Weekly Market Summary

July 16th, 2021

In Fed Chair Jerome Powell We Trust!

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Another day, another hotter-than-expected inflation reading and Fed dovish tilt - and the stock market keeps recording new highs whilst government bond yields remain depressed (alternatively "*repressed*"!)

But it was surely not supposed to go like this (to think I spent the past 28 years closely monitoring financial markets and strategizing differently 😊). Rising producer and consumer prices (in the 12 months through June, PPI has surged 7.3% for its biggest year-on-year rise since November 2010; consumer prices, on the other hand, have increased 5.4% from a year ago - the highest 12-month rate since August 2008!) were expected to trigger a large jump in yields and act as a drag on the value of future earnings, particularly for the duration-heavy technology sector. However, for everyone following the price action in markets over the past week, a very different picture has emerged: Mega-cap tech stocks are once again dominating and accounting for nearly most gains in equity indices while the buy-the-dip mentality prevails in fixed-income markets (S&P 500 last at 4,360 - near record levels - and UST 10-year yields hovering around 1.30%).

In other words, even the strongest price pressures in over a decade have been unable to shake portfolio managers' current bullish outlook for both stocks and bonds. The reason? Investors have been content to buy into the Federal Reserve's party line that policy makers would look past what they view as transitory inflation. US Fed Chair Jerome Powell hammered that message home again on Wednesday and Thursday, arguing that the "*substantial further progress*" needed to begin scaling back the central bank's massive monthly asset purchases still has not been met! "*At our June meeting, the Committee discussed the economy's progress toward our goals since we adopted our asset purchase guidance last December,*" Powell told the House and Senate Financial Services Committee. "*While reaching the standard of 'substantial further progress' is still ways off, participants expect that progress will continue*." That dovish message provided the green light to the likes of Apple Inc., Alphabet Inc. and Netflix Inc. to power ahead, lifting the S&P 500 higher (to infinity & beyond).

"*Forget Inflation, Enjoy Markets' Bull Run!"* seems to be the market's new motto. Yet, wise and rational critics (pick me 😊) assert that ultra-easy monetary policy alongside massive government spending (Senate Democrats agreed this week on a new $ 3.5 trillion top-line spending level for a bill that would carry most of President Joe Biden's economic agenda into law without Republican support) is overheating the US economy - growing its sensitivity to interest rate rises and addiction to low yields. Let's not forget it: Fed policies (as well as irrational investors' behaviour) caused the dotcom bubble in the 1990s; it later caused the pre-Lehman subprime bubble. Whatever Mr. Powell professes, US central bankers (and their ECB, BOJ, BOE colleagues across the globe) have already baked another crisis into the pie with too much cash kicking about and forcing bond, commodity, equity and house prices ever higher (in other words, infinite money chasing finite assets!)

Stephen Stanley, chief economist at Amherst Pierpont Securities in New York, believes the Fed policy committee is "*in the middle of making a serious policy error*." "*The inflation crescendo is building everywhere except within*" the Federal Open Market Committee, the Fed panel that sets interest rates, he wrote in a note to clients. "*Companies across virtually all sectors of the economy are seeing sharp input cost increases and are passing them along with far more success than they have seen in decades.*" Other economists and strategists agree; In their opinion, the so-called secular forces that have kept inflation low over the past few decades (namely globalization, demographics and the rise

of e-commerce) have lately begun to reverse in ways that the pandemic has intensified. "*The factors that were playing a significant role in that low-inflation environment last cycle are beginning to fade*," said Sarah House, director and senior economist at Wells Fargo. "*That means either inflation will run higher in the years ahead or the Fed will have to keep monetary policy tighter than it otherwise would to meet its 2% inflation target*," Ms. House added.

For now, the market trusts Fed Chair Powell will keep the punch bowl in place (Powell's "*transitory*" inflation was originally assumed for 2-3 months but seems to have turned lately into a 6-9 month time span, with the Fed Chair simply "*wishing, hoping and praying*" that inflation goes away – according to DoubleLine Capital CEO Jeffrey Gundlach). Still, the real question is how long it will continue believing that the latest crisis response is not gradually triggering the next downturn. Repeatedly, monetary policies introduced by the US Federal Reserve in response to a crisis have set in motion the next monetary policy mistake and economic catastrophe. To avoid this, policymakers would have to dare return to countercyclical economic policies, those that become neutral or restrictive again once the economy enters into growth periods (specific rules and guidelines, not just thinking how to interpret high inflation, "*night and day*" - as Powell suggested in his latest testimony 😊)

This afternoon, Treasury Secretary Janet Yellen and Federal Reserve Chair Jerome Powell are scheduled to discuss the hot U.S. housing market and the risks it could pose to the financial system at a meeting with fellow regulators. The aim of the closed-door session: To make sure the U.S. is not vulnerable to a crisis akin to the one it suffered more than a dozen years ago, when the bursting of a property-price bubble drove top banks to the brink of insolvency and the economy into a deep recession. Today's session will be the first time that Yellen's FSOC will discuss concerns about the housing market in a substantial way, according to people familiar with the matter. The Treasury is increasingly aware of the dangers that a sudden relapse in property prices could pose to the economy after a sharp run-up on the back of a low inventory of homes for sale. That follows questions raised by Larry Summers, a senior Treasury Department official throughout President Clinton's administration and former director of the national Economic Council for President Obama, in relation to the reasons that are pushing the Fed to continue to buy mortgage-backed securities monthly while home prices are skyrocketing!

In other major news, it appears that the United Arab Emirates has made progress in resolving its standoff with OPEC+, nearing a compromise that could give the country a more generous output limit next year and allow the whole group to pump more oil in the coming months. The talks, involving the UAE and Saudi Arabia, are still ongoing and any deal would need the support of other OPEC+ nations, according to delegates familiar with the discussions. Last week, the Organization of Petroleum Exporting Countries and its allies were forced to abandon a tentative deal to boost oil production in monthly instalments of 400,000 barrels a day because of last minute objections from the UAE. If the compromise is ratified at the Group's next meeting - for which there is still no date - it could potentially open the way to higher output. Without extra output from OPEC+, the International Energy Agency (IEA) warned last Tuesday that the oil market will "*tighten significantly*" and potentially damage the economic recovery. Brent crude prices were last trading at $73.75 a barrel, with the recent drop attributable to the resurgence in covid cases globally as well as the risk that UAE's demands could open a "*Pandora's Box*" for OPEC+ as other members seek better terms to redress grievances of their own.

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