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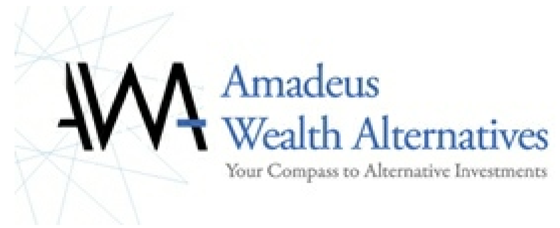

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In this week's recap: Despite Delta variant fears, stocks rise on strong jobs, strong earnings reports.

Weekly Economic Update

Presented by Ed Papier, August 9, 2021

THE WEEK ON WALL STREET

Overcoming jitters about the Delta variant and the reintroduction of mask requirements, stocks climbed higher on strong employment data and a fresh batch of strong corporate earnings.

The Dow Jones Industrial Average rose 0.78% while the Standard & Poor's 500 advanced 0.94%. The Nasdaq Composite index gained 1.11% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, picked up 1.61%.[1,2,3]

PUSH AND PULL

The crosscurrents of strong corporate profits and the rise in Delta variant infections led to a roller coaster week of price action, as markets alternated between daily gains and losses. By Thursday, however, investors appeared to grow more optimistic that the economic reopening was not under serious threat when back-to-back employment reports suggested that the economic recovery remained on track.

A favorable initial jobless claims report was enough to send the S&P 500 and Nasdaq to new all-time highs. Thanks to Friday's stronger-than-expected employment report, the S&P 500 managed to add to its previous record close, while the Dow Jones Industrial Average set its own record high. The more tech-centric Nasdaq, however, slipped off its highs.[4]

EMPLOYMENT BRIGHTENS

Last week reinforced the idea of an improving labor market. After a disappointing ADP (Automated Data Processing) National Employment Report that showed a slowdown in private-sector hiring, with just 330,000 new jobs added, subsequent employment data were much more encouraging.[5]

Thursday's report of a modest drop in initial jobless claims to 385,000 and a more substantial drop

of 366,000 in continuing claims was followed by a solid employment report on Friday, which showed employers had added 943,000 new jobs in July—the biggest jump since August 2020. This hiring increase shaved the unemployment rate to 5.4%, down from June's 5.9% rate.[6,7]

THE WEEK AHEAD: KEY ECONOMIC DATA

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

Wednesday: Consumer Price Index.

Thursday: Jobless Claims.

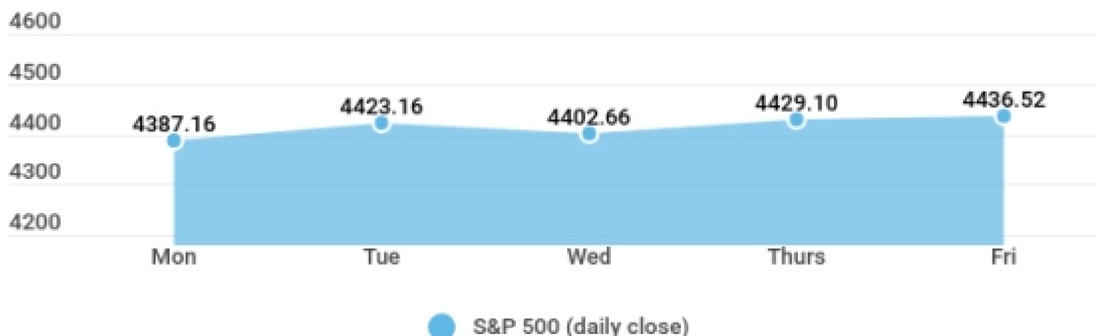
Friday: Consumer Sentiment.

QUOTE OF THE WEEK

"A great deal of intelligence can be invested in ignorance when the need for illusion is deep"

SAUL BELLOW

Market Index	Close	Week	Y-T-D
DJIA	35,208.51	+0.78%	+15.04%
NASDAQ	14,835.76	+1.11%	+15.11%
MSCI-EAFE	2,358.52	+1.61%	+9.82%
S&P 500	4,436.52	+0.94%	+18.12%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.31%	+0.07%	+0.38%

Sources: The Wall Street Journal, August 6, 2021; Treasury.gov, August 6, 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 30, to Friday, August 6, close. Weekly performance for the MSCI-EAFE is measured from Friday, July 30, open to Thursday, August 5, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

Some people wonder whether the Fed might produce perpetual prosperity, preventing recessions or minimizing them as it did last year. Some hope low interest rates can keep markets aloft forever. Some think the Treasury can issue as much debt as is needed, with the Fed willing to step in as the buyer of last resort. Obviously, a lot of people in the federal government think unlimited sums can be spent without negative consequences from the resulting increased deficits and debt.

These assumptions seem too good to be true. They have the appearance of a perpetual motion machine or a credit card with no credit limit and no requirement to pay off the balance. It's hard to say exactly what the catch is, but there has to be one.

In the 1930s, John Maynard Keynes suggested that nations should run fiscal deficits in times of weakness to stimulate demand, reenergize their economies, and create needed jobs. It's not for nothing that deficit spending is described as "Keynesian." But even Lord Keynes asserted that while deficits are a reasonable way to jumpstart a sluggish economy, governments should run surpluses in times of prosperity and use them to repay the debts incurred in times of weakness. However, in the 21st century, concepts like fiscal discipline, budget surpluses and debt repayment seem to have gone out the window.

A great deal of the current debate over the macro-outlook surrounds the Fed and its policies and behavior. In March 2020, the Fed triggered the recovery we're enjoying by cutting the key federal funds rate to 0-0.25%, initiating loan and grant programs, and buying vast amounts of bonds. This combination was very successful, producing powerful recoveries in the economy and the financial markets. However, the same actions helped create the threat of persistently higher inflation.

The Fed however, seems to be relatively unworried about inflation. At first it said it didn't think there would be inflation (recent data has disproved that). Then it said if there is inflation, it will be transitory. And the Fed went on to say if inflation appears to be other than transitory, they have the tools with which to fight it. Still, we must consider these ramifications:

- Higher inflation could lead to higher interest rates as investors demand positive real yields, but also if tighter monetary policy and higher rates are employed to fight the inflation.
- Higher interest rates could negatively affect the economy.
- Higher interest rates make investors demand higher returns, leading to lower prices for financial assets and the possibility of a market collapse (see 1972-82).
- Higher inflation would hit low-income Americans the hardest, since they spend the lion's share of their incomes on necessities, thereby threatening the lifestyle of the millions of retirees and others on fixed incomes.
- Higher interest rates would raise the cost of servicing the national debt, further swelling the annual deficits (and therefore the national debt).
- Larger deficits could make lenders (and foreign buyers) demand still-higher interest rates on U.S. debt securities, creating a negative feedback loop.
- If we continue to print enough money to pay the interest and fund the deficit, eventually the value of the dollar and its use as the world's reserve currency could be called into question.
- As we've experienced in the past, rapidly rising prices could cause inflationary expectations to become embedded in Americans' psyches, making the increases self-perpetuating and hard to combat.

Further, we should consider the negative aspects of accommodative monetary policy itself:

- Fed largesse can be viewed as implying the existence of a "Fed put," or a guarantee of future bailouts. The consequences can include increased moral hazard (the belief that investors can take risk without consequences) and a diminution of the risk aversion that must be present in order for markets to be safe.
- The above conditions can lead businesses and investors to use more leverage, magnifying the potential damage from a slowdown.
- As we've seen in the last 16 months, the Fed can't stimulate the economy without increasing the value of the economy. And who receives the benefit? The people who own the economy (i.e., the owners of equities, companies and real estate). Thus, stimulus and the resultant asset appreciation exacerbate the disparity in wealth, which is receiving increased consideration.

The upshot of it all is we no longer have a free market in money today, and we haven't had one since at least 2008's Global Financial Crisis; the Fed cut the federal funds rate to zero in January 2009 and has kept it low ever since. There have been attempts to raise interest rates, but the markets greeted them with a series of "tantrums," discouraging continued efforts. To have a healthier allocation of capital, interest rates should be "naturally occurring." Rates held artificially low distort the capital markets, penalizing savers, subsidizing borrowers, lifting asset prices and encouraging increased risk taking and the use of more leverage. The long-term rate of growth can't be lifted perpetually through monetary and fiscal policy, and certainly not without the risk of negative consequences.[8]

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CITATIONS:

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