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Stop the Fed Before it Kills Again

By Mike Whitney
September 9, 2016

Why has the Fed created incentives for US corporations to loot their companies and drive them deeper into debt?

Despite four consecutive quarters of negative earnings, weak demand and anemic sales, US corporations continue to load up on debt, buy back their own shares and hand out cash to their shareholders that greatly exceeds the amount of profits they are currently taking in. According to the Wall Street Journal: “SandP 500 companies through the first two quarters of the year collectively returned 112% of their earnings through buybacks and dividends.”

You read that right, US corporations are presently giving back more than they are taking in, which is the moral equivalent of devouring one’s offspring.

These companies have all but abandoned the traditional practice of recycling earnings into factories, productivity or research and development. Instead, they’re engaged in a protracted liquidation process where the creditworthiness of their companies is used to borrow as much money as possible from the bond market which is then divvied up among insatiable CEOs and their shareholders. This destructive behavior can be traced back to the perennial low rates and easy money that the Fed has created to enhance capital accumulation during a period when the economy is still mired in stagnation. The widening chasm that has emerged between the uber-wealthy and everyone else since the end of the financial crisis in 2008, attests to the fact that the Fed’s plan has succeeded beyond anyone’s wildest imagination. The rich continue to get richer while the middle class drowns in an ocean of red ink. This is from CNBC:

“Corporate debt is projected to swell over the next several years, thanks to cheap money from global central banks, according to a report Wednesday that warns of a potential crisis from all that new, borrowed cash floating around.

By 2020, business debt likely will climb to $75 trillion from its current $51 trillion level, according to SandP Global Ratings. Under normal conditions, that wouldn’t be a major problem so long as credit quality stays high, interest rates and inflation remain low, and there are economic growth persists.

However…should interest rates rise and economic conditions worsen, corporate America could be facing a major problem as it seeks to manage that debt. Rolling over bonds would become more difficult should inflation gain and rates raise, while a slowing economy would worsen business conditions and make paying off the debt more difficult. …

Central banks remain in thrall to the idea that credit-fueled growth is healthy for the global economy,” SandP said. “In fact, our research highlights that monetary policy easing has thus far contributed to increased financial risk, with the growth of corporate borrowing far outpacing that of the global economy…” (Corporate debt seen ballooning to $75 trillion: SandP says, CNBC)

Well, if the risks are so great, then why is the Fed encouraging the bad behavior by perpetuating its low rates and super accommodative monetary policies?

Could it be that the Fed is not really the “independent” institution its proponents claim it to be, but the policymaking arm of the big Wall Street investment banks and the mega-corporations that arbitrarily impose the policies that best serve their own profit-making ambitions?

It sure looks that way to me, after all, how many jobs were actually created by the Fed’s $3 trillion in QE?

How about zero. In contrast, stock prices have more than tripled during the same period increasing the net-worth of US plutocrats by many orders of magnitude. Bottom line: Fed policy has been a windfall for the moocher class, but a bust for everyone else.

But there are risks associated with the Fed's trickle up policies. For example, check out this blurb from an article in last week's Wall Street Journal on dividends:

"The data highlight the stampede into dividend-paying stocks in response to the plunge of interest rates in recent years. Many investors now are supplementing slumping fixed-income payouts with high-yielding shares, a strategy that some analysts warn could expose buyers to the risk of large capital losses that could wipe out years of income.

That risk appears particularly acute in part because earnings, historically the strongest driver of stock-price gains, are in retreat and valuations are above long-term averages. Many companies are paying more in dividends than they are earning, a practice that analysts view as unsustainable for the long term…

The problem: There is only so much that companies can raise their payouts to shareholders if their profits aren't keeping pace. And right now, U.S. corporations are struggling to boost profits…." (Dividends are what matter now, Wall Street Journal)

What does that mean in plain English? It means that Mom and Pop investors are increasingly rolling the dice with their meager retirement nest-eggs by moving their money from ultra-safe fixed-income investments (like US Treasuries) to volatile equities (that could crash in the blink of an eye) because the Fed's perennial low rates have prevented them from getting a decent return on their savings. Zero rates are the equivalent of putting a gun to Pop's head and frog-marching him back into the stock market. Does that make sense? Here's more from the same article:

"With dividends up and earnings down, companies are handing out an increasing amount of their earnings in such payouts to investors. During the second quarter, that measure was at its highest since 2009, according to SandP.

"I tend to think that there will come a point when dividend growth will be slowed if earnings and sales don't improve," said Sam Stovall, U.S. equity strategist at SandP Global Market Intelligence." (WSJ)

Good call, Sam. Companies can't keep boosting dividends if earnings continue to shrivel. And earnings WILL continue to shrivel unless the government increases its (deficit) spending enough to rev up growth. And that's not going to happen anytime soon, so don't hold your breath.

The only thing that's keeping this Ponzi scam afloat is the fact that companies are borrowing hundreds of billions of dollars in the bond market from yield-starved investors who honestly believe the CEOs are investing the money in their company's future. But that's not what they're doing. They're taking the money and putting it in their pockets so they can add another

Lamborghini or Marc Chagall to their collection. That's where the dough is really going, into a big black hole created by our friends at the Federal Reserve.

And the same is true of stock buybacks, another swindle that persists due to the Fed's suicidal interest rate policy. The surge in buybacks during a period when the economy is dramatically underperforming, is due entirely to the ridiculous availability of credit at rock-bottom prices. So, even though consumers and households are not borrowing in numbers great enough to put the economy back on track, CEO's are piling on the debt to purchase their own shares thus destroying their own prospects for future growth. It's what you call corporate hara kiri. Take a look at this clip from an article at Barron's:

"Corporate debt is now near record levels, due in part to borrowing to buy back stock. It isn't a situation that can last.

The bond market should be concerned about stock buybacks, but not because of their bullish effect on share prices. Instead, bondholders should be anxious about where the cash to pay for them comes from. It isn't widely appreciated that the money has been borrowed in the credit markets, and that the borrowers have taken on a large amount of debt to support the buybacks. That's cause for worry on several fronts.

The first is simply that outstanding corporate debt is now at a record high. … According to the Federal Reserve's flow of funds data, outstanding nonfinancial corporate debt is 45.3% of GDP. That nearly matches the level seen in the first quarter of 2009 (45.4%) and exceeds the prior peak of 44.9% achieved in the third quarter of 2001…

In the first quarter, nonfinancial corporate borrowing hit $724 billion. That's the second-highest on record and is surpassed only by, again, the third quarter of 2007 with $807 billion. The similarities should give pause." (Stock Buybacks Are Driving Companies Into Debt, Barron's)

Of course, the Fed has all this data at its fingertips, but it persists with the same lethal policies in spite of it all because the objectives of its rich constituents far outweigh the dangers to the general public. That's just the nature of the beast.

It's beyond me how anyone can watch the way this treacherous, double-dealing organization works and not support the movement to see it dismantled once and for all.

End the Fed more than an empty slogan, it's a fight for survival.