The Greatest Money Pump

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So, where are we? No one knows what the eventual outcome will be for the economy after the lockdowns and ongoing effects from COVID-19.

Here's what we do know: Central bankers of the world have produced the greatest money supply pump in history to offset the negatives of high unemployment and lockdowns resulting from COVID. There's a rule in the markets: Never underestimate the power of central bankers. On the other hand, if it's too good to be true, then it usually is. In this country, the current result is a stock market bubble again, but in just a few Mega-cap stocks along with the flavor of the day bubble stocks. Many stocks including the well known banks and other areas of the economy are still depressed. Precious metals like gold and silver and the FAANG stocks (i.e., Facebook, Apple, Amazon, Netflix, and Google) are in a bubble and account for about 45% of the S&P500 gains since the bottom in March. Some sectors like cloud software stocks and work from home stocks have gone parabolic, but have recently rolled over.

Even though I'm optimistic that we'll eventually get out of this mess in the next year or two, the shift from momentum stocks like the FAANGs will have a negative impact on the markets even though other sectors like value stocks will be going up. Just the way FAANGs made it appear to the investors that everything was wonderful with markets, so too will these stocks make things look worse in markets when they pop out of their bubble.

If it looks too good and easy to be true, then it's not true. If the Federal Reserve could keep pumping up the money supply the way it has, then there would be no need for many jobs, operation of businesses, student loan paybacks, pension plan bailouts, or debt repayment. The Fed could just keep the printing presses going forever.

There is one minor problem in the above scenario. Take trillions of dollars coming out of thin air, throw it into an economy that is in a deep recession/depression, and what do you get? Hyperinflation is usually the result. The previous rounds of Quantitative Easing (money via printing) since 2009 didn't become inflationary because there was no fiscal stimulus to go along with monetary stimulus. That has changed this time around. Now, there's both.

Some economic scholars out there contend that deficits don't matter. These deficits may not matter in a functioning and normal operating economy, but the history of money printing into this kind of economy portends big negatives in the form of much higher inflation down the road. Take a look at past history via Weimar Republic Germany in the 1920s and the current situation with Venezuela for examples of how these situations can play out.

What are the consequences of such a state of affairs? Usually, the early years are big negatives for bond and debt investments and good for value stocks, commodities, precious metals, real estate, emerging markets, and other areas of the economy. Retirement of debt in mortgages, pensions, student loans, and similar becomes much easier as they're all paid back with cheaper dollars.

The above scenario is not a guarantee of what will happen nor is it a guarantee of how long it will take to do so. It is, however, a real possibility, as evidenced by the moves in gold and silver. The first serious evidence to act on will be a crack in the US Treasury bond market. There are trillions of dollars of new debt that's been created this last year to support the economy, and most of it is paying below one percent in interest. Should rates move up substantially, such as a 100% rise to two percent interest, then watch as a stampede of investors breaks down the gates.