

CSI TECHNICAL JOURNAL

DATA ♦ SOFTWARE ♦ SERVICE

Volume XII, Number 9

September 1996

\$10.00

In This Issue

- The Consequences of the Federal Reserve's Decisions on the U.S. Economy 1
- Ask Customer Service 4
(Topic: Unfair Advantage®)
- Unfair Advantage: On your mark...get set...go! 5
- Market Statistics Update & IPOs 5, 6 & 7
- Product Summary 8

Editor: Sabrina Carle
Publisher: Commodity Systems, Inc.
Layout/design: Moran Advertising, Inc.

Notice: The views and information expressed in this document reflect exclusively the opinions and experience of the author, Robert C. Pelletier. **NEITHER CSI NOR THE AUTHOR UNDERTAKE OR INTEND TO PROVIDE TAX ADVICE OR TRADING ADVICE IN ANY MARKET OR ENDORSE ANY OUTSIDE INDIVIDUAL OR FIRM. ALL RECOMMENDATIONS ARE PROVIDED FOR THEIR INFORMATIONAL VALUE ONLY.** Readers should consult competent financial advisors or outside counsel before making any trading, software purchase, or investment decision. CSI does not stand behind or endorse the products of any outside firms.

Advertisements Enclosed: We have enclosed advertisements for "The Market Master Trading System" offered by R&W, and for "VantagePoint" offered by Mendelsohn Enterprises Inc.

CSI accepts advertisements to accompany our Technical Journal for the sole purpose of defraying postage costs.

Copyright © 1996 Commodity Systems, Inc. (CSI). All rights reserved.

The Consequences of the Federal Reserve's Decisions on the U.S. Economy

Last month we reprinted the first half of this series on the Federal Reserve, which was originally published in the July 1995 CSI Technical Journal. That installment explained the basic purpose and functionality of the Federal Reserve System. We discussed the Fiscal Theory, led by John Maynard Keynes (now out of fashion) and the Monetary theory, which is in practice now. We demonstrated the enormous power placed in the hands of the Fed to control the U.S. economy as a whole and we explained how the monetary system works.

Part II, below, addresses the unbridled power of the Fed's 12-member Federal Open Market Committee (FOMC) in shaping the course of the U.S. economy. We explore how the Fed impacts our money supply, our "free market" economy and the lives of all Americans.

An Essay Part II

Have you ever stopped to consider that you and I are victims of the Federal Reserve's attempts to control our economy through what often appears to be trial and error? Having researched the workings of the Fed, I now wonder how the fate of so many can be in the hands of so few. The Federal Reserve's FOMC seriously affects and controls our lives in many ways. This is a committee of seven Federal Reserve Board members and five Federal District Reserve Bank presidents. The members are people

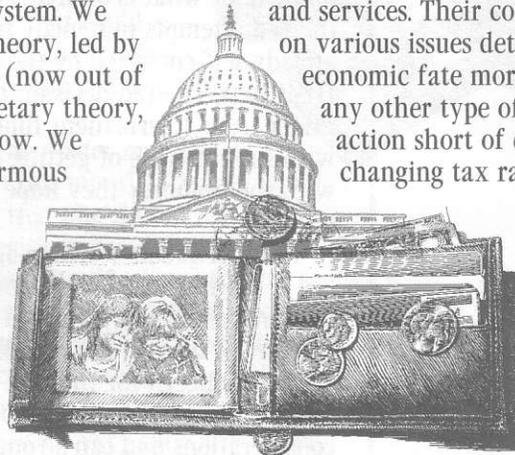
like you and me with families and children. Each member has several aides who are likely to possess economic training. Many may play the stock market, and all probably purchase mortgages and consume goods and services. Their collective decisions on various issues determine our economic fate more than nearly any other type of government action short of declaring war or changing tax rates.

The effect of the FOMC voting may be to make changes in the money supply or raise or lower the federal

discount and the federal funds rate. Each decision made by the FOMC alters the course of the economy in one way or another. Naturally, these decisions are taken very seriously and are based on a wide range of economic data, including: the Producer Price Index (PPI), the Consumer Price Index (CPI), Gross National Product (GNP), Gross Domestic Product (GDP), non-farm employment, factory work week and overtime, the rate of growth in the money supply as indicated by M1, M2, and M3, foreign trade imbalances, percentage unemployment trends, production capacity utilization, bank reserve balances, the velocity of money, the stock and bond markets, etc.

Unfortunately, many of the FOMC's decisions are based upon survey

(continued on Page 2)



The Consequences ...

(continued from page 1)

"The Fed decision-makers suffer from a permanent time lag, with limited hope of getting in step with the economy they hope to control."

information that reflects the economy a few weeks before their meetings. Because of the time lag in compiling statistics, the Federal Reserve System is inherently slow to react to changes in the money supply or interest rates. Their resulting delayed decisions could easily impede their own efforts to limit or promote growth. What is achieved may be exactly the opposite of what is desired. Problems the Fed attempts to remedy may have already self-corrected by the time the FOMC acts. The Fed decision-makers suffer from a permanent time lag, with limited hope of getting in step with the economy they hope to control.

Another factor working against the Fed is the rate at which money turns over in the economy. Known as the velocity of money, this rate is a matter of great concern for the Fed. Velocity tends to amplify money supply considerations and can strongly and more quickly influence recessionary or inflationary effects. The velocity of money is the ratio of the Gross National Product (GNP) to the average money supply. The GNP is the dollar sum of all goods and services that have changed hands in the economy over the past year. This sum divided by the average money supply is the number of times the money supply has turned over. Money velocity has gradually moved upward since World War II from around two to about five or higher. Credit cards and electronic banking are a couple of modern factors which increase the rapid turnover of the money supply.

Whether we like it or not, the money supply must be controlled and it must vary according to the demands of the economy. Population demographics in the U.S. are such that more



goods and services are required every day. The simple fact that new births and increasing human life expectancy increase our population daily creates an ever-increasing demand for money. By doing nothing, the Fed can put a pinch on the money supply. Whether or not the money supply is increased over a period by the Fed, the demand for money grows because of simple population demographics.

Increasing the money supply beyond what is needed is considered inflationary and decreasing the money supply has recessionary effects. Similarly, the raising of interest rates by the Fed is an anti-inflationary measure, while decreasing rates (or easing credit) is a stimulating or inflationary move designed to improve the economy.

The Fed may not always act rationally in controlling credit and the money supply. Our economy is often called a "free market" economy, but the Fed leads me to challenge this definition. How can an economy be called "free" when credit is expanded (interest rates are dropped) to expand business activity or credit is contracted (interest rates are raised) to slow down business activity? Such bridled control produces an oscillating economic effect when the reins are held too tight.

The Political Connection

Despite my wish to the contrary, the Fed is a super-political organization. The 12 FOMC members and their respective aides do not publish the minutes to their frequent meetings, but they can certainly profit directly or indirectly from the decisions they make. The Fed acts on very short-term issues and they attempt to pacify current administration needs and

concerns, including reelection. The longer term view may be better, and the population would be better served if the political element were removed from the equation.

A Computerized Alternative

In my view, the Federal Reserve System could more equitably be managed by a computer. Given the information the Fed has at its disposal, a computer could do an unbiased and fair job of controlling the money supply and the credit markets. Interjecting a politician's opinion is a sure way to achieve a biased and impractical result that will usually benefit one side at the expense of the other.

The computer control model could make published changes in moderation, without resorting to Senate hearings formalizing each and every strategic decision. Subtle changes orchestrated from factual (rather than political) motives would occur in such small deltas as to be largely unnoticed. The economy could be fairly managed and controlled without the usual trauma that may be caused by poorly chosen words of testimony by the Fed Chairman.

This would put an end to the ludicrous practice of acting on espoused feelings and subjective rhetoric from the direction of the Fed. Today, it seems, whatever is said in public or in private about money supply or credit by the Federal Reserve chairman or any key Board member has an effect on the economy. These comments, whether planned decrees or misplaced whims, can reverse well entrenched stock market trends, affect mortgage lending practices and change the direction of the bond markets.

A Debt Free Future?

The work done by the Federal Reserve might take a quantum jump in simplicity of management control should the economy ever be free from debt. This, of course, is not within the

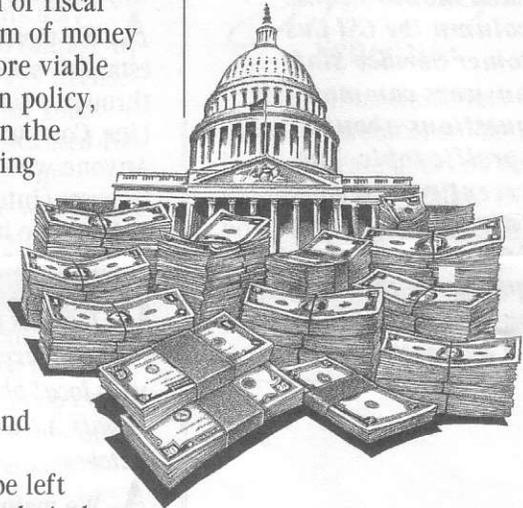
current responsibilities of the Federal Reserve. Perhaps the possibility of a balanced budget will soon become a reality. Only then will we be better protected from some form of fiscal disaster. Our current system of money management, although more viable than the former Keynesian policy, does not avoid nor dampen the ever more wildly fluctuating boom to bust oscillations that we regularly experience. At some point there may be little that can be done to control the oscillations that could ultimately become catastrophic for the country and our currency.

What the reader may be left with from this month's Technical Journal is that one should not make trading decisions based on political rhetoric, nor should we expect the government to make rational decisions. On the other hand, markets are very directly affected by the Federal Reserve Board. I urge you to turn to C-SPAN and listen very carefully when the chairman has something to say. Try to capture the substance of his remarks, then prepare as best you can for the economic response. ♦

Bob Pelletier

Bibliography:

- American Economic Review, March 1968, "The role of Monetary Policy," p. 1-17.
- Economics, Eighth Edition, Campbell R. McConnell, McGraw-Hill Book Company, New York, N.Y. 1981-1963.
- Financial Institutions, Markets, and Money, Second Edition, D.S. Kidwell and Richard L. Peterson, The Dryden Press, Chicago, 1984.
- Lore and Legends of Wall Street, The. R. M. Sharp, Dow Jones Irwin, Homewood, Illinois, 1989.
- Methods of a Wall Street Master, V. Sperandeo and T. S. Brown, John Wiley and Sons, New York, N.Y., 1991.
- Monetary History of the United States 1867-1960, A., Princeton University Press, 1963.
- Money, Second Edition, L. Ritter and W. Silber, Basic Books, Inc., New York, 1973.



Ask Customer Service

Each month in this column the CSI Customer Service Staff answers common questions about a specific topic. The recent release of Unfair Advantage has brought a flurry of questions that were not sufficiently addressed in previous columns.

Q. *What do you mean when you say I'll use my own Web browser and Internet connection to get data for Unfair Advantage?*

A. We mean that you'll need to establish some sort of on-line account through a service such as America On Line, CompuServe, Prodigy, Gatenet, etc. Anyone who provides you with a web browser (Internet access program) and at least one hour of access time per month should meet your needs.

Q. *It seems that the online servers are prone to service outages and problems with local phone connections. How will Unfair Advantage accommodate these glitches?*

A. We maintain a backup dial-in connection which allows you to bypass the Internet for an occasional retrieval session. When you dial direct, the call will be a little longer than usual and you'll pay for the call.

Q. *What data is downloaded each day with Unfair Advantage?*

A. The software picks up daily updates for ALL contracts of ALL world commodities for ALL days inclusive of your last collection for up to a two month period through the current day. The initial release will support just commodities and futures indices, but stocks, funds, indices and options will follow later.

Q. *What is the difference between the historical data supplied with Unfair Advantage (which I can license for just \$135) and the CD of commodity data which you sell for \$1390?*

A. The Unfair Advantage data base is designed for use with the system and is therefore licensed for use during your subscription term. This data can only be updated via regular accesses to CSI and will become unusable should your service lapse for more than two

months.

The full domestic and foreign commodity data bases on CD are sold to you for use with whatever system you like and are supplied in the corresponding format of your choice. They will not lose their accessibility or functionality as time goes by. They will, however, become outdated.

Q. *What will happen if I don't update my files with Unfair Advantage?*

A. When you begin accessing again, Unfair Advantage will automatically pick up all the days you missed for up to two months in the recent past. If you let more than two months go by, the software will lose its ability to retrieve and process the data. A replacement CD must be purchased at then-current prices to bring your data base current and re-activate the software.

Q. *Why can't I just buy Unfair Advantage?*

A. The data base supplied has such a high value that most users could not afford to buy it outright. By licensing the data, you get the full benefit of a complete data base without the full expense.

Q. *What type of analysis is provided with Unfair Advantage?*

A. The initial release includes basic charting, trend lines, stochastics, RSI, moving averages, MACD and seasonal index calculations. We are considering additional requests, which may be incorporated in the next edition.

Q. *What kind of customer support is available for Unfair Advantage?*

A. CSI's full staff of customer service representatives is being trained in using the software. They are available from 8:30 a.m. to 10 p.m. Monday -

(continued on Page 5)

Unfair Advantage:® On your mark..get set...go!

And they're off! Unfair Advantage users have finally left the starting gate on their way to better trading through technology. By the time this journal reaches you, Unfair Advantage version 1.0 should be in the hands of the first 50 or so licensees. Feedback from our Alpha Testers has so far been overwhelmingly favorable and we expect similar results from the our new subscribers.

The inaugural version includes a full commodity data base on CD along with management and analysis software. Upgrades are planned which will add stocks, options and fundamentals. We extend a heartfelt welcome to all newcomers and a special thanks to the trailblazing original subscribers of the Unfair Advantage system. ♦

Ask Customer Service ...

(continued from page 4)

Friday. You will probably find that you need very little personal assistance with Unfair Advantage because of its simple design. The initial release includes a concise printed manual.

Q. Please explain the fee structure for Unfair Advantage.

A. Unfair Advantage is offered under a licensing plan, whereby users pay a one-time license fee plus an annual service fee. The current service fee is \$22 per month (\$264/year). If you prefer to pay on a month-by month basis, the rate goes up to \$64 per month. A one-time license fee is also due to receive the software and historical data on CD. The introductory license fee of \$135 is discounted to \$99 for current CSI subscribers. Your only additional expenses will be for your internet or phone connection and nominal new release charges when applicable.

Q. I am a happy QuickTrieve® user. Must I switch to Unfair Advantage?

A. Not at all! If you want to, you can take the option of switching to Unfair Advantage, but it is not required. CSI customers who are on a prepayment program with unused credits may receive a copy of Unfair Advantage by paying just the discounted \$99 license fee. All months remaining on your current account can be substituted for use with Unfair Advantage. The following year's service fee will be due when your current subscription expires. If our records show that you have purchased a CD ROM of commodity data from CSI, your license fee will be further discounted to just \$49.

Please see the Product Summary on page 8 or call CSI marketing for information on ordering Unfair Advantage. ♦

Market Statistics Update

DELETIONS FROM THE STOCK DATA BASE

9914	WFSB	1st Washington Bancorp Inc
6500	AST	AIM Strategic Income Fund Inc
2696	ADA	Ameridata Technologies Inc
5817	ATC	Atari Cp
8200	BBNK	Baybanks Inc
6830	BNTL	Bentley Int'l Inc
7751	BEP	BET PLC ADR
8213	BIGO	Big O Tires Inc
6943	BWIP	BW/IP Inc
9773	CYH	Community Health Systems Inc
3663	EMI	Encore Marketing Int'l Inc
2014	EXTRE	Exstar Financial Cp
3205	FAL	Falcon Cable Systems Co
12043	FFOX	Firefox Communications Inc
8079	FCBK	First Charter Bank
7765	FGL	FMC Gold Co
4770	FOOQ	Foodquest Inc
8775	GNDR	Gander Mountain Inc
3280	HEM	Hemlo Gold Mines Inc
4180	HHRD	Horsehead Resource Development Co
2746	JAKE	Jake's Pizza Int'l Inc
15974	MSMO	Masimo Cp
9126	MDTC	MDT Cp
12558	MIXX	Medical Innovations Inc
4539	MPTV	MPTV Inc
12237	VETS	Pet Practice Inc, The
3134	PSCO	Protosource Cp
8724	RSFCP	Republic Security Financial Conv. Pfd. series A
5466	RCP	Rockefeller Center Properties Inc
15095	SFCO	Safety Fund Cp, The
9826	SIER	Sierra On-Line Inc
1279	SYS	Sterile Concepts Holdings Inc
7201	SHP	Stop & Shop Cos
4626	STRM	Stratacom Inc
3532	SIR	Struthers Industries Inc
9010	SMFR	Summit Family Restaurants Inc
3011	SUSTE	Sunstates Cp
4319	SGTI	Surgical Technologies Inc
9924	WWTK	Weitek Cp

(continued on Page 6)

Holiday Schedule

CSI will be closed for voice communication on Monday, September 2nd for the Labor Day holiday. The host computer will be operational, but U.S. exchanges will be closed. Data from other exchanges will be available as usual.