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Amadeus Wealth Alternatives
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In this week's recap: Federal Reserve says tapering likely in 2021, but no interest rate hikes for now.

Weekly Economic Update

Presented by Ed Papier, August 30, 2021

THE WEEK ON WALL STREET

The stock market powered to record levels last week amid talk of Fed tapering and a deceleration in new Delta variant cases.

The Dow Jones Industrial Average gained 0.96%, while the Standard & Poor's 500 increased 1.52%. The Nasdaq Composite index led, picking up 2.82%. The MSCI EAFE index, which tracks developed overseas stock markets, rose 1.39%. [1,2,3]

PUSHING HIGHER

Stocks surged to begin the week as investor sentiment improved on news of the FDA's approval of its first COVID-19 vaccine, a strong housing number and comments by the Federal Reserve Bank-Dallas president that he would support delaying tapering if the Delta variant spread worsened.

Stocks continued their climb through midweek, pushing the S&P 500 to another record high and the NASDAQ Composite above 15,000 for the first time. The S&P 500 and NASDAQ Composite closed the week at record highs following Fed Chair Powell's comments that Fed is likely to begin winding down its monthly bond purchases (aka tapering) by year-end, though no interest rate hikes were imminent. [4]

POWELL SPEAKS

At last week's Jackson Hole Economic Policy Symposium, Fed Chair Jerome Powell's speech on Friday provided further insights into Fed plans to begin tapering. Powell said that the Fed may likely commence tapering prior to year-end, adding that the wind down of bond purchases should not be seen as a signal for future rate hikes. Powell emphasized that labor market conditions remain short of the Fed's target for maximizing employment. He also reiterated his case for why inflation remains a transitory phenomenon. [4]

With a number of Regional Federal Reserve Bank presidents already supportive of tapering, investors may see more definitive steps coming out of next month's FOMC (Federal Open Market Committee) meeting.

THE WEEK AHEAD: KEY ECONOMIC DATA

Tuesday: Consumer Confidence.

Wednesday: ISM (Institute for Supply Management) Manufacturing Index. ADP (Automated Data Processing) Employment Report.

Thursday: Jobless Claims. Factory Orders.

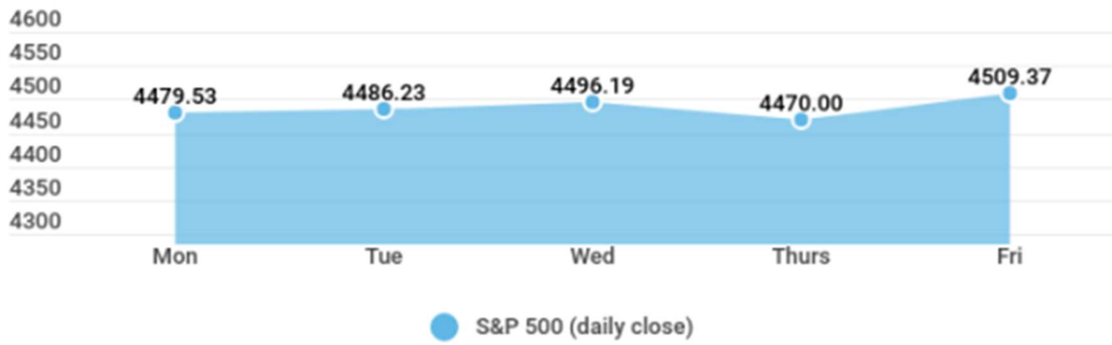
Friday: Employment Situation Report. ISM (Institute for Supply Management) Services Index.

QUOTE OF THE WEEK

"It's frightening to think that you might not know something, but more frightening to think that, by and large, the world is run by people who have faith that they know exactly what's going on."

AMOS TVERSKY

Market Index	Close	Week	Y-T-D
DJIA	35,455.80	+0.96%	+15.84%
NASDAQ	15,129.50	+2.82%	+17.39%
MSCI-EAFE	2,339.25	+1.39%	+8.93%
S&P 500	4,509.37	+1.52%	+20.06%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.31%	+0.05%	+0.38%

Sources: The Wall Street Journal, August 27, 2021; Treasury.gov, August 27, 2021
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, August 20, to Friday, August 27, close. Weekly performance for the MSCI-EAFE is measured from Friday, August 20, open to Thursday, August 26, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

"Inflation is the one form of taxation that can be imposed without legislation ." - Milton Friedman

One thing that hasn't returned yet from the late '70s is something called Stagflation. This situation occurs when economic growth stagnates combined with fast rising inflation, hence the term Stagflation.

We already have the inflation part of the equation down. Gas prices have shot straight up this year and are at their highest levels since 2014. The July Consumer Price Index recently posted a 5.4% year-over-year rise while the July Producer Price Index rose 7.8% from the year ago period. Renters certainly have taken it in the shorts recently. The median asking rent jumped 19% from the second quarter of 2020 to the second quarter of 2021, according to the U.S. Census Bureau. Zillow reports the average rent has moved up six percent in the first half of the year.

Some of these price increases may be " *temporary* " and " *transitionary* " as the Federal Reserve keeps assuring us. Some were indeed caused by the restarting of the global economy after the Covid-19 lockdowns. There also have been some severe global supply chain challenges that remain problematic.

And, of course, some of the surge of inflation has to do with bad government policies. The huge rise in rents was in part bolstered by a moratorium on evictions that has been in place for more than a year from where most lockdowns ended and was recently extended again by the administration.

Then there are the enhanced federal unemployment benefits which run out in two weeks nationwide. They have already ended in approximately half the states like Texas and Florida months ago, which have experienced higher job growth and lower unemployment rates than states like New York that have kept them in place. The jobless rate last month averaged 4.4% in the 25 states that ended benefits in June or July and 5.7% in the others that still have them in place.

For many jobs, workers have been paid as much or more to stay home than to work thanks to state and supplemental federal unemployment benefits. This has led to many businesses being short staffed or having to raise wages substantially for some of their personnel. This is especially true in lodging, restaurant and retail. The result has been to either compressed margins and/or result in higher prices to the consumer. Hopefully, as these benefits end in early September, job growth will accelerate and these impacts to wage price inflation go away.

Inflation is starting to take a major bite out of the consumer. Wage growth has risen four percent over the past 12 months, which is less than the recent 5.4% rise in the July CPI. Consumers have been kept buoyant through government stimulus checks, child tax credits, enhanced unemployment benefits, deferral of student debt payments, etc. However, as some of those programs go away and stimulus provided funds run out, the elimination of these programs is going to impact the consumer in a significant way. Since the consumer is approximately 70% of the economy, these reductions in income could represent where economic stagnation emanates from.

We have already seen some early signs of the latter. The August Consumer Confidence Survey from the University of Michigan recently fell sharply to a level of 70.2. This level is far under the consensus of 81.0 and down from the prior month's level of 81.2, bringing the measure down below pre-pandemic levels and from over 120 earlier in the year. It was one of deepest monthly drops ever measured. July Retails Sales recently showed a 0.3% contraction during the month instead of the 0.6% gain expected. Given how consumer's buying power has been eaten up by inflation so far in 2021, these data are hardly surprising.

Falling consumer sentiment combined with growing business restrictions and vaccination mandates in many cities such as San Francisco due to the Delta variant led to some significant downward revisions in GDP projections this week. Goldman Sachs recently substantially reduced to its 8.5% Q3 GDP forecast and now sees just 5.5% even as it warns of a " *stagflationary burst of even higher inflation* ".

The debacle in Afghanistan has already pulled the administration's approval ratings lower and makes the $3.5 trillion spending package Speaker Pelosi and Senate Leader Schumer have been pushing for less likely to pass in its current form due to the president's decreasing political capital. This is a positive on the stagflation front given the package contains huge tax increases and additional work disincentives which would likely further slow the economy.

The possibility of stagflation remains however, and if history repeats, would result in much lower earnings multiples for the overall market. [5]

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Know someone who could use information like this?
Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

CITATIONS:
1. The Wall Street Journal, August 27, 2021
2. The Wall Street Journal, August 27, 2021
3. The Wall Street Journal, August 27, 2021
4. CNBC, August 27, 2021
5. seekingalpha.com/article/4451238-stagflation-clear-and-present-danger