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Investment Institute

Weekly perspective on current market sentiment November 10, 2021

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Last Week's S&P 500 Index: +2.0%

Queasy about tapering? Don't be.

Key takeaways

- The Federal Reserve (Fed) is beginning the process of buying fewer bonds (tapering) this month.
- The Fed has telegraphed the process well, and financial markets know what to expect.

You can call this piling on if you wish. Our strategists have been driving home the point that "tapering is not tightening" for some time. This strategist has even done it a few times in this weekly publication. But a lot of investors have continued to get nervous that the Fed's shift into tapering mode is going to give the financial markets indigestion. We don't think that is going to be the case.

The economy, based on our current projections and barring any unforeseen events, should grow well above average this year and next, even after the less-than-stellar 2% growth rate in the third quarter. Under these anticipated conditions, does the Fed need to be employing "emergency" monetary policy strategies to help boost the economy? We don't think so, and it appears the financial markets agree. The S&P 500 Index has been in something resembling a "melt up" mode for the last four weeks that has carried the index strongly into record territory. Market participants have been well aware the tapering process would likely start before the end of the year based on the many hints that Chairman Powell and other Fed representatives have been dropping for most of this year, and especially since June.

The goal of our central bankers in this tapering process is not to slow the growth in the economy but to bring monetary policy back on a more normal path. We believe that will almost certainly be the case when eventual rate hikes occur. Clearly, the majority of Fed policymakers do not believe that the high levels of year-over-year changes in the Consumer Price Index (CPI) are here to stay. We agree. Our call, as we have stated many times, is for inflation to peak early in 2022 and then decelerate into the end of the year. We continue to believe that interest rates will drift modestly higher over the next year or so, but U.S. Treasury debt has many interested buyers to fill the gap as the Fed steps back and buys less every month.

For a market comparison, we have one historical period in terms of Fed tapering, which occurred in 2014. In that episode, unlike today, the Fed's decision to taper was somewhat of a surprise. Like today, the S&P 500 Index had surged higher before the tapering process began. Once the process started, during the first 10 months of 2014, the S&P 500 Index was volatile but gained 12%. During that period, the 10-year Treasury yield fell from just above 3% to approximately 2.25%. Of course, past performance is not a guarantee of future results. We look for a modest rise in interest rates from meaningfully lower levels.

We believe the economy is in a good place. The labor market is gradually improving. Inflation is in the process of peaking. The Fed is committed to keeping the recovery moving ahead. Markets have been comfortable with the tapering schedule the Fed has laid out. Don't be queasy. We believe the stock market has more upside.

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Forecasts and targets are based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors.

Definitions

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market.

An index is unmanaged and not available for direct investment.

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