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I'm not an Economist

I'm not an economist. But I think there's a way to make sense of the current economic and market environment. My limited qualification is having spent the past 15 years building an investment firm that has introduced liquidity to one of the most illiquid investment classes, venture capital and private equity. So I have watched the ebbs and flows of perceived liquidity from the front line for quite a while and seen its effect on investor motivations and valuations. Here is my simple thesis.

We all know that in 2009, in order to stem a run on the U.S. banks, the Fed started pumping capital into the financial system. But stabilizing the banks and cutting the fed funds rate wasn't enough to prevent the mortgage market from collapsing and stem the recession. The Feds then kept pumping through quantitative easing. Basically flooding the system with excess capital, hoping it would end up stimulating something.

So what happens when the Fed continued to pump an extra $4.5 trillion into the U.S. financial markets? Just to put it in perspective, the entire US GDP is $17 trillion. That capital oozed its way into every corner of the markets. Money made its way into the energy market leading to massive overcapacity and a crash in oil. It led to incredibly inexpensive financing for new real estate development. It spawned alternative lenders originating small business loans over the internet. In search of returns in a market and economy that weren't cooperating, that capital found its way into the high growth technology and biotech markets. What's an entrepreneur to choose when they are offered maybe $20 million to build a steady profitable growth company over time or handed hundreds of millions at multi-billion valuations to burn money and go for it?

A portion of all that capital did make its way into improving job growth and reducing unemployment, but how much of it really went to produce sustainable growth and productivity. Did any go to infrastructure, health care or education?

So within days of the Fed taking away the candy, the markets are screaming. As all the excess capital evaporates, how will assets react? Oil infrastructure will likely get scooped up for below replacement value, small business borrowers will be testing the collections resolve of upstart lenders who won't have the capacity to continue to roll delinquent loans and tech companies that can't sustain themselves without unfettered access to cheap capital will have to somehow stabilize. How many of the jobs created in the past five years will remain?

The question of exactly where should organic interest rates settle and what should the risk premium be is impossible to know at this point. We haven't had a market that wasn't manipulated by Washington for at least a decade. No other country in the world could have printed that much money without deflating its currency but given the U.S. is still the least leaky boat in the sea, others will support it. While I believe, in my limited capacity, that the Fed knew all of this and was prepared to gently prick this bubble, it is now rethinking whether taking away all the candy is the right thing to do.

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