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In this week's recap: Stocks retreat as inflation advances.

Weekly Economic Update

Presented by Ed Papier, July 19, 2021

THE WEEK ON WALL STREET

Despite a good start to earnings season and some solid economic data, worries of slower second-half economic growth led to a pullback in stock prices last week.

The Dow Jones Industrial Average fell 0.52%, while the Standard & Poor's 500 lost 0.97%. The Nasdaq Composite index sank 1.87% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, was flat (-0.06 %). [1,2,3]

STOCKS RETREAT

Stocks weakened amid an active week of news, including two important inflation reports, Congressional testimony from Fed Chair Jerome Powell, a string of economic reports, and the start of the second-quarter earnings season.

The earnings season began on a strong note as 95% of the first S&P 500 constituent companies to report checked in with "earnings above estimates" by an average of 22%. Despite these above-expectation earnings, stocks moved little on the results. [4]

Bond yields continued to trend lower amid Powell's testimony that monetary policy would remain unchanged. A decline in consumer sentiment fed worries of economic slowdown, leading stock lower and cementing losses for the week.

HOT INFLATION

The Consumer Price Index (CPI) jumped 5.4% in June, representing the biggest monthly gain since August 2008. The core CPI, which excludes food and energy, increased 4.5%, which was the fastest pace since September 1991. [5]

The CPI report was followed by the Producer Price Index, which surged 7.3% from a year earlier, outpacing May's jump of 6.6%. Higher wholesale prices were primarily attributed to increased commodity prices and labor costs. [6]

Fed Chair Powell, in Congressional testimony subsequent to these reports, reiterated his position that the accelerated inflation of recent months will be temporary.

THE WEEK AHEAD: KEY ECONOMIC DATA

Tuesday: Housing Starts.

Thursday: Jobless Claims. Existing Home Sales. Index of Leading Economic Indicators.

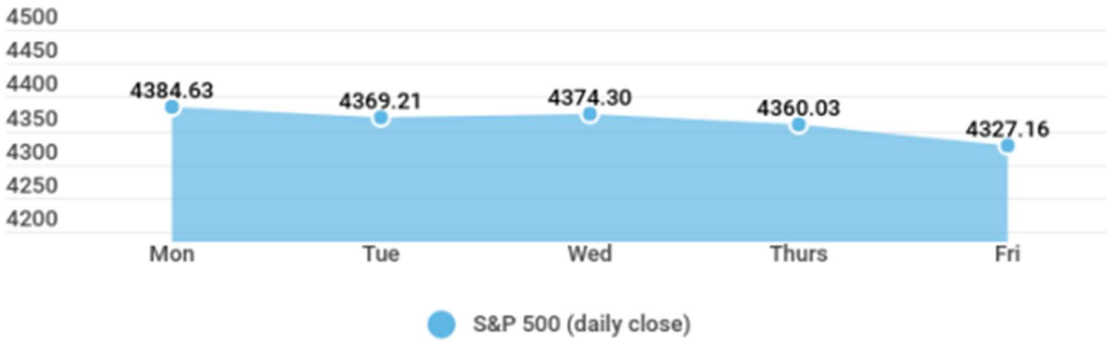
Friday: Purchasing Managers Index (PMI) Composite Flash.

QUOTE OF THE WEEK

"Whoever would overthrow the liberty of a nation must begin by subduing the freeness of speech."

BENJAMIN FRANKLIN

Market Index	Close	Week	Y-T-D
DJIA	34,687.85	-0.52%	+13.33%
NASDAQ	14,427.24	-1.87%	+11.94%
MSCI-EAFE	2,311.97	-0.06%	+7.66%
S&P 500	4,327.16	-0.97%	+15.20%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.31%	-0.06%	+0.38%

Sources: The Wall Street Journal, July 16, 2021; Treasury.gov, July 16, 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, July 9, to Friday, July 16, close. Weekly performance for the MSCI-EAFE is measured from Friday, July 9, open to Thursday, July 15, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

Inflation, deflation—where are we heading? Last week, Jamie Dimon, chairman and CEO of JPMorgan, commented, "The inflation could be worse than people think. I think it'll be a little bit worse than what the Fed thinks. I don't think it's only temporary." On Wednesday, BlackRock chairman and CEO Larry Fink said, "It is my view that inflation is going to be more systematical. I believe it is a fundamental, foundational change in how we navigate economic policy…now we are saying jobs are more important than consumerism…. That is going to probably lead to systematically more inflation." [7]

Economist Dr. Lacy Hunt alternatively argues that deflation, not inflation, will win the day going forward. [8] He predicts that much of the sudden sharp rise we are seeing in input prices will be transitory. The current debt, demographic and technological trends are very deflationary. To those who think that the flood of new $trillions in monetary and fiscal stimulus will trump these, Dr. Hunt shows how much of that money just isn't making it out into the real world. Instead, it's pooling up within the banks as massive excess reserves and the banks aren't lending enough of it out, as shown by the plunge in the Total Loan to Deposit Ratio.

"The weakness in the LD (loan/deposit) ratio, as well as the money multiplier, confirm that the banking system is not in a position to assist the Fed in achieving their goals for economic activity and inflation. The obstacle for both variables to function normally is the massive debt overhang."

"Lower for longer," Lacy concludes:

- The current economic growth and inflation rates of 2021 will be the highest for a very long time to come.
- The main obstacle to a return to sustained growth in the standard of living - extreme over-indebtedness - was dramatically worsened by the multiple rounds of fiscal stimulus, which has caused the temporary improvement in economic growth and inflation in the second quarter.
- No pathway out of this trap exists as long as the overreliance on debt remains the only tool of monetary and fiscal policy.
- The situation is no different in Japan and Europe. Thus, while long Treasury yields can increase over the short run, the fundamentals are too weak for yields to stay elevated.
- More debt does not cure a subpar economy mired in a debt trap.

Given the above, his view is that the trend in long-term Treasury yields remains downward.

While the money supply (M2) has skyrocketed over the past year, money velocity is lower than it has been in over a century. This observation reveals an important limit of central bank policy. There is a point of diminishing return at which the Fed is truly "pushing on a string". It can shove as much new money into the banking system as it wants, but there's no guarantee that money will make it out into the economy.

And as some of that money invariably finds its way into asset prices, causing them to inflate, corporate executives have a mal-incentive to invest their capital into financial assets vs productivity. The end result is that overall economic productivity is depressed.

Dr. Hunt concludes with a warning: deflation will win out *unless the rules are changed* . If the Fed's mandate is altered, as some are now advocating for, to become the "spender of last resort" and able to monetize its liabilities as legal tender, then that would change the game and runaway inflation would ensue.

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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, July 16, 2021
2. The Wall Street Journal, July 16, 2021
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7. www.cmgwealth.com/ri/on-my-radar-lower-for-longer/
8. nationandstate.com/2021/06/20/lacy-hunt-warns-fed-has-reached-its-limit-sees-inflation-today-deflation-tomorrow/