Weekly Market Summary

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Killing Me Softly With his Complacency … Killing Me Softly with his Words!!
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Makers of monetary policy, also referred to as central bankers, typically implement interest rate policies (and lately Quantitative Easing operations) based on a set of observed and un-observed variables. The former includes important economic releases such as GDP growth, CPI, Non-Farm Payrolls / Unemployment Rate, Consumer Confidence, Housing, whilst the latter refers to financial parameters such as u*, r*, y*; These are, respectively, the lowest unemployment rate consistent with stable inflation, the neutral interest rate (neither stimulating nor detracting from growth), and the highest level of GDP consistent with the size and productivity of the labor force.

At times, however, the world's central banks are in danger of storing up problems for later by simply focusing on short term actions to ensure financial variables improve fast and economic expansion stays on track. In other words, cutting already low interest rates or boosting money supply excessively to bolster a sagging economy risks fueling asset bubbles that may prop up zombie companies or eventually burst, further dragging down growth as time progresses. More importantly, they also encourage a dangerous built-up in leverage that poses a grave danger for the future health of the world economy.

Take for instance the 2008 financial crisis, which was an "*avoidable"* disaster caused by widespread failures in government regulation, corporate mismanagement and reckless risk-taking by Wall Street - according to the conclusions of a federal inquiry at the time. The panel that investigated the crisis – the Financial Crisis Inquiry Commission - faulted two administrations, the Federal Reserve and other regulators for permitting a catastrophic blend: Careless mortgage lending, the excessive packaging and sale of loans to investors and risky bets on securities backed by those loans. "*The greatest tragedy would be to accept the refrain that no one could have seen this coming and thus nothing could have been done*," the panel wrote in the report's conclusions. *"If we accept this notion, it will happen again*." And whilst it accuses several financial institutions of greed, ineptitude or both, some of its gravest conclusions concern government failings. As to the central bank's responsibility, the report finds fault with two Fed Chairmen: Alan Greenspan, who led the central bank as the housing bubble expanded, and his successor, Ben S. Bernanke, who did not foresee the crisis but played a crucial role in the response; It criticizes Mr. Greenspan for advocating deregulation and cites a "*pivotal failure to stem the flow of toxic mortgages*" under his leadership as a "*prime example*" of negligence.

Back in November 2017, President Donald Trump's official choice for a new US Fed Chair settled on Jerome Powell, a member of the Federal Reserve Board of Governors and a former investment banker at Carlyle (i.e. a seasoned central banker with a solid business background). During the ceremony in the White House Rose Garden, Mr. Powell talked up the strength of the US economy as he pledged to guard against financial market risks. "*In the years since the global financial crisis ended, our economy has made substantial progress toward full recovery*," Powell noted. "*By many measures we are close to full employment, and inflation has gradually moved up toward our target. While post-crisis improvements in regulation and supervision have helped us to achieve these gains, I will continue to work with my colleagues to ensure that the Federal Reserve remains vigilant and prepared to respond to changes in markets and evolving risks."*

And Vigilant they Stayed … Up until that Glorious December 19th, 2018 FOMC Meeting!

In a series of weekly market updates, released in late 2018 ("*Caught between a Stubborn Federal Reserve & a Mad President? Join the Club!*" & "*Should One Side with US President Trump or His Fed Chair in Relation of Recent Market Turmoil? Think Twice Before making a Final Call?*" – both available on GIB's website, www.gib.com, under the Treasury section), I noted that Jerome Powell & his Federal Reserve colleagues had for once looked past market fury and political pressure – unanimously voting to hike the US overnight benchmark Fed Funds rate by 25 bps, even as market expectations for a hike had largely dwindled on account of depressed equity/oil prices and weaker global economic data. In his ensuing press conference, Chairman Powell had emphasized that whilst the Federal Reserve takes financial conditions into account when setting policy, they are only one of many factors it considers. My take, back then, was that Mr. Powell was right in reminding everyone that the Federal Reserve is independent from Wall Street as well as politics; At last, here was a Fed Chair willing to walk away from the Fed's unofficial third mandate (i.e. making sure asset prices rise as the market wants, also known as the Fed's Put), raising hopes that Federal Reserve officials under his leadership would stick to their guns and continue running monetary policy in a way that benefits the US & global economy, rather than opt to adjust short and long term rates in a way that benefits greedy investors and rewards deceptive hedge fund managers!

Fast Forward to 2021 - Meet the "New" Jerome Powell!

Federal Reserve Chair Jerome Powell recently said that he has nothing but affection for his work, suggesting that the 68-years old central bankers could be open to a second term if asked by newly elected US President Biden. "*I love my job … It's a chance to do work that I think helps people. I have great colleagues, and the subject matter is endlessly interesting and important. I really do enjoy the work*."

At a previous appearance with reporters on January 27th, after the Fed's latest Federal Open Market Committee Meeting ("FOMC"), Mr. Powell called financial stability vulnerabilities overall "*moderate*." He also argued that the increase in equity prices in recent months had been driven more by fiscal policy (a large fiscal package he had repeatedly called for!) and the dissemination of vaccines, rather than by the Fed's easy monetary stance. The Fed Chair had been very outspoken lately on the need to keep rates very low even if inflation tops the 2% target, and that he would let unemployment run lower than his predecessors had tolerated in the past. "*We will not tighten monetary policy solely in response to a strong labor market,*" Powell said in explaining the Fed's new framework earlier this month.

Yet, according to minutes of the January 27th FOMC gathering, Federal Reserve staff members had given a more worrisome assessment of the risks to financial stability than the one presented publicly by Chair Jerome Powell, telling policy makers that vulnerabilities on balance were "*notable*." The Fed's appraisal of financial stability risks is important as it can play a vital role in determining the central bank's stance on monetary policy and its approach to financial regulation. If policy makers consider market complacency to be extremely elevated, they can tighten rules governing banks or even raise borrowing costs to try and reign further excesses.

Speaking of Fed and market complacency, it appears that global investors are the least fearful they have been in two decades, and perhaps the greediest – according to a JPMorgan Chase & Co. gauge of cross-asset complacency that is based on valuations, positioning and price momentum. Some of that get-rich-quick spirit has already been in display in 2021 from Bitcoin's surpassing the $50,000 mark to the craze for cannabis firms and speculative warfare over penny stocks. Since the beginning of the year, global equities have added more than $7.0 trillion, digital currencies have ballooned to a market value of $1.5 trillion and high-yield bond sales are gathering in records! "*We've been comfortable advising investors to stay long most markets*," JPMorgan strategists led by John Normand wrote in a February 12th note to clients, "*When growth is above trend, monetary policy is ultra-loose and fiscal policy is on overdrive, markets ten to exhibit the financial variant of Newton's Law: They stay in motion until acted upon by another force!*"

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