Weekly Market Summary

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Ever Wondered How Easy Market Manipulation Is?

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Market manipulation, also known as price manipulation, is the act of artificially inflating or deflating the price of an asset or otherwise influencing the behaviour of the market for personal gains. Typically, manipulators find it easier to move the price of smaller companies (penny stocks) and/or financial instruments in less mature markets simply because analysts and large market participants do not watch those closely. In market manipulation, the manipulator tries to influence the market by raising or lowering the price of an asset - pushing it away from the true price implied by market fundamentals (fair value) to create false impressions / deceit among other market participants - and later acts to profit from the situation.

To prop the US economy and stave off another great Depression scenario, the US Federal Reserve took control of financial markets in early 2020 (March) through unprecedented intervention, manipulating market prices, controlling rates and propping up companies on a previously unimaginable scale (if you're wondering about the extent of such market meddling, look no further than the Fed's balance sheet which is projected to balloon in size to $10.2 trillion by the end of 2021 from just $4.0 trillion at the start of 2020! And its standard $900 billion cap prior to the 2008 financial crisis). Knowing that prices can fall only so far before the Federal Reserve acts, market participants have constantly been encouraged to buy assets at any level (raising moral hazard). Effectively, what was previously a market-run, capitalist economy had now shifted to a mixed market economy governed by an unelected and largely independent group of technocrats that directs markets through the use of unconventional policy tools. Those policies have somehow stabilized the economy and surely prevented a 2020 meltdown, though the Fed has - by its own admission – so far failed to fully reach its dual goals (stable prices and maximum employment).

Many have argued that Fed officials were forced into this position as a result of the devastating impact of the Covid pandemic and that their extraordinary economic intervention was their finest/greatest attempt to make up for a new world of slowing growth, growing debt, and aging population and a dysfunctional Congress. In that context, promising to buy an unlimited amount of US government bonds and mortgage-backed securities, purchasing corporate bonds (including debt with a "*junk*" rating ... Hooah!) and even providing financing directly to individual companies was simply meant to jumpstart the economy, push companies to hire more workers and improve personal spending. Instead, companies have bought back their stocks and invested in technology designed to replace workers whilst retail investors got encouraged to take more risk – empowering a wave of speculative and unproductive investments (frenzy speculation in meme stocks and crypto currencies). Fed policies also allowed companies to issue record amounts of debt at record low levels, keeping many of them in business and able to run essential functions (including "zombie" companies that have little revenue to pay off current debt obligations).

Worse, many market participants will soon stop trusting that the US Federal Reserve is behaving like a credible central bank. Billionaire fund manager Stan Druckenmiller (better known as the trader that orchestrated George Soros' $10 billion bet that the Bank of England would have to devalue the British pound in late 1992, generating more than $1 billion for the fund) previously noted that the "*Fed policy is endangering the dollar's reserve status*," and added that "*I don't think there has been a greater engine of inequality than the Federal Reserve bank of the United States*." 61-year old bond legend Jeffrey Gundlach, founder and CEO of $135 billion DoubleLine Capital agrees. "*The Fed has been manipulating markets for a long time*," and on top of that, valuations have crept up thanks to "*incredible amounts of stimulus*," he told Yahoo Finance back in late May.

Whilst the US Federal Reserve's wild purchase of financial assets - the cause of the exploding money supply - is surely great for financial markets in the short-term, its longer impact on inflation and social inequalities could prove devastating should the Fed's experiment reignites inflation. One might assume that the benefit of extreme Fed action is supposed to reach everyday Americans but the truth is that it is largely resulting in a bonanza for the wealthy and large corporations (just under 90% of stocks are held by the top 10% of US households and similarly homeownership rates are skewed significantly toward older wealthier white Americans) while there are still some 6.5 million fewer Americans employed than before the pandemic, food insecurity has increased and poverty rates have remained elevated (during the same period, America's billionaires have seen their fortunes grow by nearly $1.5 trillion!) More worrisome are concerns that the authorities' ultra-loose fiscal and monetary policies for struggling families and businesses risk become a double-edged sword, encouraging behaviour detrimental to economic recovery and creating pressure for additional bailouts and permanent citizens' checks (the universal basic income concept).

For now, the general sense is that markets are too "*seamlessly priced for perfection*" - and that can surely persist for many more weeks/months. Trying to define the exact trigger for a future market correction or meltdown has always been a notoriously pointless game and a losing investing proposition (like the famous economist John Maynard Keynes says, "*markets can remain irrational longer than you can remain solvent*"). Does the recent Greensill scandal (involving former prime minister David Cameron's personal lobbying to change rules and allow emergency loans to the insolvent supply chain financing firm Greensill Capital) or the Archegos blow-up (a family office that behaved far more like a highly speculative hedge fund and caused large losses for banks after its debacle) hint at further setbacks - rooted in greed - that are set to floor markets soon? Or could the recent jump in prices prove stickier than the Fed's transitory assumptions / hand-wavy guesstimates and result in inflation fears getting out of control (self-fulfilling prophecy)?

Needless to highlight that very few investors expect inflation to become a real problem, and surely no one at this point is assigning high probabilities for a bond market meltdown (sizable jump in US yields from current depressed levels) or a major USD collapse. Still, the traditional investment world (listed bonds and stocks) is starting to look tired and vulnerable; The consequences of years of distortion as a result of insensitive pre-2008 mortgage lending practices and hasty post 2008 regulation, subsequent tinkering with market mechanisms, and the malicious consequences of addicting markets to low rates and flooding liquidity from QE, are slowly becoming clearer! "*Doing God's Work*," as Lloyd Blankfein, a former Chairman of Goldman Sachs stated in 2009, is likely to lead to constant disorder and chaos!

Many commentators believe the world has changed lately and markets behave differently today, but it never is! Additionally, investors must always prepare for the worst and at the same time be ready for the best. Currently, the level of bullishness in financial assets is in extreme high territory, according to various surveys and technical indicators (high RSI readings). However, that usually does not end well, when "*everyone*" is bullish, as theoretically there is nobody left to buy. Demand dries up and one spark can send the herd stampeding toward the exit doors. One can only hope that financial markets don't move soon into a scenario where high inflation takes hold of the economy and the USD weakens drastically, two events that would set the stage for a farewell bid to yet another failed monetary system and futile monetary policies (just when JP Morgan's Jamie Dimon was confirming to Fox Business that he does see himself staying in the job for another five years. "*I'm not going to go play gold and smell flowers*", he noted 😊)

In other news, the July employment report is slated for release over the coming hour (3:30 pm Bahrain time). All eyes will be on the monthly job increases as well as movements in the unemployment rate, as investors and policy makers alike look for further labour market improvements to justify early Fed tapering. Bloomberg consensus is for an 858K increase in NFP following a similar large increase the previous month. A strong report would support an announcement at the September 22nd FOMC meeting as to exactly how the Fed will taper, with a clear outlined timetable/mechanism. By that time, the delta variant's impact, the rent eviction moratoria and the back-to-school process would also be much clearer.

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