July 2021: A Profitable Six months for Stock Investors. All Eyes on the Fed

Above is the imposing image of our Central Banking System, the Federal Reserve Building in Washington DC. The Federal Reserve is not a branch of the US government. Strictly speaking, it is not a government entity at all.

So Who Runs the Show?

Chairman Jerome Powell is its titular head and spokesman. "Fed" policy is set by twelve regional reserve divisions. The twelve, in turn, are owned by various member bank shareholders. The NY Fed is regarded as the most powerful of the twelve. This is where it gets interesting. The NY Fed's two largest shareholders are Citibank and JP Morgan, followed by Morgan Stanley and Goldman Sachs. And don't forget the foreign shareholders HSBC and Deutsche Bank Trust to remind us that there is indeed a system of sometimes entwined central banks across the globe.*

What does this have to do with the Markets?

While Fiscal Policy (shorthand for spending, and more) remains in the hands of government and the US government Treasury department prints the money passed out as stimulus, **Monetary Policy is firmly in the hands of the Fed**. It is the Fed that determined the amount to print. It is the Fed that creates money out of thin air, nominally as loans. And greases the wheels of commerce through overnight and short-term lending to corporations in the "Repo" (repurchase agreements) market.

Among the short list of Fed mandated objectives is "the stability of the financial system and prices by influencing money and credit conditions in pursuit of full employment."

It is a mistake to believe that the Fed is directly purposed to prop up the US stock market. But that is how it feels in this period of dampened interest rates designed to spur investment and a Fed willing to buy investment assets of questionable quality from the member banks regarded as too big to fail.

Fed Watching is not an Idle Exercise

Lowering interest rates has often been used by central banks to promote investment and spending to revive an economy in trouble. That helps technology firms starved for cash but hurts savings banks who depend on loan interest for their revenue and conservative investors who depend on bond and savings account interest. Along with interest rates, money printing may have boosted many stock prices as much by these tools as the demand for services and products, the quality of a company's management, or the psyche of stock investors. Market traders of all stripes are keeping their ears focused on Fed announcements and actions in hopes of divining market outcomes and charting a course of action.

If Something Can't Go on Forever, It Won't.

The Fed recognizes its interventions have taken it into almost uncharted territory. Coming out of the depths of Covid 19, the market has responded remarkably with many stocks near or at historic highs. But it's not unreasonable to wonder how long this can last. Corporate earnings are OK in many sectors but not stellar. Food prices, car prices and housing prices are soaring in the face of pent-up demand and short supply. While recent history suggests stock prices can continue higher for months or more, rising employment remains elusive—perhaps for more reasons than the injection of stimulus money. Is more inflation around the corner? Or will prices retreat as something approaching normal gradually returns?

Or something else; maybe an overdue market correction of 10%, or a crash far exceeding that?

What might trigger such a decline?

The Fed might make a bad call or run short of tricks. Some seventy percent of the daily trading volume in the stock market may be in the hands of the trading community, some of it highly leveraged. This community focuses on the short term. Some may decide to grab profits before their competition does. As that urge takes hold, others sell. The selling can snowball, driving prices down until the big investment bankers (remember who they are?) at the helm of trading see it is time to buy back in at bargain prices. Or maybe something else is lurking. Perhaps we are in the end stages of the long-term business cycle fueled by debt come due. Or a seismic shift in demographics. A new generation of investors has joined the millennials pouring money into the markets through 401k plans and more. But at some point, the baby boomers will begin to pull more money out of the markets for retirement income. If withdrawals dwarf contributions, watch out below. Pick your own nightmare scenario.

What Should You Do?

There is a difference between your risk capacity and your risk tolerance. A **high-risk capacity** can be the result of an abundance of resources (pension, secure savings, earned income, etc.) relative to income needs (basic expenses, wants, and special objectives). But it can be accompanied by a **low risk tolerance** when market fluctuations keep you up nights, or if market downdrafts convince you the sky is falling.

Let's review your capacity for risk and your tolerance for market surprises. Let's dress rehearse with illustrated "what ifs" to map out how you should proceed. You might decide to stay the course, raise cash or something else.

In response, we will then make needed refinements or revisions in your portfolio. While we aren't the Fed or investment bank traders, we do have an array of tools and strategies, one or more of which might prove right for your prosperity and peace of mind.

***** If you are out of things to do on a rainy day you might enjoy, *Money: The True Story of a Made-Up Thing* by Jacob Goldstein. His story of money and central banking can be enjoyed without reading it page by page.

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If you have questions or would you like to learn more about our services:

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