



212-697-3930

Edward Papier, CIMA[®], CFFep@amadeuswealth.com

In this week's recap: Markets tap brakes, but hold fast against downbeat news.

Weekly Economic Update

Presented by Ed Papier, August 22, 2022

THE WEEK ON WALL STREET

Stocks tumbled on Friday, sending stocks to a weekly loss after an otherwise quiet August week of trading.

The Dow Jones Industrial Average slipped -0.16%, while the Standard & Poor's 500 lost 1.21%. The Nasdaq Composite index declined 2.62% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, fell 0.88%. ^{1,2,3}

SUMMER RALLY HITS PAUSE BUTTON

The market rally that began in mid-June paused last week. Despite the week's losses, stocks exhibited resiliency in the face of a string of troubling economic news that included flat retail sales, weak housing numbers, an inversion in the yield curve, and tepid economic data out of China.

Nevertheless, stocks tumbled on Friday amid hawkish comments about future rate hikes, rising bond yields, and ahead of the annual meeting of global central bankers in Jackson Hole, Wyoming, in which Fed Chair Jerome Powell is scheduled to speak on August 26th.

EXPECT MORE RATE HIKES

Minutes from July's Federal Open Market Committee meeting indicated that additional rate hikes would be needed to help manage inflation. Fed officials did acknowledge that further rate hikes risked unintended economic weakness because of the time it takes for higher rates to work through the

economy. The committee indicated that they might slow rate hikes to determine the impact of previous rate increases. ⁴

The minutes also contained the Fed's latest economic forecasts, which projected inflation to decline faster than its June estimate due to a bigger economic slowdown in the year's second half. ⁵

THE WEEK AHEAD: KEY ECONOMIC DATA

Tuesday: Purchasing Managers' Index (PMI) Composite Flash. New Home Sales.

Wednesday: Durable Goods Orders.

Thursday: Jobless Claims. Gross Domestic Product (GDP).

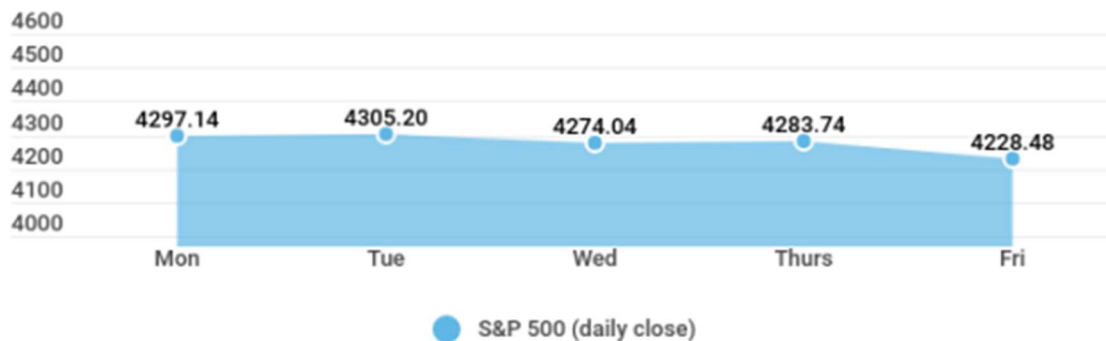
QUOTE OF THE WEEK



"Always assume incompetence before looking for conspiracy."

NICCOLÒ MACHIAVELLI

Market Index	Close	Week	Y-T-D
DJIA	33,706.74	-0.16%	-7.24%
NASDAQ	12,705.21	-2.62%	-18.79%
MSCI-EAFE	1,946.51	-0.88%	-16.68%
S&P 500	4,228.48	-1.21%	-11.28%



	Treasury	Close	Week	Y-T-D
	10-Year Note	2.98%	+0.14%	+1.46%

Sources: The Wall Street Journal, August 19, 2022; Treasury.gov, August 19, 2022
 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 12, to Friday, August 19, close. Weekly performance for the MSCI-EAFE is measured from Friday, August 12, open to Thursday, August 18, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

With inflation hitting 9.1%, what is off the table are those actions that propelled asset prices upwards for 14 years. In a dramatic Fed policy reversal, quantitative easing is gone, as are zero-percent interest rates. The economist Richard Duncan declared, *"Americans should prepare for a very hard landing."* How hard? Harder than we wish to imagine.

Between 2009 and the end of 2021, household sector wealth soared by 150%, increasing from \$60 trillion to \$150 trillion. To track the household sector wealth, the Fed's publishes an index called *Household Net Worth as a Percentage of Disposable Personal Income*. The index, which is commonly referred to as the Wealth-to-Income Ratio, has a 68-year average of 550%. It's interesting to observe how the index behaved in the face of past examples of record high stock prices. For example,

in March 2000, the index reached a then, all-time high of 615%. Notable for sky-high valuations of soon-to-be-failed companies such as Worldcom, Global Crossing, NorthPoint Communications, Alta Vista, InfoSpace, Pets.com, Ask Jeeves, and Excite, this was the apogee of the "Dot-Com bubble" that burst shortly thereafter. By October of 2002, the NASDAQ 100 had fallen by 78%.

How did the wealth-to-income ratio react? The index reverted to its long-term average of 550%.

In October 2007, the wealth-to-income ratio reached another all-time high of 670%. Over the next 18 months, the Dow fell by more than 50%. The index? It again fell right back to its long-term average of 550%.

As of June 30, 2022, the wealth-to-income ratio stood at a never-before-seen level of 818%. Richard Duncan has calculated that, due to the sell-off in stocks, \$16 trillion of wealth has been destroyed this year, dropping total household wealth to \$134 trillion. If over the next several months, the index once again falls back to its long-term average, we can expect an additional \$34 trillion in wealth destruction, taking total household sector wealth from \$150 trillion down to \$100 trillion. This is a likely outcome barring some extraordinary policy reversal by the Fed. But it is hard to imagine that happening given today's rate of inflation.

"Actual" inflation is likely much higher than the official number. According to Shadow Government Statistics, if inflation were calculated in the manner that it was back in 1990, we would have an "official" inflation rate of more than 17%. If you've visited a supermarket lately, you probably view the 1990 calculation as the more accurate measure.

It was in 1964 when total credit first exceeded \$1 trillion. Over the subsequent 50 years, total credit expanded 90-fold, rising to today's total of \$90 trillion. Since 1968, when Congress authorized the delinking of gold and the dollar, credit growth became the primary driver of economic growth (total credit = total debt). Over the past five decades, for the U.S. economy to avoid a recession, credit growth must have been at least 2% after inflation. Between 1952 and 2009, credit growth fell short of 2% after inflation nine times. In all nine cases, the U.S. entered an economic recession.

Duncan has pointed out that between the early 1980s and 2009, credit growth substantially outpaced economic growth. The surge in credit expansion blew the economy into a bubble leading to the 2008 crash. But from 2009 thru 2019, credit growth and economic growth were demonstrably weaker. The government responded to both the 2008 crash and the COVID-19 pandemic with massive fiscal stimulus. The Fed responded to both crises by slashing the federal funds rate to 0% and created unprecedented amounts of money. In both instances, the combination of huge fiscal stimulus and massive money creation twice prevented the economy from falling into depression. These policy responses created never-before-seen levels of wealth that drove consumption and economic growth.

From 2008 to 2021, total government debt nearly tripled, increasing to \$28.3 trillion. And the Fed's balance sheet increased by more than 800%. Classic economics may have predicted hyperinflation

resulting from these moves. But that was prevented by the massively deflationary impact of globalization. In fact, from 2009-2020, inflation averaged just 1.6%. That began to change in 2021. Duncan commented, *"The reemergence of high rates of inflation threatens to collapse the global economic bubble that has been forming for decades."* In fact, since the fourth quarter of 2020, credit growth has been contracting. Remember, when this happens, we can expect an economic recession.

What will the Fed and the government do now? This time, it is unlikely that the government will step in to save investors. Additional fiscal stimulus would likely drive inflation even higher. And in the face of high inflation, the Fed's response is money destruction, not money creation. Investors, therefore, are in a very tough place. ⁶

Ed Papier may be reached at 2126973930 or ep@amadeuswealth.com
www.amadeuswealth.com

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CITATIONS:

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