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Amadeus Wealth Alternatives
Your Compass to Alternative Investments

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In this week's recap: Market copes with unpleasant news; Powell surprises, Omicron concerns, and a less than stellar jobs report disappoints.

Weekly Economic Update

Presented by Ed Papier, December 6, 2021

THE WEEK ON WALL STREET

Stocks took investors on a wild ride last week as the Omicron variant and Fed comments upended market expectations.

The Dow Jones Industrial Average fell 0.91%, while the Standard & Poor's 500 stumbled 1.22%. The Nasdaq Composite index dropped 2.62% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, lost 0.62%.[1,2,3]

A TUMULTUOUS WEEK

Stock prices were volatile all week, swinging wildly after staging a modest recovery to begin the week. Omicron fears were not the only issue weighing on investors. Markets were also rattled by Fed Chair Powell's Congressional testimony stating conditions warranted considering an acceleration of its bond purchase taper schedule. Last week's roller-coaster action was epitomized on Wednesday when stocks rallied intraday by 520 points on the Dow Industrials, only to close the session lower by 460 points.[4]

Stocks staged a powerful rebound on Thursday on news that a second Omicron infection exhibited mild symptoms. Also helping the rebound was news that an agreement was reached in the House of Representatives to temporarily fund the government and word from President Biden that an economic lockdown was not in the plan to fight COVID this winter. Emblematic of the volatile week, stocks fell on Friday following a weak jobs report.

POWELL SURPRISES MARKETS

Markets easily digested the Fed's early-November announcement that it would pull the trigger on its bond purchase tapering program, but were caught off-guard by Powell's comments during Congressional testimony last Tuesday. Powell indicated that the Fed would discuss the option of accelerating its tapering plans at its next meeting.[5]

Powell cited the risk of higher inflation and substantial improvement in the labor market as warranting ending bond purchases a few months sooner than planned. Powell sought to move away from describing inflation as transitory, acknowledging that rising energy prices, higher rents, and strong wage gains could keep inflation elevated, though he maintained inflation would decline sometime in 2022.[5]

THE WEEK AHEAD: KEY ECONOMIC DATA

Wednesday: JOLTS (Job Openings and Labor Turnover Survey).

Thursday: Jobless Claims.

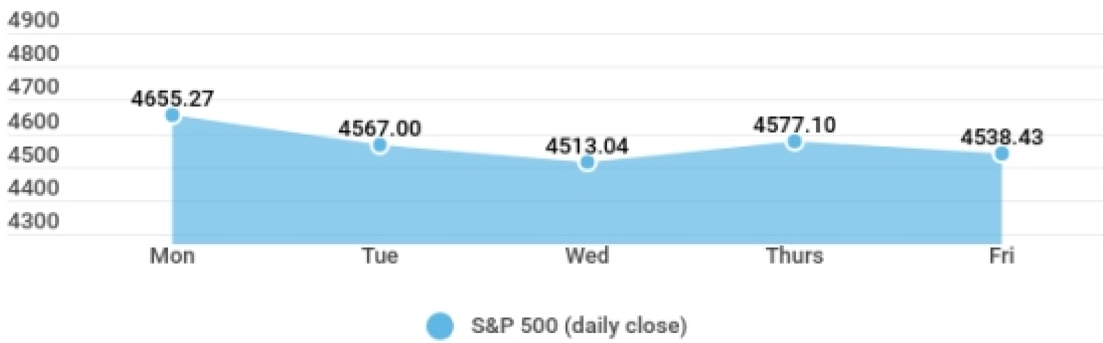
Friday: CPI (Consumer Price Index). Consumer Sentiment..

QUOTE OF THE WEEK

"It's easier to fool people than to convince them that they have been fooled."

MARK TWAIN

Market Index	Close	Week	Y-T-D
DJIA	34,580.08	-0.91%	+12.98%
NASDAQ	15,085.47	-2.62%	+17.05%
MSCI-EAFE	2,242.99	-0.62%	+4.45%
S&P 500	4,538.43	-1.22%	+20.83%



	Treasury	Close	Week	Y-T-D

	10-Year Note	1.35%	-0.13%	+0.42%

Sources: The Wall Street Journal, December 3, 2021; Treasury.gov, December 3, 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, November 26, to Friday, December 3, close. Weekly performance for the MSCI-EAFE is measured from Friday, November 26, open to Thursday, December 2, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

The Role of the Fed: There's no need to spend a great deal of time on this subject since everyone knows the story. But it has to be part of a memo that purports to discuss important changes that are underway.

Historically, the job of central banks has been to control the level of inflation and make sure the economy grows fast enough to create "full employment." In recent years, however, the Fed seems to have taken on the additional task of keeping the securities markets on an upward trajectory. This has been achieved through the radical lowering of interest rates and the injection of massive amounts of liquidity into the economy.

The Fed funds rate – the bellwether of short-term interest rates in the U.S. – was reduced to zero for the first time during the Global Financial Crisis of 2008-09. And it worked – what followed was the longest economic recovery in U.S. history. But rates weren't raised when the recovery was at its strongest, and when they finally were raised in 2017-18, the markets threw a tantrum and the Fed backed down, cutting rates instead.

Now the Fed funds rate is zero again, the markets are far higher than they were in the last decade, and we're seeing serious inflation. The Fed has announced that it's going to "taper" its stimulative program of bond buying, and it is widely expected that it will begin to raise interest rates next year. Will the impact on the economy be highly negative? Will the markets revolt again, and will a market correction convince the Fed to go back to a low-interest-rate regime? Will the Fed keep asset prices rising in perpetuity as the optimists think is now its job?

The expectation that the Fed can keep the economy and markets rising without interruption is too good to be true. The economy will likely perform best in the long run if it's a free-market economy, which does the best job of moving resources to their optimal use. As Richard Masson at Oaktree wrote in 2008, "Creative destruction and a functioning market economy assure change toward the best solution over time." We could use a free market in money.

Larry Goodman, president of the Center for Fiscal Stability, recently wrote as follows: Since 2010, Fed purchases of Treasury debt have funded as much as 60% to 80% of the entire government borrowing requirement. In other words, Fed actions have crowded out private-sector price discovery for more than 10 years, pushing yields to lows and stock prices to record highs.

In fiscal 2021, the Fed purchased $1 trillion in Treasury debt, and the Treasury drained $1.6 trillion from its savings account at the Fed. These actions covered nearly the entire budget deficit, equal to nearly all the pandemic-related government borrowing. Based on monthly estimates, there was actually a funding surplus this past summer. It is no wonder the 10-year Treasury yield reached a low of 1.17% in August despite high inflation rates. (*The Wall Street Journal*, November 18, 2021)

So guess what - the U.S. is still able to issue debt at low interest rates, a ringing endorsement of its creditworthiness from buyers. And who's the main buyer supplying that endorsement? The U.S.!

By the way, a few progressive Democrats have announced their opposition to the reappointment of Jerome Powell as Fed chair, because they think he's not active enough in addressing climate change. So now we have a Fed that's supposed to control inflation, foster growth, and employment, support markets, and fight climate change. How many roles can one institution have and still maintain a coherent effort? [6]

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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, December 3, 2021
2. The Wall Street Journal, December 3, 2021
3. The Wall Street Journal, December 3, 2021
4. The Wall Street Journal, December 1, 2021
5. Reuters.com, November 30, 2021
6. cmgwealth.com/ri/on-my-radar-the-role-of-the-fed/