Weekly Market Summary

April 30th, 2021

You Know Inflation is Transitory When Copper Prices Hit $10,000 & Palladium Prices Trade at New Highs!
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To sound like a broken record means that an individual will repeat something over and over in an annoying fashion. The phrase comes from certain characteristics of a vinyl record; When the latter has a scratch, it may either skip over a section while playing or most likely repeat the same section over-and-over again until the needle is manually moved across the record. The expression *Sound Like a Broken Record*, first introduced in 1940, is an idiom that is based on a technology that most people no longer use (replaced over the years with compact disc, streaming music and iPods) and hence it will be interesting to monitor if it survives in the English language.

I, for a fact, have been sounding like a broken record lately (sincere apologies for that! 😊) – insisting that our clients should not assume/believe false market information to be correct simply after repeated exposure. After all, the sole purpose of the illusory truth effect (covered in a previous weekly market update - *Financial Markets' Myths or Truths? Take Your Pick!*) is to lead investors into believing that the repetitive statements made by US government and Federal Reserve officials are more truthful, especially as the sense of familiarity eventually overpower rationality. That in turn can and will result in investment mistakes and future losses.

Speaking of broken records, and for the nth time in past weeks, US Federal Reserve Chairman Jerome Powell and his lieutenants upgraded their assessment of the US economy at their April 28th FOMC meeting whilst insisting that the recent rise in inflation is "*largely reflecting transitory factors*." (the Cambridge Dictionary defines "*largely*" as "*to a great degree*" & "*transitory*" as "*lasting for only a short time*", leaving the door a tad open for a change of heart should future elevated inflation prove to be sticky 😊). The target range for the benchmark federal funds rate was kept at zero to 0.25%, where it has been since March 2020, and monthly bond purchases by the Federal Reserve left unchanged at $120 billion. Powell told a post-meeting press conference that the recovery has been faster-than-expected but "*it remains uneven and far from complete*" and the economy "*is a long way from our goals*."

Hours later, US President Joe Biden unveiled a sweeping $1.8 trillion plan to expand educational opportunities and child-care for families, funded in part (fingers crossed for now) by the largest tax increases on wealthy Americans in decades. This new proposal, called the American Families Plan, was the centerpiece of the president's first address to a joint session of Congress last Wednesday, following hist first 100 days in office. It is Biden's third major legislative proposal in as many months (and follows on the heels of a $2.25 trillion infrastructure plan that has yet to be taken up by Congress and a $1.9 trillion pandemic relief plan that Biden already signed into law on March 11th, 2021), combining $1 trillion in spending with $800 billion in tax cuts and credits for middle-and lower-income families (what will be known as the universal basic income concept in the not-too-distant future! 😊)

What surprises us, at this stage, is how disconnected central bank and government rhetoric / actions are from realities about confident economic and corporate prospects. Take for example first quarter growth in the US (1Q2021), which showed GDP expanding at a 6.4% annualized rate, with personal consumption – the biggest part of the economy – surging an annualized 10.7% (the second-fastest pace since the 1960s). Add to that the National Association of Realtors' latest update on the median price of an existing home in the U.S., displaying a rise to a record $329,100 in March – an increase of 5.92% from the previous month and a staggering 17.2% jump from a year earlier! Then you have corn, wheat, soybeans and vegetable oils: A small handful of commodities that form the backbone of much of the world's diet and they too are dramatically more expensive nowadays, flashing alarm signals for global shopping budgets! This week, the Bloomberg Agriculture Spot Index - which tracks key farm products - has surged the most in almost nine years, driven by a rally in crop futures. And if all that bullish news wasn't enough, copper has just topped $10,000 a metric ton for the first time since 2011 and palladium has climbed above $3,000 an ounce for the first time - whilst a bond-market gauge of US inflation expectations (the 10-year breakeven rate) soared yesterday to the highest level in eight years, topping 2.4%!!

The market has now fully embraced the V-shaped recovery and is looking through few short-term difficulties still in place. But it has also stumbled into another very supportive narrative which Mohamed El-Erian, president of Queens' college and chief economic adviser at Allianz, calls the "Win-Win." It simply does not matter if you are right or wrong on the V-shaped recovery because governments and central banks have done things in scale and scope that were simply unthinkable just 15 months back. Fearing financial instability that would cross contaminate the real economy, central banks have opted to do whatever it takes to try and regress financial volatility, including the purchase of high yield bonds! However, by supporting markets in a way that is disconnected from fundamentals, they are not only encouraging zombie companies to eat away the viability and dynamism of the global economy but also allowing the persistence of zombie markets that no longer price risk in a rational way!

The key challenge facing the Federal Reserve in the coming months will be how to reduce its stimulus without triggering unwarranted tightening of US and global financial conditions. The longer it waits to acknowledge the fast-improving economic fundamentals (fast rise in growth and inflation) and the need to seriously consider initiating a gradual and careful retreat from expansionary policies, the harder it will be to pull an eventual normalization without risking both significant market volatility and damaging what should and must be a durable and inclusive economic recovery. So far, Fed Chair Powell's response on that matter has been strong and definitive: "*No, it is not time yet! We've said we would let the public know when it is time to have that conversation, and we said we'd do that well in advance of any actual decision to taper our asset purchases*."

One can only hope/pray that Fed Chair Jerome Powell is right, and that his ardent doubters (pick me 😊) are wrong!

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