Weekly Capital Market Comments

August 28, 2020

NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

Whatever It Takes…Takes Nerve

On Thursday, Fed President and FOMC Chairman Jerome Powell spoke at the Jackson Hole Economic Symposium, an annual confab sponsored by the Federal Reserve Bank of Kansas. During his virtual presentation, Powell announced a shift in strategy intended to help achieve the Fed's dual mandate of stable prices and maximum employment. While the Fed reaffirmed a 2% target rate for inflation, Powell added that the Fed would be flexible in adopting monetary policies and strategies geared toward an "average inflation target of 2% over time," thus implying the Committee's comfort in **allowing inflation to drift well in excess of 2% for extended periods**. The news in itself should be no surprise, as just days earlier, one of the Fed's most hawkish policymakers, Kansas City Fed President Esther George, hinted at such a move. But was surprising of today's announcement was the timing. Most market participants expected this move to come at the Fed's next FOMC meeting in September.

Ok, what does all this mean, and why should I care? Well, in our opinion, today's policy shift suggests that the Federal Reserve is willing to do whatever it takes to keep interest rates lower for longer, in an attempt to resuscitate economic growth and help drag Main Street from the grasps of potential depression. This may be especially true as Washington remains in gridlock as it relates to additional COVID stimulus. Stocks initially rallied on today's Federal Reserve news, and then fell back down. **We believe today's price action suggests that while lower rates are initially good for stocks, the need to utilize larger and larger counter-measures implies the economy may be more challenged than the record-setting equity markets would lead you to believe**. Hence this is the main reason the Fed announced these moves now, rather than waiting until mid-September.

But just as investors began to rationalize the inconceivable – that economic fundamentals may not be supportive of record-high index levels (driven mostly by 5 or 6 companies), Mr. Market latched on to perceived even better news. Just a few hours earlier, Abbott Labs (ticker: ABT) issued a press release announcing that the US Food and Drug Administration approved its 15-minute rapid COVID-19 test. And what's more, it costs only $5 per test. Then news outlets began to report that President Trump will announce a $750 million deal with ABT to purchase 150 million tests. In our opinion, the advent of a cheap and rapid COVID test could have wide-spread positive ramifications for colleges, professional sports, restaurants, and the travel/leisure industry. And while there remain reliability concerns regarding antigen and/or serological tests, this didn't seem to stop the bid for equities, led by the most badly beaten sectors. For example, investors witnessed a 5.98% rise in shares of Royal Caribbean, and welcome moves in other companies including Norwegian Cruise Lines (NCLH, +5.92%), United Airlines (UAL, +5.75%), Carnival Cruise (CCL, +5.50%), Marriot (MAR, +4.41%), American Airlines (AAL, +3.87), MGM Resorts (MGM+3.73%) and Darden (DRI, +3.66%). What's more is that we also witnessed a pullback in most of the FAANGMs, with Microsoft being the day's only gainer, up 2.5%, with this group down about 0.7% overall, suggesting a potential rotation and widening of breadth. But one day does not make a trend.

So as of Thursday's close, the S&P 500 is now up almost 8% YTD and has recovered by over 50% from the March lows. But at the same time, initial claims recorded another 1 million-plus week, and consumer confidence missed expectations, American Airlines announced the elimination of an additional 19k jobs next month, while United will furlough an additional 2,859 starting October 1, 2020. CNBC reported earlier this month that 50% of furloughed workers don't expect a job to return to, and NYC unemployment remains close to 20%. We are far from the economic strength from late 2019, and yet the market has already discounted its return. Call us what you want, a perma-bear, chicken-little, or maybe just early. Only time will tell.

We remain guarded, despite the modest reprieve offered in Thursday's news. As we pointed in our note a couple weeks back entitled, "Do Stocks Ever Go Down," negative real rates will increase asset values given a lack of alternatives in risk-fee bonds. And this latest move by the Fed will just continue to test investor's nerve, as implicit in the strategy shift, is the

<u>notion that the Fed is also willing to pump up asset values to unwarranted levels.</u> <u>This is the silent risk that many investors may be unaware of.</u>

We are taking next week off, so look for us to return in September. We hope to provide some new ideas and positioning, and maybe even a new bi-weekly format.

We'd love to hear your thoughts.