Weekly Market Summary

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The Federal Reserve is One Step Away from Tapering! Long Live the US Fed!!

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In past months, the spread of the delta variant has continued to weigh on investor sentiment - with serious questions being raised about recent data coming out of the US and Israel showing that breakthrough infections among vaccinated people are on the rise. That fact has been interpreted to mean that the immunity conferred by vaccines is waning (a scary thought for everyone that felt very safe after receiving the two shots), though it could just as easily indicate nothing more than an inevitable rise attributable to the more infections covid variants. Additionally, scientists are raising serious questions about the wisdom of the push for Covid-19 boosters unveiled on Wednesday by President Joe Biden. Their argument is that it is hard to judge at this point whether extra shots for the vaccinated will be helpful or counterproductive until more of the data behind the decision become available (*i.e. does a rise in infections amongst the vaccinated lead to severe diseases and deaths?*)

Regardless, it surely appears that the delta variant has already worked its way into our heads, and into financial markets. On Wednesday morning, the Reserve Bank of New Zealand opted to shelve a widely anticipated 25 bps increase in its benchmark interest rate (last at 0.25%) after a national lockdown - announced because of a single case initially! – injected last-minute drama into a decision many economists previously thought was a sure thing. Whilst the country lived Covid-free for months and growth thrived, officials have now confirmed seven more infections the past few days. The shift was enough for the RNBZ to balk, adding in a statement the decision to hold rates at 0.25% was made "*in the context of the Government's imposition of level 4 COVID restrictions on activity across New Zealand.*" It takes a lot for a central bank to be blown off-course on a well-telegraphed change! Did the New Zealand central bank make the right call this week and should this rate hike deferral be a lesson for the rest of the world, given that there will always be plenty of time to get this right (that sounds very much like the senseless "*transitory*" inflation argument advanced by US Fed Chair Powell, especially following the release of an index compiled by the United Nation's Food and Agriculture organization that showed food prices in July were up 31% from the same month a year back!)

With a sense of caution well visible in markets, jittery investors turned their focus to the latest Federal Reserve report to gauge the future direction of US monetary policy. "*Various participants commented that economic and financial conditions would likely warrant a reduction in the pace of bond purchases in coming months*," minutes of the Federal Open Market Committee's July 27-28th gathering, released late Wednesday, showed. "*Several other indicated, however, that a reduction in the pace of assets purchase was more likely to become appropriate early next year*." US central bankers next meet September 21-22nd. Whilst the record shows that they might not yet have agreement on the timing or pace of tapering asset purchases (currently at $120 billion a month), most have reached consensus on keeping the composition of any reduction in Treasury and mortgage-backed securities purchases proportional. The minutes also showed split views on the durability of faster inflation as well as on key areas of policy makings. US Treasuries have persistently advanced since those minutes were released, with 10-year UST yields last at 1.22%, compared with about 1.30% before the release. The S&P 500 index of equities has slumped 1.65% from its record high closing of $,479 last Monday.

For a sense of just how uncertain and confusing the Fed outlook for the general economy and financial markets has become, look no further than Bank of America Corp.'s latest rates forecast. Strategists at the Charlotte, North Carolina-based bank see 10-year US government yields either sliding below 1.0% by year-end, or surging as high as 2.0%, from a current level of about 1.22% (makes a lot of sense if you ask me! 😊). For now, yields are likely to stay in their recent trading range until clarity emerges on the path of inflation, the impact of coronavirus variants and the Federal Reserve's policy response, the strategists (confused species 😊) said in a report Tuesday. "*The market seems to be sitting at the threshold of a major bifurcation of scenarios with material implications for likely rates ranges both near-term and over the current cycle,"* they wrote. The bank's rather wide forecast range illustrates just how low conviction in the market has gotten. JPMorgan Chase & Co. survey data released this week also sum up the market's stance well: The number of clients with a neutral position on Treasuries has spiked recently and is now at the highest since March. Effectively, the US Federal Reserve, along with other central banks across the globe, has continued to destroy true price discovery in the market by executing short squeeze after short squeeze (with well-timed and biased announcements; Moral hazard be damned!) – leaving financial markets in unchartered waters and setting the stage for a major economic and financial carnage once common sense and true market fundamentals prevail again!

In other major news, oil was headed for its longest stretch of daily declines since 2019 as the Fed's taper signal prompted a rally in the US dollar, and concerns continue to mount about global energy demand. Add to that reports that US shale output is rising again just as a resurgence in Covid cases eats away at driving demand, and you have the best recipe for a supply-demand imbalance resurgence! Oil traders have taken notice that more barrels are coming on the market than can be consumed, sending US crude prices on their longest losing streak since they went negative in April 2020 and underscoring views from the international Energy Agency that the virus will wipe away demand growth in major consumer markets. Brent and West Texas Intermediate (WTI) prices are down 2.0% this afternoon from the previous day closings, last trading at $65.20 and $62.30 per barrel respectively.

Next week's focus is on global preliminary PMIs (Purchasing Managers Indices) as markets look for signs of slowing growth momentum. However, the major feature and top interest for investors and fund managers will certainly be the Jackson Hole Symposium (26-28th August) as markets will look for hints and/or announcements from Jerome Powell with regards to future tapering of Fed asset purchases (remarks to be delivered virtually on Friday, August 27th at 10 am Washington time and the topic is the US economic outlook). The gathering of the world's top central bankers and economists has traditionally been scrutinized for signals on upcoming policy changes.

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