



## **CIO OFFICE MORNING MARKET WRAP – Wednesday November 17, 2021. ALSO AVAILABLE ON ALEXA**

Global stocks were in the green again, and rightly so, with both macro- and earnings releases delivering the clear message that stagflation may be in investor minds, but not in the economy, as growth remains solid. The US outperformed other major markets buoyed by strong retail sales, yields edged higher as central bankers commented on tighter policy, the dollar appreciated, crude oil rebounded and gold was weaker.

If there was any concern about the curtailed purchasing power of US consumers due to inflation, that was lifted by a robust retail sales print and a solid start to retail earnings. Retail purchases rose 1.7% in October, above expectations and the most in seven months, up a firm 1.4% excluding the vehicle component. The so-called control-

group sales, which excludes different volatile components and contributes to GDP, also surprised to the upside. Flat food and services sales, a proxy for services, suggest that virus concerns could have boosted online spending, which was particularly strong. With nominal sales already 21% above the February 2020 level, a reversion to pre-pandemic trends is to be expected, with services then catching up. No doubt that elevated savings and wage gains helped Americans spend more, signifying that current price pressures are not only due to constraints limiting supply, but also hefty demand. And indeed, hedge fund Bridgewater Associates highlighted in a paper that on a global scale, while real production is now back to longer-term trends, it is real demand to have skyrocketed. Real trends matter much more than nominal ones, and the Bridgewater study should be enough to suggest that as of today stagflationary concerns are misplaced. Results from Walmart and Home Depot pointed also to consumers maintaining purchasing power. Walmart comparable sales exceeded forecasts, while the home improvement retailer reported stronger than expected results.

As signs of a stronger economy accumulate, calls are multiplying for the Federal Reserve to start tightening earlier than planned. James Bullard, St Louis Fed president and FOMC voting member next year, said that the committee should shift more hawkish right from the next few meetings in order to manage inflation risks “appropriately”. Yet, he would not see policy rates rise to 3% or 4%, as ex-NY-Fed-president Dudley suggested in a recent interview, but rather get to the pre-pandemic levels of 1.5% to 2%. Gold retreated on Bullard’s remarks and the euro weakened. PIMCO founder Bill Gross was more explicit and said that investors live in “dreamland”, as interest rates remain where they should not be due to relentless central bank stimulus even as the economy rebounds strongly from the pandemic. But he also acknowledged that central banks “can’t do much”, with the Fed tapering and only gradually raising interest rates maybe next year.

In spite of Bill Gross ominous remark that in the long run the system could “collapse”, because “capitalism depends on savers saving and investing”, negative real rates seem to be here to stay for still quite a while. Deutsche bank produced an interesting study, going back two-hundred years and comparing real yields and debt-to-GDP dynamics. The author came to the conclusion that financial repression, that is central banks keeping yields lower versus where they should be as compared to inflation, is set to continue for the current large pile of debt to be paid off. At the expense of savers, artificially low yields make servicing debt easier, while high inflation ensures that the real value of debt is smaller. This worked in the past already, with periods of negative

yields being the Great Depression, or war times - the civil war and WWII - when governments managed to finance war with capped yields. As Bill Gross mentioned, this is also a risky proposition which, when entertained for too long, would not end well. Stay safe.

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