

## **Trader Profile: Howard Blum Uses Fundamentals to Track Bonds**

### **Howard Blum Relies on Fundamentals for Monitoring Financials**

By Allen Sykora, FWN News, [www.CapitalistEdge.com](http://www.CapitalistEdge.com), October, 1999

Howard Blum focuses so heavily on fundamentals in his financial analysis that he is in the process of writing a book on his observations about Federal Reserve policies during the 30 years he has been monitoring the markets.

He is suspicious of many of the government economic reports that are released, however, wondering whether bureaucrats are sometimes tinkering with figures to make political hay for the administration. So he tends to rely more heavily on private-sector data, such as the National Association of Purchasing Management (NAPM) indexes, along with reports put out by the Fed itself.

Blum operates the Financial News and Information Service, which offers commentary on the bond market, from Novato, Calif., about 30 miles north of San Francisco. He takes positions in the options markets, mainly in the long bond, gold, silver, Japanese yen, and occasionally crude oil. He tends to use his trading to help with him with his bond-market analysis more than vice-versa, however.

“I probably execute between 20 and 30 options trades a month,” he said. Others have encouraged him to trade more heavily. “But I got into it for a different reason—to fine-tune my analysis skills,” continued Blum. “When I would make a bad market call, I would go back and look at the fundamentals that I had examined to find out which factor I had missed in the equation. It helps my perception of where the bond market is going.”

Later, he commented, “I am primarily a fundamentalist. I look at historical paradigms—the way things have behaved in the past based on certain stimuli. I’m not comfortable making those decisions strictly on a technical-analysis basis. In my mind, there’s a very important reason why the Securities and Exchange Commission makes people put a disclaimer on every prospectus that says past performance is no indication of future results.

“I’m not saying that technical analysis doesn’t have a place in this world, because it has a very important place. It’s a good analysis tool and a lot of people

rely on it. But I use it more for perspectives.”

Blum described a “symbiotic relationship” between the bond market and the economy.

“I use the bond market as my barometer for what’s happening in the economy,” he explained. “At the same time, I use the market as a yardstick for what the economy will do....Everything in this economy needs the fuel of capital, and the best barometer of the cost of capital in this country is the bond market.”

He tends to mainly rely on private-sector and Fed reports in his analysis because he is becoming “increasingly skeptical” of economic news releases from cabinet-level departments, especially the Department of Labor. He commented the number adjustments from the Labor Department on reports for weekly initial claims for unemployment benefits and monthly job creation has grown exponentially over the years

Blum said he finds it “hard to believe” the number can vary so much. He doubts most market watchers realize how much the data vary in a report from week to week and month to month, due to the heavy emphasis placed on the

most recent numbers.

“I would venture a guess that maybe two out of 100 forecasters actually read the (entire) Labor Department report on employment every month. But there is some incredible information to be gleamed out of it.”

Blum pays close attention to the NAPM surveys for the manufacturing and non-manufacturing sectors and the University of Michigan’s consumer sentiment index. He pointed out that the NAPM non-manufacturing survey is still relatively new—only a couple of years or so.

“Since the service sector is probably four to five times greater than the size of the manufacturing/industrial sector in this country, it’s a more viable number,” he said. “But it’s going to take a few more years to build credibility and data base to draw upon before it replaces the manufacturing sector (as the more critical number).”

He commented that the Federal Reserve itself has “incredible research facilities” for compiling its own data for use when deciding monetary policy. A key Fed report, which many no longer pay much attention to, is the weekly money supply

data, said Blum. That money supply creation is a more critical factor in determining inflation than consumer buying, he said.

As an analogy, he said, suppose all of the goods and services in the country are represented by 100 cows. If the total number of dollars in the economy is \$100, then each cow will cost \$1. If the Federal Reserve were to double the money supply to \$200, each cow would end up costing \$2.

“When money is created at a pace greater than the increase of goods and services in this country, that’s what creates inflation,” he continued. “We are now living with the consequences of the heated-up expansion of our money supply that began in October of 1998 due to the Asian crisis and liquidity problems (when the Fed trimmed rates by 25 basis points three times). For about a year, the Federal Reserve was expanding M3 at a pace in excess of 10% annualized. The economy was expanding, in real terms, at a pace of 3.5% to 4.0%.”

Thus, it should not come as a surprise if inflation returns, he continued. “It doesn’t happen immediately; it takes time to work its way through the system.”

Blum added that much of the low inflation of the 1990s was caused by low energy prices. But now that crude oil has more than doubled in the last half year, he looks for inflation to heat up again.

“Everything you buy is either delivered or manufactured with energy,” he said. Since energy costs are largely beyond the Fed’s control, any attempts to fight inflation by hiking rates could exacerbate the situation by raising the cost of obtaining capital by companies, he continued. “I fear the consequence may be a recession next year.”

While Blum is a fundamentalist, he noted that the advent of computerized and fund trading has affected his analysis, due to the potential for large institutional traders to move a market.

“It has changed the way fundamentals are viewed, because they have triggered buy and sell orders,” he said. “So you have to look at some of the things that technical analysts look at....They can really make the bond market react in unexpected ways.”

As an example, on the day he was interviewed, the U.S. trade deficit contracted, which he said is

normally constructive for bonds. Likewise, when the dollar rose against the yen, which also tends to help the financials. Yet, on this particular day, bonds declined.

“Computers have both simplified the process of trading and made it more complicated at the same time,” said Blum.

In his trading, he turns to mainly options in order to benefit from large moves with a smaller cash exposure.

“Plus when you buy futures, your liability can extend beyond your principal investment,” he said. “When you buy options, your liability is strictly based on the dollars invested. If the options become worthless, you have limited exposure, which is not true with futures.”

Blum’s advice for novice traders is to read as much as possible about the markets they want to trade, then do their own research rather than relying on “Street noise.” He also advised them to “find good, solid sources of independent information,” preferably from more than one source.

“If you don’t have sound fundamen-

tals yourself and understand what moves the market and why, then you are becoming a little bit too reliant on other people and as a result are vulnerable.”

Blum’s involvement with the markets came in the late 1960s when he entered a management training program in New York for E.F. Hutton. He later moved to California to operate an industrial supply company. After he and his partner sold the business, he became a loan officer for a bank. There, he began writing a newsletter for clients.

“When it got to the point where my fax bill was \$1,000 a month 10 years ago, I thought, ‘there’s something wrong with this picture.’ So I culled the herd.”

It made sense to start trimming those who were not providing any business to the bank from the list. Soon, some began to ask if they could subscribe to his report. “A business as formed,” concluded Blum. He has been operating the business on his own for about a decade.

Blum’s Financial News and Information Service offers daily and weekly newsletters distributed via e-mail or fax. He also puts out a monthly report, which is also available in hard copy. His services are outlined

on the web site [www.econonews.net](http://www.econonews.net).

Away from work, he described himself as a “passionate orchid grower” and “lover of golf.” While he conceded he will be “forever be a hacker” on golf courses, “that doesn’t prevent me from enjoying the game.”

Blum was attracted to the markets early in his career by a fascination with the Federal Reserve and the nation’s banking system.

“I first began observing the Fed more than 30 years ago, and even though I left the industry for a number of years, I never stopped observing the Fed,” he said. “I never stopped observing how they respond to different economic situations. Different Fed chairs impose their will differently, but after awhile you begin to see reoccurring patterns.”

The book on the Fed that Blum is writing likely won’t be out until late 2000. At the time of this interview, he was preparing to travel to New York to interview officials involved with Fed market operations. He is thinking of naming his book: “The Most Powerful Man in the World — Alan Greenspan.”

“There is no other figure in the world today who can dramatically move the

markets with one sentence the way he can,” said Blum. “And since all wars henceforth will be essentially economic, he wields an awful lot of influence.”

Blum offered the view that Greenspan has politicized the Fed more than other chairman, instituting press releases and announcements. At one time, he pointed out, “nobody knew what the Fed’s monetary policy was going to be unless they had a runner go up to the day window at the Federal Reserve and ask people as they walked away what the discount rate and what the Fed funds rate was.”

He also called Greenspan an “incrementalist.”

“He only likes moving rates a little bit at a time,” said Blum. “Generally speaking, he will not make a move more than 25 basis points at a time. He carries an awful lot of clout and doesn’t use it to his advantage.”

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