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CASE STUDIES

"Case Studies" presents a case pertinent to contemporary issues and events in investment management. Insightful and provocative questions are posed at the end of each case to challenge the reader. Each case is an invitation to the critical thinking and pragmatic problem solving that are so fundamental to the practice of investment management.

Jack L. Treynor, Senior Editor

THE FED WATCHERS

Agile Fund promised its shareholders that its managers would make a genuine effort to avoid catastrophic market collapses. To this end, the managers included some high-beta stocks in the portfolio, where they stood ready to sell at the slightest hint of trouble (or buy back at the slightest encouragement).

They combed the media for clues, including data on

jobs
business investment
government fiscal policy
op-ed pieces by prominent economists
consumer spending
inflation
decisions of the Federal Reserve Board
pronouncements of the Fed chairman

The managers had all taken economics courses in college. Their teachers, who divided their time between teaching and Washington, had explained that the private sector was intrinsically unstable and that only a mixed economy with a large government sector had any hope of avoiding periodic collapses.

On the one hand, the managers of Agile Fund were determined to avoid the investment consequences of market collapses for their shareholders. On the other hand, they were equally determined that their shareholders not miss out on the investment consequences of good times.

The managers of Agile Fund knew from bitter experience that the price of avoiding the two kinds of failure was eternal vigilance. Sometimes the various kinds of information would be in conflict. Sometimes information would shift from bullish to bearish, or bearish to bullish in the space of a few hours. Fortunately, their trading desk understood the importance of being able to act quickly and decisively.

The managers paid special attention to the Fed's constant struggle to keep the economy on an even keel—to the decisions of the Federal Reserve Board and the pronouncements of its chairman.

DISCUSSION

1. When does the market react to news about the economy?
2. How will the Fed react to bad news? To good news?
3. What should Agile focus on—the news, or the Fed's reaction to it?
4. If the Fed's action lags the economic news, should Agile attempt to anticipate the Fed?
5. What will the Fed do if its action turns out to be too little? Too much?
6. What is the role of economists in a mixed economy?