

Weekly Market Summary

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Mirror, Mirror on the Wall, Who's the "Dove-iest" of Them All?

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Most of us surely still remember the story on Evil Queen and Snow White. The magic mirror never lies. “*My Queen, you are the fairest in the land,*” answered the mirror until Snow white got older and the answer changed to “*My Queen, you are the fairest here so true. But Snow White is a thousand times more beautiful than you.*” This old story suddenly popped into my mind while following Janet Yellen and Jerome Powell rhetoric over the previous week!

So where is the analogy you might ask? Let me explain how I see it.

The success of the vaccine rollouts in the US has fueled expectations that the economy could outperform in the near-term. Growing prospects for aggressive fiscal stimulus have further supported the view that the US outlook could improve more rapidly and even raised concerns that the economy may start overheating as a result. And yet, ever-dovish Federal Reserve and Treasury officials continue to pour cold water on any suggestion that less policy accommodation may be needed from here onwards. The result has been another big week for financial markets: The S&P500 set another record high yesterday (last @ 3,916, up 4.27% year-to-date, on the back of stellar 16.3% jump in 2020), while yields on US Treasuries have continued their slow advance, reaching their highest since March 2020 (10-year US yields last @ 1.16%, endlessly suppressed by \$ 120 billion of monthly bond purchases by the US central bank). Not to diminish the importance of those moves, the more meaningful action has been in the oil markets, where the price of West Texas Intermediate (WTI) crude soared to as high as \$58.91 a barrel in intraday trading on Wednesday (last @ \$57.75). Not only was the two-week increase of 12.5% the largest since last November, but the price of oil had finally recovered all of its pandemic-related losses (you can attribute the move to excessive OPEC supply reductions, a weakening US Dollar and/or a broader comeback in the markets for raw materials - with the Bloomberg Commodity Index reaching its highest since 2019!)

As far as the positives go, the above market moves are a proof that the US economy is on firmer footing and should only get stronger as President Joe Biden’s \$1.9 trillion Covid-19 relief plan moves closer to reality (by mid-March latest). Such aid, the second-largest injection of federal cash in US history (only last year’s Cares Act was bigger, but that came at the start of the pandemic, when the deepest recession in decades laid directly ahead) should hopefully bolster the finances of hard-hit individuals and corporations following the Covid-19 pandemic. The reality however is that there are far too many negative factors surrounding the fast rise in asset prices and market rates, the most important of which being market projections that faster inflation will come with a vengeance (with demand soon surging and supply remaining depressed given that the pandemic did wipe out a lot of small and medium size business over the past year). Breakeven rates on five-year Treasury notes, a measure of what traders expect the rate of inflation to be over the life of the bond, just surged to 2.29% this week, the highest since early 2013 and well above the Fed’s 2.0% target for inflation. At the same time, the difference between short- and long-term yields, known as the yield curve, is at its widest level since 2017 – a strong indication that investors currently demand higher yields to protect against future inflation. Should inflation expectations translate into real inflation down the road (a lot will depend on money velocity, or the frequency with which the Fed’s new money changes hands, as people / companies use cash to buy goods and services, instead of hoarding it), it could become a serious problem for the bull run in stocks (and bonds). After all, the latest rally in equities (and other asset classes) has been founded on the Fed’s intentions (both implicit / explicit) to keep short term borrowing costs unchanged till early 2023 whilst also pumping \$120 billion monthly into the financial system well into next year (what I regularly refer to as the long-lasting “*Zombification*” of the global economy prior to the launching of the “*Great Economic Reset*”!)

Nevertheless, both Treasury Secretary Janet Yellen and current Fed Chairman Jerome Powell continue dismissing market inflation concerns, insisting the world's most powerful government and central bank will go full speed with their efforts to reduce slack in the US economy and revert-back rapidly to full employment. At an address to the Economic Club of New York on Wednesday, Mr. Powell underscored that the central bank's ultra-easy monetary policy approach will continue apace and vowed that the Fed will do all it can to promote its mandate of maximum employment (some 10 million Americans remain without work due to the fallout from the pandemic). During the ensuing question-and-answer session, the US Fed Chairman emphasized that while the Fed is closely watching inflation trends by monitoring a very broad range of inflation measures (excluding those that move up 😊), it is not expecting a sustained rise in prices in the near term. *"There is a chance inflation could increase in coming months,"* Mr. Powell acknowledged. *"But that's really not going to mean very much. If inflation does rise, it won't be very large or persistent."* Those statements have echoed previous comments made by Mrs. Yellen during her January testimony to Congress. *"The world has changed"* and the *"future is likely to bring low interest rates for a long time."* As a result, Yellen added, *"even though the amount of debt relative to the economy has gone up, the interest burden hasn't,"* so *"the most important thing we can do is to provide relief to the American people and to make long-term investments that make the economy grow and benefit future generations."* Although Mrs. Yellen admits the risk of rising inflation from a robust fiscal policy that former Treasury Secretary Larry Summers (Democrat too) had recently raised, she did tell CNN that there is a far greater risk *"that we leave workers and communities scarred by the pandemic and the economic toll that it's taken, that we don't do enough to address the pandemic and the public health issues, that we don't get our kids back to school."* (difficult to achieve when keeping the economy closed and handing out individual cheques that could be used to trade cryptos and equities! 😞).

If you are over 40, you've lived through at least three epic financial bubbles: Junk bonds in the 1980s, tech stocks in the 1990s and real estate in the 2000s. Each was spectacular in its own way, and each threatened to take down the whole financial system when it burst. But they all pale next to what's happening today! Whilst those past bubbles were sector-specific, meaning the mania and resulting carnage occurred mostly within one asset class, today's bubble is spread across pretty much everything – hence the term "everything bubble." Central bankers (Janet Yellen is a previous Fed Chair) may be determined to allow inflation to run higher over the short term and will pretend that this time is different and that they are able to calibrate this delicate extraction, but this must be seen as a white lie and a necessary bluff to keep financial markets and traders reassured – at least for now! The liquidity administered by the US Government and Federal Reserve (fiscal & monetary easing) should keep everything floating upwards in the short term, but the world economy and financial assets will eventually have a very hard time adjusting to less stimulus and higher yields going forward!

To end this weekly write-up on a happier note, I reproduce some of the bubbly (or bubble-ly 😊) headlines in past days:

- Top-Notch Hedge Fund Manager: My portfolio is up 7% YTD / 10-years old kid (whose strategy consists of buying what Elon Musk tweets): My portfolio is up 800% YTD!
- Stages of a bubbles as seen by a 45-year trading veteran:
Stage 1: A neighbor asks me what I know about \$BTC (bitcoin) / Stage 2: A friend ask if \$BTC is a good buy / Stage3: A relative asks if he/she should buy \$BTC & Stage 4: A person I have not been in contact with for more than a year, calls, bragging he/she bought \$BTC!
- The richest person in the world who is a CEO of a manufacturing company that hasn't made a profit from the product it makes but has a pre-split valuation of +\$4,300 a share, recommends \$BTC and buy \$1.5 billion worth. NO Bubbles here!

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