FEDERAL RESERVE BANK *of* NEW YORK

33 LIBERTY STREET, NEW YORK, NY 10045-0001

Minutes of the Investor Advisory Committee on Financial Markets

July 21, 2014

Federal Reserve Bank of New York

<u>Committee attendees:</u>

Nicole Arnaboldi, Credit Suisse Group
Louis Bacon, Moore Capital Management, LP
Tim Buckley, Vanguard
James Chanos, Kynikos Associates
Britt Harris, Teacher Retirement System of Texas
Joshua Harris, Apollo Management
Alan Howard, Brevan Howard
Derek Kaufman, Citadel LLC
Scott Minerd, Guggenheim Partners
Rick Rieder, BlackRock, Inc
Jes Staley, BlueMountain Capital Management LLC
Morgan Stark, Ramius LLC
David Tepper, Appaloosa Management LP

<u>FRBNY attendees:</u>

William Dudley, Chair
James Bergin
Mark Cabana
Christine Cumming
Tom Kennedy
Sandy Krieger
Sandra Lee
Matthew Lieber
Jamie McAndrews
Alberto Musalem
Simon Potter
Matthew Raskin
Michael Schetzel
Kevin Stiroh

Monetary Policy

Committee attendees discussed the U.S. economic outlook and the likely path of monetary policy. Overall, they noted that labor market conditions have generally continued to improve. However, some indicators, such as the job hiring and quit rates, remain below pre-crisis levels, suggesting that labor market slack remains. Attendees acknowledged the recent rise in inflation, but believed more information was required to determine how persistent the increase was likely to be.

Committee attendees suggested that there is uncertainty regarding the monetary policy normalization process, specifically the timing of the first increase in the federal funds target rate, the pace of rate increases thereafter, and the longer run neutral federal funds rate. Analysis presented by attendees suggested the market is generally expecting a later liftoff date and a more gradual tightening cycle than what is implied by the FOMC's most recent Summary of Economic Projections. A few attendees further noted that their own outlook for the economy suggests the path of the target rate is likely to be higher than the path currently implied by financial markets.

Financial Market Developments

Attendees discussed the low levels of realized and implied volatility across financial markets and assessed that the stance of monetary policy has been a factor suppressing volatility. Lower potential GDP growth globally, low economic forecast uncertainty by market participants and the FOMC and an increase in investment strategies that entail selling options were also cited as drivers. A few attendees noted that the low levels of volatility are not anomalous with similar points in previous monetary policy cycles. Nonetheless, attendees suggested the low levels of volatility have suppressed credit and liquidity risk premiums, potentially causing the normalization of monetary policy to be more turbulent than it otherwise would be.

Financial Landscape

The meeting concluded with a discussion of dark pools and financial intermediation occurring in the non-bank financial sector. Overall, committee attendees did not suggest that dark pools present a significant risk to market stability. They suggested that dark pools provide anonymity for large trades and lower transactions costs, but that they limit price discovery somewhat and offer opportunities for high-frequency traders to arbitrage prices between the various fragmented dark pools. Attendees felt that limit orders and investor communication with their peers and the various exchanges appropriately mitigate risks, but enhanced regulation and transparency would increase confidence in dark pools.

Committee attendees discussed evidence that financial intermediation in the non-bank financial sector had increased notably since the financial crisis. Several believed that maturity and liquidity transformation occurring outside the non-bank financial sector presents risks to financial stability, particularly amid the current low volatility environment. Attendees suggested that a standardized liquidity requirement, exit fees and increased investor awareness regarding the risks presented by the sector could mitigate the risks. Limiting investors' fund withdrawals was not seen as an effective mitigant as it presents a 'first mover' advantage and could serve to accelerate concerns in time of crisis.