Weekly Market Summary

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A Trillion Here, a Trillion There ... And Hedge Funds Quietly Blowing Up in Between!

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Last Wednesday, US President Biden unveiled a US$ 2.00-2.25 trillion jobs, infrastructure and green energy proposal to reshape the US economy. Under what the new administration calls the American Jobs Plan, the White House aims to tackle some of the nation's most pressing problems - from climate change to decaying water systems and the nation's crumbling infrastructure. And yet, the announcement was immediately met with a chorus of opposition from Republican lawmakers who criticized it as a partisan wish-list, liberals who challenged it as not sufficient to combat global warming and business groups who rejected its proposed tax hikes.

In his late afternoon speech at the United Brotherhood of Carpenters and Joiners of America on that day, Biden pitched his plan as a transformative effort to overhaul the nation's economy. He called it the most significant federal jobs investment since World War II, saying it would put hundreds of thousands of electricians and laborers to work laying miles of electrical grid and cap hundreds of oil wells. Additionally, the plan's research funding would make America the global leader in emerging sectors such as battery technology, biotechnology and clean energy. "*This is not a plan that tinkers around the edges. It is a once-in-a-generation investment in America, unlike anything we have done since we built the interstate Highway and the Space Race in the 1950s and '60s*", Biden noted.

The White House had earlier indicated that the proposal would pay for itself with a slew of tax hikes over 15 years because many of those would remain even as the spending proposals only last for eight years. Biden said the plan would reduce the federal debt "*over the long haul*." (more likely over an "*extremely*" long haul 😊). Legislation in Washington is typically evaluated on a 10-year budget window, and it is unclear precisely what the plan would cost over a decade. In terms of taxes, Biden's plan includes raising the corporate tax rate from 21% to 28%; increasing the global minimum tax paid from about 13% to 21%; ending federal tax breaks for fossil fuel companies; and ramping up tax enforcement against corporations, among other measures. The White House is also proposing as much as $400 billion in clean energy credits.

Surreal How Times Have Changed!

Back in 2009, a new Democratic administration facing down a massive economic crisis pushed an $800 billion stimulus package. A bloc of centrist Democrats balked at the price tag, whilst Republicans were thrown into a frenzy warning about the impact to the federal deficit (to put things in perspective, 2009 Federal Deficit stood at $1.4 trillion, Federal Debt at $11.9 trillion, Deficit to GDP at 9.8% and Debt to GDP at 82%. Those same numbers are projected to reach $3.6 trillion, $30.0 trillion, 15% and 109% respectively in 2021!) A little more than a decade later, another new Democratic administration takes office facing a different, milder economic crisis (though still with devastating effects for small and medium size businesses). This time, it proposes an additional $1.9 trillion stimulus package and secures its swift passage in Congress, even though the federal deficit last year was $3.1 trillion – much larger than during the last crisis. Centrist Democrats unify behind passing the measure, and the GOP rejects it but in a more muted fashion.

The disparity between the reception to President Barack Obama's 2009 stimulus plan and President Biden's is the result of several seismic shifts in American politics, the most dramatic of which may be the apparent impact of the pandemic on attitudes about the role of government in helping the economy. A growing number of Americans, including politicians, are now open to government providing regular aid to those in need - with little fears about spending too much. "*It's been a* *major shift. People have gone from being anti-government, to beyond being even neutral on it, to thinking: We need the government; it has to help us*," said former congressman Barney Frank (D-Mass.), who helped craft Congress' response to the last financial crisis and Great Recession (It's called The Great Reset, Barney! You'll own nothing but still be happy! Klaus Schwab from the World Economic Forum is the right person to speak to 😊)

Speaking of drastic disparities in past two decades, some things never seem to change! Everything old is new again on Wall Street – including a volcanic market crack-up involving a heavily indebted, high-flying hedge fund that is able to operate with enough anonymity and impunity that nobody seems to be aware of how bad it might get until the eruption occurs.

Today it is Archegos Capital (a hedge fund that Bill Hwang ran out of his family office) which was forced to liquidate more than $ 20 billion worth of stocks last Friday (and possibly early Monday) because it had essentially loaded on more debt than it could handle. When markets moved against his bets on a cluster of Chinese equities and shares in at least two US companies, Viacom CBS Inc. and Discovery Inc., the bottom fell out. Back in 1998, it was Long-Term Capital Management (LTCM), a hedge fund run by legendary trader John Meriwether and a band of former Salomon Brothers bond traders, which was also forced to liquidate – after receiving a cash infusion of $3.6 billion in a rescue orchestrated by federal regulators - because it had essentially gorged on more debt than it could handle; When Russia defaulted on its sovereign debt and markets moved against LTCM's bets on interest rate spreads, the bottom fell out.

Whilst complexities always reside in the details of how and when various meltdowns eventually occur, the animating force behind a lot of them isn't rocket science; It is simply greed colliding with overconfidence and an undisciplined – sometimes juvenile – approach to debt/margin calls management. The one thing, perhaps, that makes this week's moment different from 1998 is the fact that Archegos' meltdown – like many other Wall Street failures in past year – doesn't appear to have posed a systemic risk (even though Nomura Holdings Inc. and Credit Suisse Group AG said they face potentially "*significant"* losses as they tally their exposures to the massive unwinding of leverage equity bets). In contrast, LTCM - which had real geniuses on its payroll (two economists, Nobel Prize winners, worked for the firm!) - had an enormously leveraged gamble with various forms of arbitrage involving more than $1 trillion in market positions. Their unwinding would have had significant international monetary implications, potentially jeopardizing the financial system itself (clearly explaining why the Federal Reserve Bank of New York, fearing a panic by banks and investors worldwide, eventually stepped in and organized a bailout with the various major banks at risk).

In other news, OPEC+ expressed growing confidence in the global economic recovery by agreeing to increase oil production gradually in the coming months. Before yesterday's monthly meeting, the cartel had been widely expected to maintain its cautious stance by rolling over the current supply cuts, just as it did last month. Yet, the Organization of petroleum Exporting Countries and its allies showed they are more convinced now that fuel demand is on a firmer footing, opting to add more than 2 million barrels a day to world oil supplies from May to July (Saudi will roll back its voluntary extra 1 million barrel-a-day cut, while the 23-nation coalition boosts supply by 1.15 million during the same 3-month period). That will restore about a quarter of the crude they are still withholding after deep cuts made a year ago in response to the pandemic. Saudi Energy Minister Abdulaziz bin Salman al-Saud said OPEC+ was now "*testing*" the market and has the opportunity to reverse course - if necessary - at its next meeting on April 28th. Oil prices settled up more than $2 yesterday (last at $64.86 for Brent oil) despite the latest production ease. "*Ironically, the market has bought the OPEC+ story that demand will increase and the barrels will be needed, despite multiple calls by OPEC for caution in the days leading up to the meeting*," said Bob Yawger, director of energy futures at Mizuho (with 1- Iran and China recently signing a huge economic and security partnership, 2- Iran nuclear deal participants meeting in Vienna next week, 3- New lockdown measures coming into place across Europe and 4- US oil rigs operating in the US rising by 13 this week according to Baker Hughes, there is a high risk that markets witness a large sell-off in oil prices over the coming month!)

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