Weekly Market Flash

An Unsteady Calm

October 15, 2021

Weather maps of the continental United States have been in vogue this week on account of a strange pattern in the jet stream (weird climate events, in 2021? Really?). Out west the jet stream dipped into territories south of where it normally flows, bringing an unusual blast of Arctic cold and heavy snows to western and southwestern regions more used to dry heat at this time of year. East of this dip, though, the jet stream bulged up into Canada and produced some record heat conditions in places one normally does not associate with heat – North Dakota, Minnesota and further north still into Ontario.

Fragile Equilibrium

Along the border of the jet stream, in between the extremes of blizzards and scorching heat, lies a somewhat unstable equilibrium, not entirely unlike the present conditions in securities markets. During this past week we seemed to be teetering back and forth between the two narrative forces vying for our attention: the bear case of stagflation and geopolitical dysfunction versus the bulls' longstanding argument based around unlimited central bank liquidity and global economic recovery.

After a couple down days early in the week investors got to take a look at the published minutes from the latest Fed meeting on monetary policy in September. The minutes didn't really have anything new to add in terms of substance, but the hot take seemed to be that there was nothing new to worry about in terms of the Fed raising interest rates. So – good enough! Markets recovered smartly and look to be on track for a winning finish to the week.

Peak Stagflation?

A couple days of exuberance does not a trend make, but the recovery in sentiment over the past couple days seems to have been enough to bring out the Pollyanna crowd reading the obituary for stagflation. The actual case for stagflation, as we see it anyway, doesn't seem particularly stronger or weaker this week than it was last week when markets were in more of a funk. The Consumer Price Index came out this week more or less in line with expectations – headline inflation of 5.4 percent and the ex-food and energy core reading at 4.0 percent (the CPI release was the same day as the FOMC minutes, which goes to show yet again that you just never know exactly which data point is going to move the sentiment needle, and in which direction). Meanwhile China's producer price index registered at 10.7 percent, a 26-year high and a bit of a concern for what might be felt in China's export markets down the pike.

Whether or not we are headed towards a repeat of 1970s-style stagflation (which we continue to think is not the most likely outcome), it appears increasingly evident that inflation will be stickier than estimates earlier this year (including those from the Fed) would have had us believe. An optimistic assessment for supply chains getting back to normal is in the 3-6 month range, while the energy shortage looks like it could go on for longer. Meanwhile, even if the Fed does start to taper its bond-buying program before the end of this year, it will still be pumping liquidity into a fixed income market with significant price distortions (as we wrote about with regard to the junk bond market a couple weeks ago). There's still plenty of time for this fragile equilibrium to come apart.

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