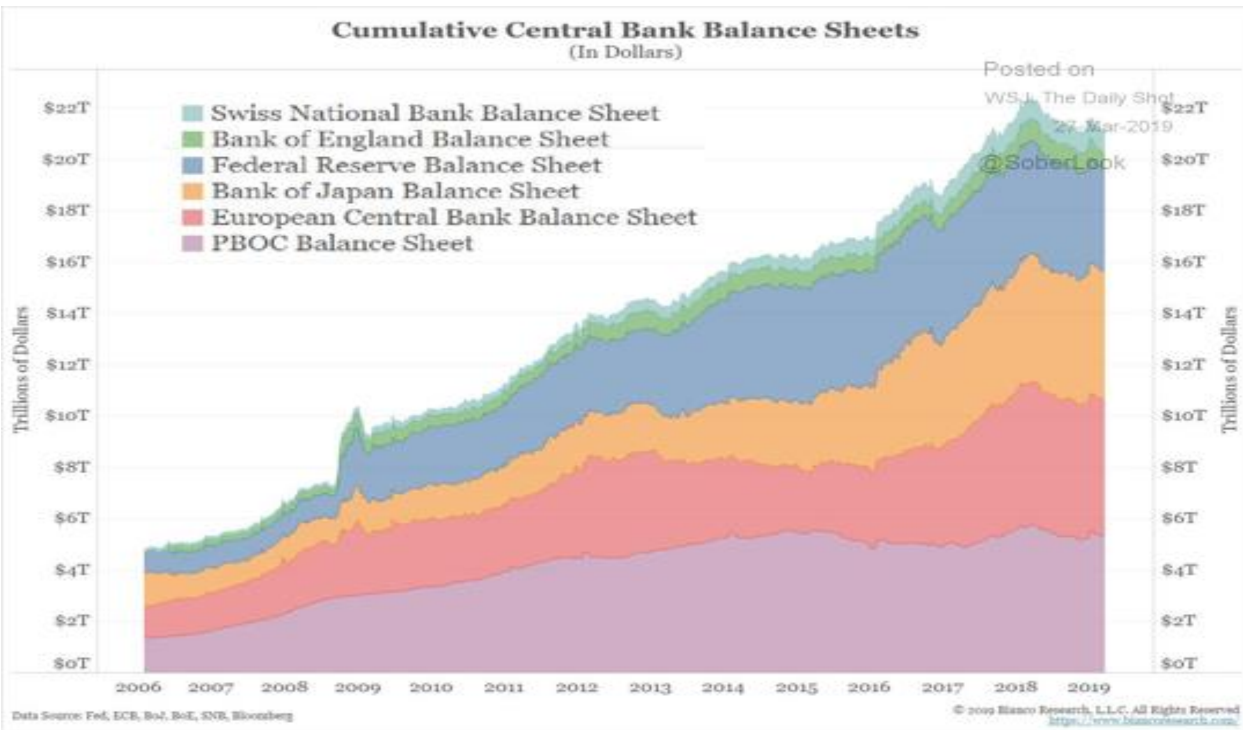
CENTRAL BANKS AND THE FUTURE

It seems like New Year's Day was very recent, but we already find ourselves in the second quarter of the year. Our 2019 forecast has held up well so far this year, with the U.S. dollar and equity markets continuing to perform strongly. On the geopolitical front, our expectation re Brexit that the proverbial can would be kicked down the road has turned out to true. The latest postponement is to June 30th, and it could well be extended. Our contention that North Korea is just stringing the Trump administration remains reasonable following an utterly unproductive "summit" meeting in the first quarter. The North Korean issue may well move back to the front burner as the U.S. presidential election nears.



A theme that we have returned to (ad nauseum) is that central bank intervention in the global economy remains at historically unprecedented levels. The chart above illustrates the point by demonstrating the growth in balance sheets of major central banks since 2008.

The dramatic growth in central bank balance sheets persists despite recent efforts to tighten monetary policy. Major central bank balance sheets remain 400%-500% larger than they were in 2006. A major contributing factor has been open market transactions such as the Fed buying Treasury bonds. The European Central Bank and the Bank of Japan took intervention further by buying corporate bonds and even, in the case of Japan, equities.

We must remind ourselves that we live in unusual economic times. The leveraged balance sheets of the central banks are mirrored by those of corporations and households. This amount of leverage is dangerous and will produce considerable economic volatility in the years ahead. The stretched balance sheets of the central banks will reduce their ability to combat the next recession, while leveraged companies and households are obviously more vulnerable to economic shocks.

Therefore, it is important to remain engaged with the factors affecting our investments, which is why I have reservations about the growth in popularity of so-called "passive" investments. We do not have the luxury to adopt a passive attitude, either as citizens or investors.

This mind-set drives the topics and analysis we discuss each month in the Global Investment Letter. While there are issues to be concerned about, there will also be opportunities in the years ahead.

By Jonathan Baird CFA