Basis Points – October 30, 2018

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Above the Fold

- If it feels like the equity market has been much more volatile than normal over the past two weeks, you are correct. The market has closed up or down more than 1 percent in eight of the past 13 days. In the prior six months, the market had closed up or down more than 1 percent on only seven days total over that time.
- Famed economist Ed Yardeni feels that the Fed should take a break from its interest rate hike plan in order to stabilize the recently volatile stock market. In a *CNBC* interview last week, Yardeni stated, "We need the Fed to pause here and just take a breather. Let's see how the economy plays out, and that will help the stock market a lot." Despite the recent sharp movements in the equity markets, Yardeni still sees strong economic fundamentals supporting strong earnings growth through next year. "I don't expect a recession any time soon," Yardeni concluded.

Three Things

- In a bold bid to boost its growth prospects, IBM agreed yesterday to acquire software maker Red Hat for $33.4 billion in the biggest-ever acquisition for the computer-services giant. IBM will pay $190 per share in cash for Red Hat, which is a 63 percent premium over Red Hat's closing price on Friday. IBM has struggled to grow revenue during the past 10 years and is now resorting to acquisitions to boost the company's fortunes. "The acquisition of Red Hat is a game-changer. It changes everything about the cloud market," said IBM CEO Ginni Rometty. Revenue at Red Hat, which sells software and services based on the open source Linux operating system, is expected to top $3 billion for the first time this year, as Red Hat's Enterprise Linux product attracts business from large customers. But sales last quarter missed analyst expectations and the forecast for the current quarter also fell short, fueling concerns Red Hat may be losing deals to rivals and growth may be slowing. Red Hat's stock price has declined 29 percent over the past six months, amid these worries of slowing growth in a highly competitive market.

- Scott Galloway, NYU Stern School of Business professor, is betting big on Washington, D.C. being the chosen site for Amazon's new headquarters. He feels that Amazon's extensive competition for where to locate its new site was "a ruse and the game was over before it started." He believes that CEO Jeff Bezos knows that the largest obstacle in front of Amazon's future growth is government regulation, and Bezos wants to be a big player in the influence of D.C. politics. Galloway concluded, "The only thing in between Amazon and $1 trillion and $2 trillion in market cap is regulation. And no one is going to regulate the guy throwing out the first pitch at the Washington Nationals opening day."
- A cognitive bias is a mistake in reasoning, and a major part of this bias is known as regret avoidance. Humans attempt to anticipate future regret and incorporate the weight of that potential regret into our decision making. Regret avoidance is most clearly seen in the behavior of people when buying a lottery ticket. When a jackpot is large and there is an office pool that combines money to buy tickets for the group, even workers who don't play the lottery usually pony up their $2 so on the off-chance that they win, they are not the only shlub to have to come into the office the next day. *Business Insider* performed an interesting study regarding how regret avoidance biases someone who has just purchased a lottery ticket. The researchers waited outside a convenience store and offered to buy newly printed tickets from their owners as they left the store for $2, when the tickets were just purchased for $1. The majority of people declined the offer, preferring to keep their one-in-350-million odds of winning rather than doubling their money in five minutes. The people could have even pocketed the dollar and gone back into the store and purchased another ticket, but regret avoidance does not allow for logic like this.

Did You Know

President Trump has recently made very public statements about his views on the Federal Reserve and the Fed's plan to raise interest rates. Some market watchers have found the comments unseemly, as the Fed is supposed to be an independent policy-making body that is not influenced by politics or the wishes of the presidency or Congress. While President Trump's comments have been more public than the views of past administrations, he isn't the first to try to influence the independent Federal Reserve.

Paul Volcker was chairman of the Federal Reserve from 1979 to 1987. He is widely credited with ending the high levels of inflation seen in the United States during the 1970s and early 1980s. He began his term shortly after the passage of the Full Employment and Balanced Growth Act in late 1978. The bill is now known as the Humphrey Hawkins bill, named after its two Congressional sponsors.

The Act explicitly instructs the Fed to strive toward full employment with price stability.

Prior to the bill, higher inflation was used as a tool to boost the economy to full employment, but the pursuit got wildly out of control. To kill off rabid inflation of the 1970s, Volcker raised short-term interest rates to more than 20 percent in 1981. Volcker's bold moves were unpopular at the time, but he was determined to break the back of inflation that had plagued the economy for more than a decade. Volcker's plan succeeded and the bull market of the 1980s began in August 1982.

Volcker, age 91, published a memoir this week about his time in Washington and his current views on the state of the union. He tells the tale of a behind-the-scenes meeting with President Reagan during his first term in office. Mr. Volcker recounts being summoned to meet with President Reagan and his chief of staff, James Baker, in the president's library next to the Oval Office in 1984.

Reagan "didn't say a word," Volcker wrote. "Instead Baker delivered a message: 'The president is ordering you not to raise interest rates before the election.'" Volcker wasn't planning to raise rates at the time, but the message was clear.

"I was stunned," he wrote. "I later surmised that the library location had been chosen because, unlike the Oval Office, it probably lacked a taping system."

So times have not changed, it is just the volume that has increased.