

# “True Money Supply” Growth Slowing Dramatically

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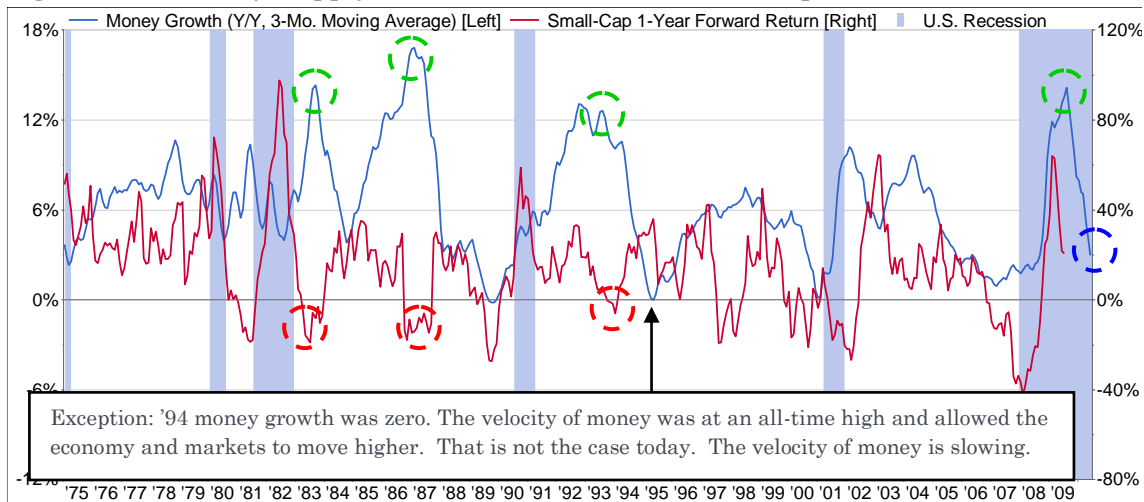
- “True Money” a/k/a “Austrian Money” YoY 3-month moving average supply growth has slowed dramatically to 3.0%, as of June 30<sup>th</sup> from over 14%. Forward 12-month small-cap returns typically struggle i.e. lose money, when money growth slows sharply from over 12%.
- When “True Money” 3-month moving average supply growth falls below 2% forward 12-month small-caps returns typically have been sharply negative.

We define “True Money” as (i) currency; (ii) demand deposits at commercial banks; (iii) demand deposits due to foreign commercial banks and foreign official institutions; (iv) U.S. government demand deposits and note balances; (v) other checkable deposits; and (vi) sweeps of transaction deposits into money market deposit accounts.

There are several explanations why money supply may be slowing. The Fed:

1. Did not believe additional monetary stimulus was necessary,
2. Was concerned about coming inflation,
3. Is concerned about right wing challenges to its independence and reacted to slow its monetary stimulus,

Fig. 1. True Money Supply Growth and Forward Small-Cap Returns



Source: Furey Research Partners and FactSet Research

We expect the Fed to act to accelerate “True Money” growth now that recent economic data has softened and Fin Reg legislation is passed. If growth does not reaccelerate, it will place pressure on forward small-cap returns.

What is driving “True Money’s” slow down?

***As of June 30, 2010***

<b><u>Component</u></b>	<b><u>Weight</u></b>	<b><u>Y/Y Change</u></b>
Currency	34.1%	3.7%
Other Checkable Deposits	14.7%	7.5%
Deposits Due to Commercial Banks	0.5%	-5.7%
Deposits Due to Foreign Institutions	0.2%	-22.1%
Demand Deposits	18.0%	4.9%
U.S. Gov't. Demand Deposits (Not at Fed)	1.7%	-36.9%
Sweeps into Money Market Accounts	30.8%	1.0%
<b>Total</b>	<b>100.0%</b>	<b>2.4%</b>

Source: Furey Research Partners and FactSet Research

“True Money’s” slowdown is being driven by stagnant Sweeps into Money Market Accounts. This is likely due to consumers having to spend more of their money market funds for living expenses due to near zero percent yields and consumers sending money market funds to bond funds and other investments searching for yield and income. There are dramatic declines in the smallest weights with “True Money”, namely deposits due to Foreign Institutions and US Government Demand Deposits.

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