"We generally don't stimulate the economy after ten good years. We usually accept that there will be an ebb and flow to the cycle and there might be justified recession."

\- Howard Marks

In August 1979, Businessweek published a story entitled "Death of Equities". Written after stocks had posted twenty years of substandard returns, the story forecasted low returns for the foreseeable future. Although written before the absolute market bottom (the bear market ended about four years later), the article was relating the entrenched consensus that future equity returns would be severely and permanently impaired by inflationary problems that would only get worse.

At the market bottom in August 1982, the SP500 index value was 119.51 – that means, $1000 invested on that day would be worth about $23,000 today. To paraphrase Mark Twain, the report on the death of equities was greatly exaggerated.

What made the editors of Businessweek so bearish on stocks? By the late 1970s, intractable inflation, which was distorting the returns of almost all investments, had become a universally accepted problem by all investors.

This is a good example of what's known as the Semmelweis Reflex - our reflex-like tendency to reject new evidence or new knowledge because it contradicts our established norms, beliefs or paradigms.

The investment industry is prone to the reflex. Being involved in investment management demands holding a view and taking a stand. The process of getting to that point all but guarantees that these positions will be strongly held. As such, we tend to hang onto them too tightly and too long.

Bloomberg Businessweek recently published another article entitled "The Death of Inflation" promoting the belief that interest rates, alongside inflation, will continue to fall -- a trend that has been in place now for nearly four decades. With lingering fears from the 2008 global financial panic, investors continue to favor "risk-off" investments in general and bonds in particular. Even though governments continue to set new records for peacetime indebtedness, demand for their debt remains unwavering.

Investor enthusiasm for further interest rate reductions by the Fed isn't surprising. Lower rates can reduce economic weakness – reducing the cost of borrowing, rate cuts encourage spending by consumers and investment on the part of businesses. Lower rates lead to increased hiring, reduced unemployment, wage inflation, and enhanced corporate profits due to reduced interest on debt. They also drive investors to take on more risk, increasing the availability of capital for various projects that may not find it otherwise.

But there is a darker side. Too much monetary stimulus leads to excessive inflation, which imposes a hardship on people who live on fixed incomes. Low interest rates can penalize savers, encourage excessive leverage, and create asset bubbles. In addition, as interest rates go lower, central banks don't have much ability to cut rates further – their best tool for stimulating economies.

We agree with Howard Marks' comments above. Continued stimulation could move us further away from easing into the inevitable recession, towards an economic shock generated by the collapse of an asset bubble once rates begin to rise.

Bill Dudley (previous president of the Federal Reserve Bank of New York and vice chairman of the Federal Open Market Committee) noted in a recent op-ed that, according to conventional wisdom, faced with President Trump's trade war with China potentially hurting the US economy, the Fed should respond by cutting interest rates to stabilize the economy. But that accommodation could encourage the President to escalate the trade war further, thereby increasing the risk of recession.

Enough with the stimulation already - all economic cycles eventually conclude. Time to back off on the economic accelerator and allow us to navigate slowly through the rough patches ahead.

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