Weekly Market Summary

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When an Ex-Presidential Fixer & Fed Chair Turn the Tables on Their Former Boss!!

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The semi-annual Congressional testimony of Fed Chairman Jerome Powell was expected to be the most important event of the week; After all, the monetary policy report to Congress - prepared by the Board of Governors of the Federal Reserve twice a year (February and July) as mandated by the Humphrey-Hawkins Full employment Act of 1978, and presented by the Fed Chair to the Committee on Banking, Housing and Urban Affairs of the Senate & the Committee on Financial Services to the House of Representatives - usually provides the top US central banker with a golden opportunity to prepare markets for upcoming Fed actions (be it a rate rise or rate cut, and lately an extra update on Quantitative Tightening (QT) extension or tapering plans).

However, this time around, it did not reveal anything new in comparison to the minutes of the January 30th FOMC meeting (released February 20th): Federal Reserve Chair Powell reiterated that a healthy U.S. economy had faced some "*crosscurrents and conflicting signals*." In describing those crosscurrents, Powell first alluded to how "*financial markets became more volatile*" at the end of last year and how "*financial conditions are now less supportive of growth*." He then talked about economic fundamentals and how "*growth has slowed in some major foreign economies, particularly China and Europe*." Mentioning financial markets before the economy was as a clear signal that the Fed's top priority is preventing another plunge in the stock market like the one in December!

Additionally, Mr Powell repeated the central bank's "*patient*" approach to interest rate changes, vowing to carefully monitor a host of unresolved questions, including the direction of Brexit talks and ongoing US-China trade negotiations. The US central bank in January shelved its prior plans for further gradual rate increases after a choppy period in which the Fed was accused in markets of being unduly hawkish about monetary policy. Minutes to that meeting also showed many policymakers now expect to complete the job of reducing its multitrillion-dollar balance sheet this year, adding to a more buoyant mood in financial markets over recent weeks. Mr Powell said some economic data have "*softened*" in the past two months, but the Fed Chairman insisted the US still remains on track for spending gains during the current quarter, and that the labour market remains strong. The effects of the Federal government shutdown prompted by a stand-off over border wall funding should be "*fairly modest*" and largely unwind over the next months, he added. While recent declines in energy prices would likely push headline inflation down further below the Fed's 2% goal, those effects were deemed "*transitory*", and price growth was still seen running close to 2%.

Recent signals that the Fed is reconsidering its approach to its inflation target – i.e. deliberately aiming for above-target inflation in order to achieve their inflation goal on average over a period of years (music to my "bearish fixed-income" ear ☺) - prompted a challenge to Mr Powell by Pat Toomey, a Republican senator from Pennsylvania. Mr Toomey said his first reaction was to be "*pretty concerned*" about that idea, given historic problems with high inflation. Mr Powell said that no decisions had been made, but these issues were going to be the subject of "*careful consideration*" over the year and beyond. Another key question facing the Fed this year is determining exactly when it should stop its balance sheet reduction programme, after total assets shrank from a peak near $4.5 trillion to around $ 4.0 trillion now (and to think that we stood roughly at just $ 850 billion before the 2008 financial crisis!). In his opening remarks, Mike Crapo, the Republican senator from Idaho who chairs the Banking Committee, said he wanted to know what factors Mr Powell will be considering in deciding the right size of its balance sheet and the quantity of reserves that will be needed for it to set monetary policy.

Responding to questions from Mr Crapo, the Fed Chair said that market estimates putting the quantity of reserves at around $1.0 trillion "*plus a buffer*" were a reasonable indicator of where the Fed might wind-up following its balance sheet rundown (reserves stands currently at about $1.6 trillion, down 40% from their peak levels but far above pre-crisis norms). Powell has said the US Federal Reserve is close to agreeing a plan to complete the process of reducing its multitrillion-dollar balance sheet by the end of 2019, teeing up an announcement as soon as its meeting this month (March 20th FOMC meeting).

Nevertheless, the Congressional testimony assuredly became more interesting when Jerome Powell was asked if he agreed with comments from his predecessor Janet Yellen (currently part of the Brookings Institution Research Group), who earlier in the week said in a radio interview that she did not believe Mr. Trump understood the Fed's economic goals (*REALLY?!?*). "*Well, I doubt that he would even be able to say that the Fed's goals are maximum employment and price stability, which are the goals that Congress have assigned to the Fed*," Ms Yellen had told the programme. "*I won't have any comment on that for you, Senator*," was Mr. Powell's reply to Senator Sherrod Brown, D-Ohio. Whereas the Fed was on the receiving end of attacks from Donald Trump when it was lifting rates last year, presidential criticism has evaporated as the central bank adopts a more dovish stance. Mr Powell, who met the president and Treasury secretary Steven Mnuchin for a private dinner earlier last month, declined to comment when asked by Democratic senator Brian Schatz whether anyone in the White House had communicated with him about interest rates. After a pause, Mr Powell said it was not appropriate for him to comment on private conversations with other government officials (more importantly, no point in opening the door once again for a deluge of idiotic tweets ☺).

Speaking of appropriate conduct, Michael Cohen - a long-time lawyer and fixer for Donald Trump - turned on his former boss on Wednesday, calling the US president a "*racist*", "*cheat*" and "*conman*" who sought business deals in Russia during the 2016 election and inflated his net worth to impress the public (*REALLY?!?*). Speaking as the US President was in Vietnam to meet North Korea's Kim Jong Un, Mr Cohen used his first public appearance before a congressional committee to portray himself as a "*fool*" who ignored his own conscience to blindly serve Mr Trump and was now trying to set the record straight before serving a three-year prison term (*REALLY?!?*). Cohen – at times emotional - gathered momentum as he levied some of his worst accusations against Mr Trump. "*Since taking office, he has become the worst version of himself. He is capable of behaving kindly, but he is not kind. He is capable of committing acts of generosity, but he is not generous. He is capable of being loyal, but he is fundamentally disloyal*." Republicans on the House oversight committee attacked Mr Cohen as a pathological liar. Jim Jordan, the ranking Republican, said: "*This is the first time a convicted perjurer has been brought back to be a star witness in a hearing.*"

Going back to the US Fed Chair's testimony, the Federal Reserve's dual mandate is ensuring full employment and stable consumer prices; Yet, Powell's remarks will only further cement the idea of a "*Fed Put*" that underpins riskier assets. Such thinking, however, could also put investors at risk, as a bullish run in risk assets such as equities and corporate bonds might eventually force the Fed to keep raising interest rates after markets have largely priced out any hikes this year and next. That, coupled with Trump's erratic political/economic policies, surely raises the odds of a global financial crisis in 2020. Unfortunately, once that perfect storm occurs, the policy tools for addressing it will be sorely lacking!

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