

CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

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Here We Go Again

Winter was likely to be a bit tricky with the Delta variant and with people going indoors where the spread is easier. Then, as Thanksgiving was unfolding, we began to learn of a new variant with many mutations and possibly alarming attributes. On the holiday-shortened trading day after Thanksgiving, traders registered their initial impressions. Dire.

Stocks fell very sharply and prices of Treasury bonds rose very sharply. The discrepancy between rising bonds and falling stocks was the biggest in percentage terms since March 2020 when we all thought that the second Black Death was at hand. In the days since, swift and large changes of prices have continued; the primary measure of stock market volatility reached its highest levels in nearly a year.

At present, of course, we do not know how serious the Omicron variant will become. The uncertainty is exemplified by the nearly contradictory statements made by the CEOs of Moderna and of BioNTech, the two companies that developed the mRNA vaccines. Stephane Bancel, Moderna's CEO, expressed his view that existing vaccines, including Moderna's, would be much less effective, while Ugur Sahin, BioNTech's CEO, offered a more relaxed and optimistic discussion of the effectiveness of the mRNA vaccines, including the Pfizer/BioNTech one. Such uncertainties, at this early stage of the emergence of this variant, will very likely continue to roil stock markets. Although the very recent news from South Africa suggests that Omicron does not seem to create serious infections, it is too early to know definitely what this new variant will bring to the world.

The timing of Omicron's appearance is inopportune, to say the very least. Stock markets--particularly the US markets--are very expensive. The Fed, which has been supporting stock markets with its low interest rates and huge purchases of government bonds and mortgages, has begun to curtail its purchases and to tighten monetary policy. Jerome Powell, the Fed's chair, gave a strong indication in Congressional testimony last week that monetary tightening will proceed more rapidly than previously announced. Inflation has been confounding those who considered price rises to be a 'transitory.' The huge federal programs beginning in March 2020 that have poured *trillions* of dollars into the US economy and into the wallets of its citizens are in the rear-view mirror. The bipartisan infrastructure bill was passed only with difficulty and Mr. Biden's Build Back Better legislation is uncertain of enactment. Near the end of last week, the two houses of Congress passed a bill to keep America's government functioning, but we still have the lurking federal debt-ceiling problem unresolved. Unless resolved very soon, the United States will default on its

By

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interest payments and principal repayments for the first time.

It's not where they open, it's where they close that counts. This is another investment adage, many of which do not make too much sense; this may be one of them. However, one rather marked change recently connects to this: Stock prices and bond prices fluctuate, as we have long observed. However, in the last year and more, prices changed as markets in the US opened, then they have generally stayed around the opening levels as the day's trading goes on. Not recently.

In our very recent Omicron emergence and Fed-tightening warnings, this pattern has been upset. In recent days, after the stock market had suffered a fair-sized sell off, the overnight trading was optimistic and the American stock markets have opened higher. Then...whoops! Second thoughts, new remarks by Jerome Powell, or something else suddenly caused stock traders to crowd the exit and prices to go down sharply. On Friday the 3rd, we had another example. After a strong day on Thursday when, on no news of any significance, the stock market rallied very sharply after its dismal selling in the previous week. Overnight, US stocks traded still higher and, at the open, the S&P rose by about one half of one percent. Indeed, before the US market opened, the Labor Department had released its monthly employment report. The report was confusing and somewhat self-contradictory--I won't bore you with the details--but, the report caused US stocks to trade still higher pre-market trading.

After buyers satisfied their 'buy-the-dip' impulse, down we went. From a gain of one half a percent, the S&P fell by more than one and a half percent, to hover some goodly distance below Thursday's close. What to make of this? I think it demonstrates the febrile condition of the stock market. It appears that, after almost everyone was sanguine about US stocks and the idea that stocks could only go up, more investors are coming to realize that the good times are behind us. The more resolute bond market did not go along with the euphoria that gripped stock investors in recent months. Treasury bonds, Core's biggest holding, have moved steadily higher for many months, despite the inflation numbers, and despite the Fed's easy and now tightening monetary policy.

Where from here? Present estimates of US economic growth for the current quarter, as made by the Federal Reserve, are quite high. But both the bond market and the recently-disturbed stock market seem to suggest that growth will weaken in the early part of 2022. This will most likely upset the flow of ever-higher corporate earnings. If the Fed continues its monetary tightening—by reducing its level of asset purchase and, afterwards, by raising short-term interest rates, it is reasonable to expect a weaker stock market than we become used to. The long-term Treasury bond market, in which Core has significant investments—will probably continue to be strong. As usual, however, such forecasts—like this one—may well prove to be off the mark. My aim is to continue to be watchful and to adjust portfolios as conditions evolve.

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