir touched on what I think is a critical question: With QE pushing interest rates lower, into negative territory on a short-term basis and generally lower on a longer-term basis, the profitability per loan could come under pressure, but the *VOLUME* of loans may ultimately go up. Tchir said that a lot of the policy focus is on volume and getting that up. He also believes that this sector is indeed attractive at current levels, and demand is of utmost importance to drive loan volume. As volume increases, banks can make money in a variety of ways, including through transaction and other fees. Brown's comments also indicated a focus on increased volume of loans—he hasn't been seeing it yet, but if it were to actually increase it would be an important indicator of the ultimate success of the QE agenda. **Interesting Policy Idea from Josh Brown** It is hard to deny that the Fed, the ECB and the BOJ are reading from a playbook that indicates easy monetary policy by any means necessary. Brown explained an interesting idea: A slow, gradual rise in interest rates might actually be better at sparking aggregate demand and animal spirit than so-called "free-money." His rationale: If different economic actors realized that free money wouldn't be around forever, it might inspire them to undertake projects that had been under consideration but hadn't progressed toward action. **Other Areas of Discussion beyond ECB Action & Central Banks** While the March 10 ECB action was a central point of the discussion with both Tchir and Brown, it wasn't the only matter on the table. Below, we cover some of those other areas. **Emerging Markets Making Strides** In Tchir's view, emerging markets have become more interesting this year. Brazil seems to be cracking down on corruption, and Argentina is addressing its long-term debt issues. Emerging market fixed income has been trading well and could very well be an outperforming asset class in 2016. **Leveraged Loans Stop the Bleeding** Tchir cited an interesting statistic: Leveraged loans have seen outflows for 33 weeks in a row, until the past week. That's a significant change. Money has also been flowing back into the high-yield fixed income space. This tied into some earlier remarks from my co-host, Wharton Professor Jeremy Siegel. Risk assets have been generally appreciating since February 11, 2016, when we saw

West Texas Intermediate Crude oil at about $26 per barrel[1]. The high correlation between these assets and the price of oil is an important factor at present, but something that Professor Siegel indicated would have the potential to break down if oil continued to increase. **2016 Volatility Continues** As we approach the end of the first quarter of 2016, it feels like we've already seen nearly a year's worth of market volatility with all that has transpired. In his closing thoughts, Tchir indicated that he liked European assets and their potential. Read Conversations with Professor Siegel Series.

[1]Source: Bloomberg, with data from 2/11/16 to 3/11/16.

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DEFINITIONS

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.

Sovereign Debt : Bonds issued by a national government in a foreign currency, in order to finance the issuing country's growth.

Long-term refinancing operations (LTRO) : Means by which the European Central Bank was able to provide liquidity to the European financial sector.

Mark-to-Market : valuing assets by the most recent market price.

Funding rates : rate at which one can fund themselves in the financial markets.

Capital : Wealth available for a particular purpose, such as starting a company.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Corporate debt : Bonds a company issues in order to raise money.

Japan real estate investment trusts (J-REITs) : Investment structure containing a basket of different exposures to real estate, be it directly in properties or in mortgages traded on the Tokyo Stock Exchange. Returns predominantly relate to changes in property values and income from rental payments.

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.

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.

Leveraged loan market : Loans extended to companies or individuals that already have undertaken considerable amounts of debt, thereby increasing their risk of potential default.

High Yield : Sometimes referred to as "junk bonds," these securities have a higher risk of default than investment-grade securitie.

Riskier assets : Assets not backed by the full faith and credit of a government entity.

West Texas Intermediate (WTI) : A grade of crude oil used as a benchmark in oil pricing.

Correlation : Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

Volatility : A measure of the dispersion of actual returns around a particular average level. .