Last Christmas night, the 4th largest earthquake since 1900, registering 9.0 on the Richter scale, created a tsunami which raced outward at 450 miles/hour from the epicenter in the Indian Ocean. The earthquake caused no significant damage; however, within only ten minutes, the resulting tsunami struck 11 nations leaving a trail of destruction, killing more than 280,000 people - the highest death toll of any tsunami.

Seismologists study the build up of pressure between the continental tectonic plates, the red areas on the map. These rigid tectonic plates float above the earth’s soft mantle in opposite directions constantly grinding against each other. This tectonic friction can create unsustainable imbalances.

Five years ago the bubble in the stock market proved unsustainable. Just like an earthquake releases the pressure built up by the movement of tectonic plates deep within the earth, so too did the pricking of the tech bubble release the pressure of over-inflated stock prices. The market collapse was the 3rd most violent in our history!

To temper the economic fallout, the Federal Reserve slashed short-term interest rates to 45-year lows. Now five years after the peak, many pundits blame Greenspan’s greased monetary policies for allowing our economic “plates” to slip too freely creating numerous other imbalances - housing bubble, near zero personal savings and a runaway current account deficit. Will the after-shocks of the market crash be equally devastating or will snail-like, quiet micro-quakes return us to balance?

As Willy Wonka might say, “So much time, So few imbalances! Check that. Reverse it.” First, let’s discuss the housing bubble.

Low interest rates have added to the “froth” in housing prices, but the Fed can only set short-term rates. Global economic integration is pushing down long-term rates thus tricking Greenspan. These low interest rates not only bamboozled the Fed Chairman but allowed us to buy even bigger houses especially using the no-money-down, ARM loans.

Is Greenspan’s coffin sealed? Is he now a befuddled old man who blew it on interest rates and created a housing bubble which will crumble with the next economic quake? Maybe not! Let’s look at some startling facts. Worldwide residential property values have doubled in the last five years. This boom equals 100% of the developed countries combined GDP (for comparison our stock market bubble was 80% of our GDP).

When the Fed signals the end to monetary tightening, what happens to the market? The short-term interest rate is a barometer of Federal Reserve policy, and the prime rate is a gauge of how the Fed will impact the cost of funds to the corporate sector. The Fed raised the short-term interest rate by 1/4% three times since last October, and the prime rate is up 1/2% since last November. The yield on the 10-year Treasury bond has fallen from 4.5% to 3.9% this year.

Instead of looking straight ahead, let’s try to peer around the corner. One year ago today the Fed started their “measured pace” tightening and true to their word at today’s FOMC meeting increased the interest rates for the 9th straight time. The corner will occur when they stop. But with this “No Surprises” Fed, they’ll tell us in advance.

See how close the 10-Year Treasury Bond is to the Fed rate today. Alan Greenspan’s conundrum was exacerbated by the 10-Year Bond dropping from 4.5% to 3.9% this quarter! You’ll see this reflected in good bond returns on your report recouping the losses of last quarter. Your stocks have been going nowhere all year.

When the Fed signals the end to monetary tightening, will the stock market react? The next two Federal Open Market Committee meetings are scheduled for August 9 and September 20—let’s see if we feel the earth move under our feet!