

Virtus Strategist Sees Need for 'Quantitative Easing, Phase Two'

'Drip of disappointing demand' will pressure Fed, says Max Bublitz

HARTFORD, Conn., Oct. 19 /[PRNewswire](#)/ -- Uncertainty reigns on the heels of the third quarter as investors consider whether the Federal Reserve Bank will begin another phase of quantitative easing (QE) that will give the U.S. economy the second shot in the arm it needs to recover, says [Max Bublitz](#), chief strategist and portfolio manager at [SCM Advisors](#), an affiliated investment manager of [Virtus Investment Partners](#).

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In the quarter, economic data "deteriorated to the point where confidence began to wane that the public sector could actually hand back to the private sector the responsibility for being the main driver of economic growth," Bublitz writes in his [latest quarterly commentary](#). In order for the cycles of economic and market recovery to continue, the reflation cycle needs to be extended. Accordingly, "it isn't a question about whether QE2 is coming, but how effective it will be."

He notes that minutes from the Fed's Open Market Committee (FOMC) meetings in June best encapsulate consensus thinking as the third quarter began. Then, the primary concern was how to shrink the Fed's balance sheet as part of an "exit strategy" from quantitative easing. "The now widely-expected QE2 wasn't even a twinkle in Chairman Bernanke's eye as the third quarter began."

So, how did the cyclical winds shift 180 degrees in mere weeks, from planning for the Fed's balance sheet to shrink at the start of the quarter to planning for it to expand? "The drip, drip, drip of disappointing demand, the hallmark of a secular debt deflation, finally began to exact its psychological toll," Bublitz says.

"The bottom line is that the economy is clearly not growing at a level that is acceptable to the most influential members of the FOMC, and it's now incumbent on the data prior to the Fed's fourth quarter meetings to show that economic activity is significantly picking up steam. If not, Fed policymakers are set to kickoff off quantitative easing phase two after the fall mid-term elections." But, while the "rapidly souring political environment should concern everyone" and there is still a lot of balance sheet repair to be done, particularly in the financial and consumer sectors, Bublitz "sees some underlying improvement" in the economy.

Bublitz, who is also a [frequent blogger](#) on the Virtus website, sees the housing and labor markets in the process of forming a bottom, but predicts that both will likely get worse before they get better. "Make no mistake about it, the economy is still very fragile and susceptible to shocks. This was never destined to be a straight-forward recovery."

With expectations of domestic GDP averaging around 1.5 - 2.0% over the next 12 months – "with a lot of volatility and revisions" – Bublitz believes phase two of quantitative easing could be a multi-step process largely dependent on economic data. The risk, he says, is that a stimulus, like any drug, will be less effective over time.

"We certainly don't claim that the economy will have much oomph over the next twelve months, and we remain concerned how the political wildcard might distort it," Bublitz says. "But the cyclical tailwinds are clearly about to stiffen, so look for gusting volatility on all fronts; financial, political, and social. Unfortunately, it isn't likely that we're even half way through the secular storm season."

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