Weekly Market Summary

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A Strong Sense of Deja-Vu! Could This Time Be Possibly Different?
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Déjà Vu is a French term (translates literally to "*already seen*") that describes that strange sensation you have already experienced something, even when you believe deep inside that you never have! Experts generally agree this phenomenon probably relates to memory in some way; If it only happens to you once in a while, then probably you don't need to worry; However, if it becomes somewhat of a regular experience, then most likely it is time to adopt stress-relieve measures and get plenty of rest (in other words, refrain from closely following irrational financial markets! 😊)

Back in the 90s, former Federal Reserve Chairman Alan Greenspan, a prominent financial figure (or possibly the person most responsible for the enormous economic damage caused to financial markets in recent history), stood as the strongest advocate of innovative financial contracts (also labelled "*financial weapons of mass destruction, carrying dangers that are potentially lethal*" by legendary investor Warren Buffet). For more than a decade, Dr Greenspan fiercely objected whenever derivatives came under scrutiny in Congress or on Wall Street. "*What we have found over the years in the marketplace is that derivatives have been an extraordinarily useful vehicle to transfer risk from those who shouldn't be taking it to those who are willing to and are capable of doing so*," Greenspan told the Senate Banking Committee in 2003. "*We think it would be a mistake to more deeply regulate the contracts*," he added. But other prominent economists and investors hold a starkly different view on this matter and the role that Greenspan played in setting up regular market unrests during his successive terms as Chair of the Board of Governors of the Federal Reserve. "*Clearly, derivatives are a centerpiece of various financial crisis, and Greenspan was the leading proponent of the deregulation of derivatives*," according to Frank Partnoy, a law professor at the University of San Diego and an expert on financial regulation. Simply put, Alan Greenspan had helped enable an ambitious American experiment in letting market forces run free, and the US economy / taxpayers had always been left afterwards confronting the damaging consequences.

Then, there is Treasury Secretary Janet Yellen! Previously, Dr Yellen took office as Chair of the Board of Governors of the Federal Reserve System in February 2014 for a four-year flawless term that ended in January 2018. Despite being the first woman to lead the US central bank, she too was far from perfect; In a 2005 speech in San Francisco, Yellen argued against deflating the housing bubble because "*arguments against trying to deflate a bubble outweigh those in favour of it*" [Oops … Wrong!] and predicted that the housing bubble "*could be large enough to feel like a good-sized bump in the road, but the economy would likely be able to absorb the shock*" [Oops.. Wrong Again!]. Still the best to come is the following. From the New York Times - which captured a moment of a 2010 FCIC hearing - we get the following count: Ms. Yellen told the Financial Crisis Inquiry Commission in 2010 that she and other San Francisco Fed officials pressed Washington for new guidance, sharing the problems they were seeing. But Ms. Yellen did not raise those concerns publicly, and she said that she had not explored the San Francisco Fed's ability to act unilaterally, taking the view that it had to do what Washington said. "*For my own part*," Ms. Yellen said, "*I did not see and did not appreciate what the risks were with securitization, the credit ratings agencies, the shadow banking system, the SIV's — I didn't see any of that coming until it happened ...I guess I thought that similar to the collapse of the stock market around the tech bubble, that most likely the economy could withstand [the housing collapse] and the Fed could move to support the economy the way it had after the tech bubble collapsed*". Her startled interviewers noted that almost none of the officials who testified had offered a similar acknowledgment of an almost universal failure. Clearly central bankers' complacency had shifted to outright delusion!

Fast forward to Wednesday 17th March 2021 - a date to remember!

Federal Reserve officials kept short-term borrowing costs and asset purchases unchanged at their March 17th FOMC meeting (US o/n Fed funds rate still in a 0.00% -- 0.25% range & monthly bond purchases unchanged at $120 billion) and continued to project near-zero interest rates at least through 2023 despite upgrading their US economic outlook (employment, growth and inflation forecasts for the coming 3 years) and the mounting worries in financial markets. "*The strong bulk of the Committee (FOMC) is not showing a rate increase during the forecast period* (i.e. till end 2023)," Powell told a virtual press conference following the Fed decision, adding that the time to talk about reducing the central bank's asset purchases was "*not yet*." Still, seven of 18 officials predicted higher rates by the end of 2023 compared with just five at the December meeting, showing a slightly larger group who projects an earlier start than peers to the withdrawal of ultra-easy monetary policy. Asked about the recent surge in yields, Powell noted that it was "*important conditions continue to remain accommodative*" and that he would be personally concerned by "*disorderly markets*," repeating a line he had used earlier this month.

Massive fiscal support and widening vaccinations that has started helping many US states re-open have buoyed investor expectations for inflation and higher interest rates, propelling long-term Treasury yields higher as the Federal Reserve and federal government keep adding further stimulus (10-year US Treasury yields shortly breached 1.75% on the upside and were last trading at 1.70%). Still, Chair Powell and his fed lieutenants don't seem to bother with the emotional swings over inflation risk that is obsessing investors. "*The fundamental change in our framework is that we're not going to act pre-emptively based on forecasts for the most part and we're going to wait to see actual data*," Powell said. "*I think it will take people time to adjust to that and to adjust to that new practice, and the only way we can really build the credibility of that is by doing it*." In the choreography of tightening, the first step will be tapering the $120 billion of monthly asset purchases which the Federal Open Market Committee has pegged to "*substantial further progress*" on employment and inflation. Powell suggested that this will be a judgment, or in other words, a committee consensus that Powell himself is in charge of forming, and "*until we give you a signal, you can assume we are not there yet*," he said.

It appears that the Fed Chair is attempting something of a high-wire circus act as he pushes forward with his average inflation targeting regime. Effectively, Jerome Powell is trying to simultaneously stimulate the economy and raise inflation through unprecedented and extraordinary stimulative measures whilst keeping short-term interest rates (and to a lesser extent longer-term yields, via the Fed's bond purchases) artificially low. "*They have masterfully navigated this meeting by sounding somewhat optimistic on the economy, but staying dovish on the policy path*," Subadra Rajappa, interest rates strategist at Société Générale noted. Yet, policymakers and various cheering economists appear to have quickly forgotten the risks that brought about the 2008 financial crash. Central bankers may surely pretend they are able to calibrate this delicate extraction (higher growth & inflation / low interest rates), but this must be seen as a white lie and a necessary bluff to keep financial markets and traders reassured. The world economy has never been more sensitive to interest rate rises and addicted to low yields! As a result, it will be much harder in the future to exit current policies without producing a mini economic downturn or "God forbid" a major market meltdown, especially if equity and commodity markets continue rallying from current elevated levels. The Fed 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!

Ray Dalio, a renowned billionaire American hedge fund manager (Bridgewater Associates) and philanthropist, seems to think the same. "*The economics of investing in bonds (and most financial assets) has become stupid*," he said last Monday in a post on LinkedIn. "*Rather than get paid less than inflation, why not instead buy stuff – any stuff – that will equal inflation or better?*". "*There is just so much money injected into the markets and the economy that markets now behave like a casino with people playing with funny money.*"

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