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In this week's recap: Positive labor numbers lead stocks to a modest gain.

Weekly Economic Update

Presented by Ed Papier, June 7, 2021

THE WEEK ON WALL STREET

A strong, but not too strong, employment report sparked a rally on the final day of trading, propelling stocks to a modest gain for the week.

The Dow Jones Industrial Average climbed by 0.66%, while the Standard & Poor's 500 added 0.61%. The Nasdaq Composite index increased by 0.48%. The MSCI EAFE index, which tracks developed overseas stock markets, edged up 0.10%. [1,2,3]

ROTATION CONTINUES

Markets have traded sideways since mid-April, though beneath the surface has been ongoing sector rotation. Last week continued that trend.

While stocks ended on a strong note, the performance of industry sectors varied widely. Energy, real estate, utilities, and a number of reopening stocks performed well, while consumer discretionary, communication services, healthcare, and technology stocks lagged.

The Fed announced on Wednesday that it will soon begin selling the corporate bonds and exchange-traded funds it had accumulated during the pandemic, an action that some observers interpreted as a harbinger of an approaching change in its easy-money policies. But the below-consensus May job figure on Friday buoyed investors who believe the Fed will not change course soon. [4,5]

LABOR MARKET RECOVERY

It was a good week for the labor market. Initial jobless claims fell to pre-pandemic levels (385,000), ADP (Automated Data Processing) reported a big jump in private-sector hiring (978,000), and the monthly employment report saw nonfarm payrolls increase by 559,000 in May – a healthy increase even though it fell short of some expectations. The unemployment rate declined to 5.8% from April's 6.1% level. [5,6,7]

Friday's report showed that total employment numbers still remain about seven million jobs below their pre-pandemic levels. It also showed an acceleration in wage gains, which rose 2% year-over-year following the 0.4% gain in April. [8]

THE WEEK AHEAD: KEY ECONOMIC DATA

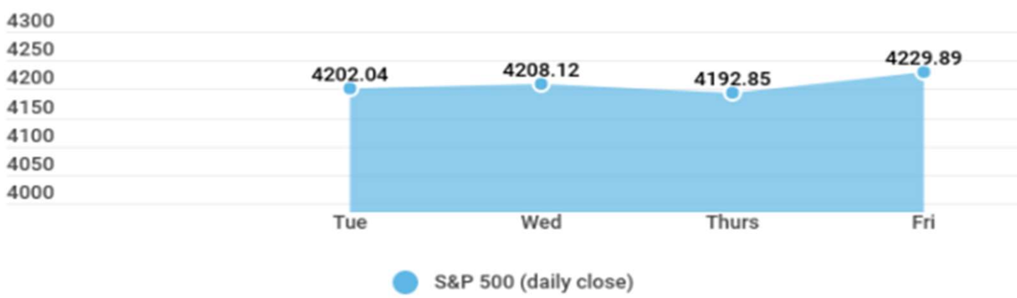
Tuesday: Job Openings and Labor Turnover Survey (JOLTS).
Thursday: Consumer Price Index (CPI). Jobless Claims.
Friday: Consumer Sentiment.

QUOTE OF THE WEEK

"There is only one good, knowledge, and one evil, ignorance."

SOCRATES

Market Index	Close	Week	Y-T-D
DJIA	34,756.39	+0.66%	+13.56%
NASDAQ	13.814.49	+0.48%	+7.19%
MSCI-EAFE	2,343.63	+0.10%	+9.13%
S&P 500	4,229.89	+0.61%	+12.61%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.56%	-0.02%	+0.63%

Sources: The Wall Street Journal, June 4, 2021; Treasury.gov, June 4, 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, May 28, to Friday, June 4, close. Weekly performance for the MSCI-EAFE is measured from Friday, May 28, open to Thursday, June 3, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

Fiscal stimulus, including the latest $1.9 trillion American Rescue Plan Act is a massive deficit, piled upon a mammoth debt, made possible by dollar debasement.

Extreme credit market intervention by the Federal Reserve is a prerequisite. So, too, is the denial of price inflation by the Bureau of Labor Statistics. Recent consumer price index (CPI) data reported the all items index increased 0.4% in February and 1.7% over the last 12 months. The combination of extreme credit market intervention and suspect inflation reporting is making a mockery of credit markets. Where to begin?

When you purchase a Treasury note you are lending money to the government for a specified period of time (i.e. 30 days to 30 years) at a fixed rate of interest or yield. The risk of default on Treasuries has generally been considered nonexistent. The federal government, with assistance from the Federal Reserve, can always print money to pay its debts. But this behavior isn't without risks because printing dollars to pay debts devalues the existing stock of the dollar. So, while the nominal return is preserved, the inflation adjusted return goes negative. In short, inflation destroys Treasury values for investors. To account for expectations of rising inflation, yields rise. But this presents another problem for long term Treasury investors.

When Treasury yields go up, Treasury prices go down. Over the last eight months, the yield on the 10-Year Treasury note has increased from 0.5% to over 1.54% – or 104 basis points. Treasury investors stand to face considerable losses. Moreover, as interest rates rise and borrowing costs become more expensive, several other things happen - high priced stocks become less attractive. In addition, higher borrowing costs make it harder for over leveraged corporations, state governments, municipalities, and Washington to roll over their debts.

When interest rates rise, explosive things can happen. There are financial blow ups. Long Term Capital Management, for example, in 1998. Or Lehman Brothers in 2008. Sometimes the stock market crashes like the Black Monday crash of 1987. There are many well-known examples.

At the moment, Fed Chairman Jay Powell says he wants inflation to run hot and that the Fed will hold the federal funds rate near zero until at least 2023. But what if the credit market has other thoughts? The yield on the 10-Year Treasury note has increased 104 basis points over the last 8 months.

The great monetary inflation has already happened. The great price inflation is picking up, regardless of what the Bureau of Labor Statics' CPI report says. Thus, it is certainly possible the yield on the 10-Year Treasury note could increase another 50-basis points come summer.

And by some analyst's estimation, we're about 50-basis points away from problems. The financial system, lured by a seemingly endless supply of cheap credit from the Fed is levered up to its eyeballs. When the yield on the 10-Year Treasury note eclipses 2.10%, something may blow. There could be corporate debt, hedge fund, and pension fund financial blow-ups galore. But these results are exactly what the Fed is trying to avoid. The Fed wants inflation without higher interest rates.

The Fed must expand its balance sheet – whatever it takes – and buy bonds with printing press money to keep interest rates from rising. In fact, the Fed is already pumping $80 billion per month into Treasuries and $40 billion per month into mortgage backed securities to suppress interest rates. Yet these Fed asset purchases will likely balloon to keep interest rates in check. Consequently, in addition to a debt crisis, the Fed is propagating a dollar crisis.

In Orange County CA's 1994 bankruptcy experience, the grand jury investigation found the investment manager relied upon a mail-order astrologer and psychic for interest rate predictions . Nowadays, we have the Fed's dots. And like astrology or psychic predictions, dot plots have nothing to do with the realities of inflation or a free functioning credit market. The Fed can resist our "50 points to disaster" situation with ever greater amounts of printing press money and they certainly will. It's the only way for the government to stay in business. But it doesn't take much imagination to see where the Fed's behavior leads. [9]

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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, June 4, 2021
2. The Wall Street Journal, June 4, 2021
3. The Wall Street Journal, June 4, 2021
4. The Wall Street Journal, June 2, 2021
5. CNBC, June 3, 2021
6. CNBC, June 3, 2021
7. CNBC, June 4, 2021
8. CNBC, June 4, 2021
9. economicprism.com/fifty-basis-points-to-disaster/