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### ***The Basement Office or the Upstairs Family Room?***

As I write this, my basement office is quite cold while my upstairs family room is quite comfortable. A single thermostat controls both parts of the house. I could choose to make my office very comfortable while making my family room very hot, but there is no way to make both my office and the family room comfortable. It is just not possible.

The Federal Reserve faces a similar dilemma. It has one knob (interest rates) which impacts multiple parts of the economy. Any tweak to the knob will improve some areas of the economy while making other areas worse.

Since 2008, the Fed has set interest rates extremely low -- at least I consider zero to be low. These low rates have stimulated spending and economic growth. As you would expect, low interest rates have encouraged buyers to take on debt to buy couches, clothes, cars, stocks, and homes, etc. After 7 years of this policy, debt levels have grown, and asset prices have started to become concerning. Increasing interest rates would curb the growth of US debt and asset prices, helping us to avoid another 2008-like event.

At the same time that the Fed wants to raise rates, Europe has lowered rates in an effort to stimulate its economy. Currently 10-year US government debt pays 2.3% while German debt pays only 0.7%. This interest rate differential has led many Europeans to convert their euros to dollars in an effort to take advantage of higher US interest rates. The increased demand for dollars relative to euros has driven up the value of the dollar, making US products more expensive overseas. Because about half of sales for the largest US businesses originate overseas, a decrease in overseas sales significantly impacts corporate profitability.

The Fed is confronted with a tough dilemma. Raising interest rates can get US debt levels and asset prices under control. Unfortunately, raising interest rates will also drive up the US dollar and therefore drive down exports and corporate profitability. Just as I have to choose between discomfort in either my office or the family room, the Fed must choose between discomfort in different parts of the economy. Any adjustment the Fed makes to interest rates will create discomfort. The question is: "Who will be comfortable?"

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