IdahoTrust

February 2012

WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

Monetary policy is one of the means that governments have of controlling their economy. Governments can influence the speed of their economies by controlling the size and rate of growth of their money supply through monetary policy. In the U.S., the Federal Reserve, the U.S.'s Central Bank, controls monetary policy.

The Federal Reserve

The Federal Reserve (Fed) was created in 1913 as an independent government agency. The Fed has ultimate responsibility to Congress, but is insulated from day-to-day politics. The Fed is structured with a Board of Governors, twelve district banks and the Federal Open Market Committee (FOMC), its main policy making committee. Benjamin Bernanke serves as Chairman of the Board of Governors and also chairs the FOMC.

Today, the Fed operates under the dual mandate to promote maximum employment and to maintain stable prices. This has been a difficult task given the state of the economy in the last five years.

Monetary Policy Tools

The Federal Reserve has many policy tools available to fulfill its mandates. Some policy tools are more conventional than others that we have witnessed the Fed use during the Great Recession.

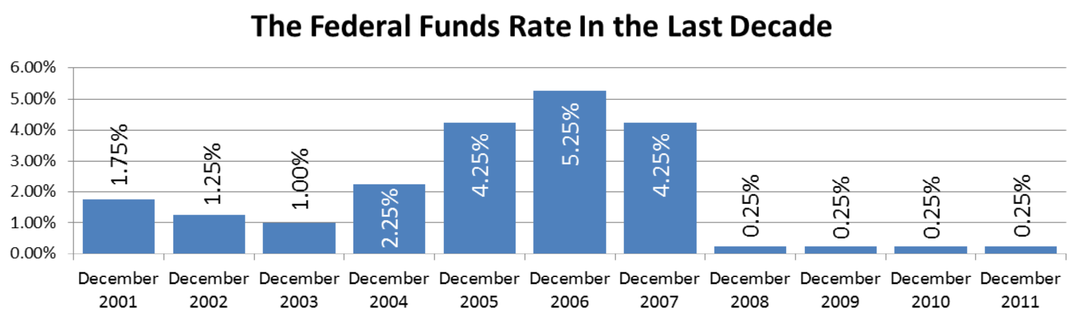
One of the main policy tools that the Fed uses is the federal funds rate. The federal funds rate is the interest rate that banks can earn on their reserves held at

Idaho Trust Bank offers holistic wealth management services featuring its LifeNeeds™ investing process. Idaho Trust's LifeNeeds™ investment process utilizes proven strategies and techniques delivered by a highly trained staff of wealth management professionals.

LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust's proprietary TacticLogic™ investment process. All of which are tailored to our client's unique financial needs.

the Fed. The Fed dictates this rate. In December of 2008, the Fed lowered the target federal funds rate to 0.25% where it has stayed since that time. A low federal funds rate—like what we have now—is designed to stimulate the economy. A low federal funds rate lowers short-term interest rates like the London Interbank Offered Rate (LIBOR), the rate that banks charge to lend one another for loans, and prime rates, the rate that banks charge their best customers. Lower rates then filter into interest paid on deposits and loans. In short, a low federal funds rate leads to expanded lending and increased spending and demand. The opposite is true for an increase in the federal funds rate.

The federal funds rate is determined by the FOMC's 12 members which meet in Washington eight times per year. The FOMC consist of members from the Board of Governors, the President of the New York Fed and four other regional bank presidents. Markets have long tuned into discussions from the FOMC's meetings; searched their meeting minutes for clues into the Fed's policies because of their potential effects on the economy. The FOMC is scheduled to meet next on March 13th.



Quantitative Easing

When the conventional methods of stimulating the economy—like lowering the federal funds rate—are not doing enough, the Fed may use more unconventional policy tools. Quantitative easing is a good example of unconventional monetary policy. If nominal interest rates are already at or near zero, as they are now, then quantitative easing can be used to effectively further lower interest rates. Quantitative easing typically involves buying bonds or other assets from institutions with newly created money increasing the money supply and creating liquidity.

Since 2007, the Fed has lowered nominal interest rates through its federal funds rate and engaged in a number of quantitative easing programs. The programs consisted of buying bonds in the open market with newly created money, thus increasing the supply of money and liquidity. Although, any monetary stimulus program bears the risk of fueling inflation.

In the Fed's first round of quantitative easing (QE1), from November 2008 to March 2010, the Fed bought mortgage-backed securities to help support that ailing market. During QE1 the Fed bought $1.25 trillion in mortgage-backed securities and $175 billion of agency debt with newly created money. The sheer size of QE1 caused the Fed's balance sheet to expand considerably. The Fed also engaged in a second round of quantitative easing (QE2), from

November 2010 to June 2011. During QE2 the Fed bought $600 billion of longer-term treasury securities. The Fed's objective was to promote a stronger pace of economic recovery and keep interest rates low.

The latest monetary program that the Fed is currently engaged in is Operation Twist. To make financial conditions more accommodative, Operation Twist intends to push down longer-term yields. Lower longer-term yields, in a combination with already low interest rates, aims to stimulate mortgage and business loans. Unlike QE1 and QE2, the Fed is funding Operation Twist with existing funds rather than newly created money so that it does not affect the money supply. Through Operation Twist the Fed is selling $400 billion of shorter-term treasuries that it holds in its investment portfolio and buying longer-term treasuries with the proceeds. These transactions place pressure on longer-term interest rates to stay low. The program was announced in September 2011 and is schedule to finish in June of this year.

The Federal Reserve's Balance Sheet

August 2007 to now

Since August 2007, the Fed's balance sheet has grown from $869 billion to over $2 trilllion.

Source: The Federal Reserve

Recent Developments

Chairman Benjamin Bernanke has been making efforts to increase the transparency of the Fed's operations. The Fed has recently published its economic projections. These new data points were first made available through the FOMC's meetings on January 25th of this year. Through these economic projections we see that the Fed doesn't foresee raising the federal funds rate until 2014. This goes further than the Fed's previous efforts of pledging low rates for an extended period.

The projections published by the Fed give insight into future Fed actions and monetary policy. Transparency into the Fed's operations is important because of monetary policy's profound effect on the economy. After all, prudent and transparent monetary policy are paramount to keeping our economy healthy.

S&P 500

3 Month	5.31%
Year-to-Date	4.48%
1 Year	4.19%
3 Year	19.22%
5 Year	0.33%

International Developed Stocks

3 Month	-0.65%
Year-to-Date	5.33%
1 Year	-9.12%
3 Year	13.95%
5 Year	-3.31%

US Aggregate Bonds

3 Month	1.90%
Year-to-Date	0.88%
1 Year	8.66%
3 Year	7.39%
5 Year	6.69%

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