THE OMNIVEST MARKET VIEW Investments

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Investment Implications of ZIRP Extension

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The Federal Reserve announcement that they intend to hold short term interest rates at or near current levels through 2014 may have several significant implications for investors.

First, money market funds and other short-dated investment vehicles (out to five years) will likely underperform the rate of inflation over the next two years. Consequently, investors concerned about real rates of return will need to shift assets away from short-dated investment vehicles either out the yield curve or down in credit quality, or to high yielding non US dollar fixed income assets or into equity -like assets.

While these actions may seem drastic, they should be considered in the context of marginal decisions. Moreover, Fed Chairman Ben Bernanke has been quiet clear that he will try to maintain the Zero Interest Rate Policy (ZIRP) through 2014, tantamount to yet another form of Fed- concocted fiscal stimulus.

Fed Chairman Ben Bernanke has also been quiet clear in his vision of how unusually low interest rates can work through the economy to promote growth and in turn, enhance returns from alternative financial asset classes. What this means is that the Federal Reserve is essentially measuring success of their programs by the performance of financial assets and perhaps even the housing market.

This policy from the Federal Reserve, though unusual, should result in re-inflating financial assets with particular emphasis on lower quality financial assets. By holding short term interest rates steady for a projected 3-year period, investors should be able to benefit from some form of the carry-trade. Investors should find short-term high-yielding assets such as 2-year notes in Canada, Australia and New Zealand as particularly attractive.

Foreign investors may also find that the negative implications for the US dollar from the ZIRP extension may be a good source of relatively inexpensive funding in purchasing high-yielding non-US assets. A weak US dollar should also promote an increase in commodity prices as most commodities are still priced in US dollar terms. Gold will also continue to benefit.

US financial institutions should benefit from fixed low-cost borrowing and incremental earnings gained from lending long term. Implicitly, banks will have more certainty about short term funding costs which should then allow banks to become more generous with lending.

Finally, investors should find the equity market as not only a source for potential capital gains but also a rich source for incremental income in the form of dividends. Stronger corporate profits and excess cash could lead to an increase in dividend payments over the period immediately ahead.

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