Weekly Market Summary

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Mission Accomplished! New Equity Records & Not Too Bad Inflation Report!!

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Last week, we made references to *market manipulation* (or price manipulation) - defining it as the act of artificially inflating or deflating the price of an asset away from the true value implied by market fundamentals (fair value) or otherwise influencing the behaviour of the market for personal gains. This time around, we allude to *Information Manipulation Theory* (IMT) and its deceptive discourse design through the manipulation of market news to justify/validate financial instruments' irrational price action.

Take for example oil price movements throughout the early part of this week. On Monday, West Texas Intermediate (WTI) prices slid to a three-week low with new waves of Covid-19 exacerbating demand concerns. Futures in New York ended the day down by more than 2.6% after Chinese air travel dropped the most since early in the pandemic as rising cases of the delta variant spurred fresh restrictions on movement. "*Chinese mobility on roads and air traffic is down, so what traders are wondering now is whether or not other large oil consuming and producing regions will start to see a China-like demobilization,*" said Vikas Dwivedi, Oil & Gas Economist at Macquarie Capital. "*We could see this domino effect, where other regions follow China's lead and that would lead to lower oil demand for the remainder of this year and beyond*." Clearly, market fundamentals were fast deteriorating with the Delta variant shaking the global demand outlook! By Tuesday morning - however - oil had recovered Monday's losses and more, rising alongside broader equity gains with investors optimistic that global economic growth will continue even in the wake of Covid-19 resurgence. Futures advanced 2.7% in New York that day, the biggest gain in more than two weeks. While the delta variant has led to rising infections and curbs on movement, global consumption was still expected to hold up and tighten the market through the end of the year. "*Some investors are also getting optimistic that the blow to demand from the delta variant spread is tapering off, if even just slightly,*" said Phil Streible, chief market strategist at Blue Line Futures LLC in Chicago (to think investors pay monthly subscription fees to read such daily non-sense! 😊)

Then came the long-awaited Consumer Price Index (CPI) release on Wednesday afternoon by the US Bureau of Labour Statistics (BLS). Prices paid by U.S. consumers climbed in July at a more moderate pace, though not enough to provide major relief from the cost increases weighing on sentiment and driving policy debates. The consumer price index increased 0.5% from June and 5.4% from a year ago. Excluding the volatile food and energy components, the so-called core CPI rose 0.3% from the prior month and 4.3% from July 2020. As a result, 10-year US Treasuries rallied on the day with yields dropping as much as 5 bps (to 1.30%), whilst US equity indices recorded new all-time highs (prompting the news story headline to be reported as "*Consumer Inflation in US Moderates While Remaining Elevated*" - rather than "*Consumer Inflation in US Remains Elevated While Moderating*" had bond yields chosen to move higher! 😊)

Nonetheless, inflation remains a clear and present danger! Faced with supply constraints and surging demand, businesses are raising prices for goods and services as cost pressures mount. Federal Reserve Chair Jerome Powell had emphasized elevated inflation will ultimately prove temporary, but it is still unclear when supply constraints will ease. A New York Fed survey released last Monday showed consumers' inflation expectations over the next year are at a record high (expectations for the medium term also rising to an eight-year high), whilst Thursday's producer price index release (PPI) showed prices paid to US producers beating market expectations – implying that higher commodity costs and supply bottlenecks are still adding to inflationary pressures for companies (PPI for final demand increased 1.0% from the prior month and 7.8% from a year earlier). This has led Dallas Federal Reserve Bank President Robert Kaplan to confirm in a CNBC interview that “*it would be my view that if the economy unfolds between now and our September meeting ... if it unfolds the way I expect, I would be in favor of announcing a plan at the September meeting and beginning tapering in October*." Prior to that, Kansas City Federal Reserve Bank President Esther George also said that it is time to dial back the central bank's asset purchases as U.S. economic growth is likely to remain robust. "*With the recovery underway, a transition from extraordinary monetary policy accommodation to more neutral settings must follow,"* George noted.

In the meantime, US stocks continue setting daily new all-time highs even as benchmark indices settle into a narrowest trading range since before the Covid pandemic roiled global financial markets (prompting the VIX index to drift lower to 15.50, its second lowest reading over the past 18-months). Elsewhere, the amount of cash investors continue to park at a major Federal Reserve facility has surged above $ 1.0 trillion once again amid an overabundance of US dollars; Seventy-four financial institutions and money market funds on Thursday placed an unprecedented total of $1.097 trillion at the Federal Reserve’s overnight reverse-repurchase facility. The record amount brings again into focus growing imbalances in front-end markets that have helped keep downward pressure on short-end rates (also shed light on the Fed’s printing press that will one day lead financial markets down the road to perdition! ☹)

Back on May 1st, 2003 - a sunny day off the coast of San Diego - US President George Bush landed on the USS Abraham Lincoln in the co-pilot’s seat of a navy fighter jet. After landing, Bush changed out of his combat suit and stepped up to the podium, surrounded by a receptive military crowd. Having marched U.S. troops through Iraq and deposed of Saddam Hussein's regime (and his statue), Bush called Operation Iraqi Freedom "*a job well done*." "*Major combat operations in Iraq have ended*," Bush added, the infamous "*Mission Accomplished*" banner hovering over him. "*In the battle of Iraq, the United States and our allies have prevailed*." Instead, the speech and the banner became a symbol of the unpopular war, which would last another eight brutal years. The image came to capture not just the war, but the mistakes of the Bush administration as a whole, as even Bush himself admitted at his final press conference as President. "*Clearly, putting a 'mission accomplished' on an aircraft carrier was a mistake*," Bush said, when asked about his errors while in the White House. "*It sent the wrong message. We were trying to say something differently but, nevertheless, it conveyed a different message*."

Fast forward to today and one can sincerely hope that Fed Chair Jerome Powell recognizes it is too early for him and his central bank colleagues to declare mission accomplished on US inflation and financial market stability! After all, the Fed continues to buy a lot of longer-term Treasury securities ($80 billion of Treasuries and $40 billion of mortgage-backed securities each month), with the effect of such quantitative easing showing in excessively depressed real yields (in normal times, a plunge in real yields would be taken as a warning that the global recovery is under threat!) and higher equity valuations. Eventually, though, the Fed will soon have to start bond tapering and later raise short-term interest rates to keep inflation in check. At that point, the Treasury market will finally face tougher competition. Clearly, current quantitative easing has sustained the bull market in bonds and equities beyond what is consistent with longer-term fundamentals!

Additionally, the Federal Reserve and Chair Jerome Powell have come under fire in past months for seemingly ignoring the spike in inflation. The latest salvo came a week back, when Senator Joe Manchin (the West Virginia lawmaker and most powerful Joe in Washington, as this conservative Democrat exerts unusual power in a Chamber where his party controls exactly half of the seats) urged Powell to start pulling back on the Fed’s $120 billion in monthly bond purchases aimed at providing stimulus. Failing to do so “*will lead to our economy overheating and to unavoidable inflation taxes that hard-working Americans cannot afford*,” Manchin wrote in a letter he made public. Mr. Manchin also criticized the continuation of "*policy responses tailored for an economic depression,*" an argument that increasingly resonates with people who don’t hold a PhD degree in economics (that should also be addressed to the US Senate, with their recent passage of an additional $1 trillion infrastructure bill!) With various measures of inflation continuing to surge, Powell has defended the Fed's stance by saying he was more concerned about the more than 6.0 million Americans who were still out of work because of the pandemic. But as last Friday's strong jobs report showed (943,000 new jobs created in July, the unemployment rate falling from 5.9% to 5.4%, whilst average hourly earnings rose 4% YoY, up from the pre-pandemic five-year average of 2.7%), Powell can no longer hide behind this excuse.

Solid job and inflation readings over the past few days make the Kansas City Fed's annual policy retreat in Jackson Hole, Wyoming later this month (August 26-28th) all the more important; This event is known for signalling big changes in monetary policy and Powell has confirmed he will speak at the conference. Afterwards, investors will get ready for the next gathering of the policy-making Federal Open Market Committee that starts on September 21st, which is when the central bank will most likely lay out when it will start tapering its bond purchases and by how much.

My best advice for this afternoon is that investors would be wise to take advantage of the recent market rally and take some money off the table before the Fed's largesse soon ends!

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