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In this week's recap: Tapering news, profits, and other encouraging data lifts stocks.

Weekly Economic Update

Presented by Ed Papier, November 8, 2021

THE WEEK ON WALL STREET

A Federal Reserve announcement on tapering, a fresh batch of corporate profits, and encouraging economic data lifted stocks to another weekly gain.

The Dow Jones Industrial Average rose 1.42%, while the Standard & Poor's 500 advanced 2.00%. The Nasdaq Composite index led, tacking on 3.05%. The MSCI EAFE index, which tracks developed overseas stock markets, added 1.58%. [1,2,3]

STOCKS POWER HIGHER

Stocks marched higher throughout the week, lifted by a succession of positive corporate earnings surprises, optimistic forward guidance by some companies, and healthy economic data. Continued strong third-quarter profits reinforced the narrative that businesses were able to meet strong consumer demand and maintain robust profit margins, despite the headwinds of inflation and supply-chain knots.

Investors were unfazed by the Fed's mid-week announcement that it would begin its bond purchase tapering plans, in part, because it had long been telegraphed and Fed Chair Powell's optimistic analysis of the current state of the economy. Also cheered was the announcement of a new COVID-19 antiviral pill and a powerful rebound in job creation, driving stocks to new heights to close out the week.

THE FED SPEAKS

In an eagerly awaited November meeting of the FOMC (Federal Open Market Committee), the Fed pulled the trigger on its plan to taper monthly bond purchases. Fed tapering will begin this month with reductions of $15 billion per month ($10 billion in Treasurys and $5 billion in mortgage-backed securities) that will end this pandemic-era policy response by July 2022. [4]

The Fed reiterated its belief that inflation remained transitory, though conceding it had underestimated its acceleration and persistence; it did not expect interest rates to be raised until after the completion of the tapering program. Powell expects inflation to stay elevated until mid-2022 when he anticipates supply-chain bottlenecks to clear. [5,6]

THE WEEK AHEAD: KEY ECONOMIC DATA

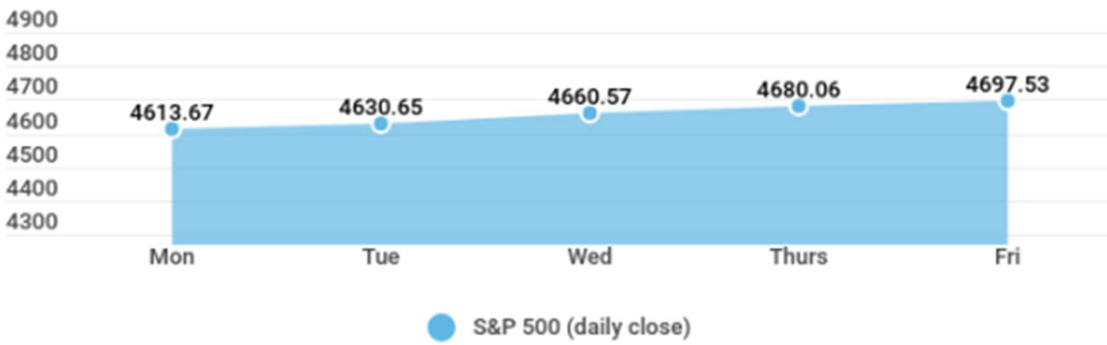
Wednesday: Consumer Price Index (CPI). Jobless Claims.
Friday: Consumer Sentiment. Job Openings and Labor Turnover Survey (JOLTS).

QUOTE OF THE WEEK

"The glory which is built upon a lie soon becomes a most unpleasant incumbrance...How easy it is to make people believe a lie, and how hard it is to undo that work again"

MARK TWAIN

Market Index	Close	Week	Y-T-D
DJIA	36,327.95	+1.42%	+18.69%
NASDAQ	15,971.59	+3.05%	+23.92%
MSCI-EAFE	2,372.46	+1.58%	+10.47%
S&P 500	4,697.53	+2.00%	+25.07%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.45%	-0.10%	+0.52%

Sources: The Wall Street Journal, November 5, 2021; Treasury.gov, November 5, 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, October 29, to Friday, November 5, close. Weekly performance for the MSCI-EAFE is measured from Friday, October 29, open to Thursday, November 4, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

Investors face a conundrum today as they examine the bullish and bearish cases for the market as we head into the end of the year. One of the biggest challenges investors always face is allocating capital to markets when they suspect a correction might occur. The concern is purely emotional as investors worry the market may continue to rise but can turn on a dime. Timing such movements is impossible.

In the longer term, it is only fundamentals that matter. So what is happening between the economic and earnings data is all you need to know if you are a long-term investor. Unfortunately, despite protestations to the contrary, most investors are not. The emotional biases of being either bullish or bearish, primarily driven by the media, keep investors from truly focusing on long-term outcomes. Instead, they either worry about the next downturn or are concerned about missing the rally. They often wind up making short-term decisions that negate long-term views. With these comments as a backdrop, let's look at the markets from both a bullish and bearish perspective. From there you can decide what to do next.

For the bullish case, there is 1) seasonality, 2) corporate balance sheets and 3) money flows:

1: With the recent correction in October now behind us, the market is entering into the *seasonally strong* period between November and May. While this period does not always provide positive returns, the statistical tendencies favor increased equity exposure owing in part to the corporate stock buyback window that opens on November 1st.

2: A significant source of liquidity over the last several years, and in this year, in particular, has been the record levels of cash utilized by companies to repurchase their shares. The latter has provided underlying support to asset prices as corporations provide a consistent bid for stocks. According to GS Research, November is the best month for buyback executions and November plus December combined is the best two-month period of the year for executions.

3: Of course, it is not just corporate share buybacks supporting asset prices currently, but record global inflows of capital is at a pace never before seen in history. Now at $982 billion, and counting, the flood of liquidity globally into equities is unprecedented.

However, while the bull's case is strong, the bears have equally valid arguments for remaining cautious. For the bearish case, there is the 1) The Fed taper, 2) Profit margins and 3) Weaking economic growth.

1: The most obvious support for the bearish view is the Fed reducing their bond-buying activity starting in November. While many have tried to argue that QE has no impact on financial markets, the psychological link between the Fed and the financial markets is apparent, the so-called "Fed Put". There appears to be a correlation between the monthly change in the S&P 500 and the Fed's balance sheet, a correlation sufficient to suggest a direct link between the markets and monetary policy. With such a high correlation, it is not surprising that periods of a contraction in liquidity corresponds with increased market volatility and corrections in the markets.

2: Another concern is the current surging level of inflation in the economy. Between supply line disruptions, inflationary pressures, and rising wages, corporations will face margin compression. There's a considerable risk to the bullish argument that earnings will fail to support currently high valuations. Peaks in real inflation-adjusted profit margins correspond with peaks in financial markets. However, with profit margins currently elevated due to the $5 trillion in pandemic relief in 2020, the current contraction in fiscal policy supports combined with higher inflation could well deteriorate profits into next year.

3: Markets can certainly rally on hope and optimism over the short-term, however there's is a high correlation between economic growth, revenue, and stock market returns in the longer term. At the beginning of Q2, the Atlanta Fed pegged economic growth at 13.5%. By the time GDP got reported by the Bureau of Economic Analysis, it was just 6.5%. The Atlanta Fed has ratcheted down Q3, which will get reported later this month, to just 1.2%. So far, while hopes are for more robust economic growth in Q4, there is a high probability of disappointment. For the bearish view, the implications of substantially weak economic growth suggests this impact on earnings will leave the bulls disappointed.

So what do you do? While there's enough to the bullish case to warrant additional equity exposure in the short term, the longer-term dynamics are bearish. But here is the crucial point – you don't have to choose since a long equity portfolio can be hedged with option spreads to protect on the downside. In any event, as our readers are aware, as Amadeus is an advocate for a healthy exposure to alternatives for investors who can allocate a portion of their portfolio to illiquid investments. The latter are typically not highly correlated with the stock and bond markets. [7]

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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, November 5, 2021
2. The Wall Street Journal, November 5, 2021
3. The Wall Street Journal, November 5, 2021
4. CNBC, November 3, 2021
5. CNBC, November 3, 2021
6. CNBC, November 3, 2021
7. zerohedge.com/markets/bullish-bearish-market-case