Chart of the Month

February 2021

Caution: Asset Bubble Ahead.

Congress passed the $2.2 trillion CARES Act last March and an additional $900 billion in December, the two largest stimulus programs ever enacted by the government. The Biden Administration has proposed another $1.9 trillion by the middle of next month. If approved, the government will have distributed $5 trillion during the past year.

On top of this massive amount of money, the Treasury, which is sitting on $1.6 trillion in cash, just announced that it plans to reduce the stockpile to $500 billion by the end of June, adding an extra $1.1 trillion in liquidity to the financial markets over the next four months. Treasury Secretary Janet Yellen believes “doing too little” is a much bigger risk than doing too much.

Meanwhile, the Fed has been buying $120 billion of Treasury and mortgage-backed debt per month since last year and Chairman Jerome Powell has pledged to keep up that pace “until substantial further progress” has been made toward its goals of maximum employment and 2% inflation. Due to the Fed’s quantitative easing, its balance sheet rose $3.4 trillion last year and now stands at an all-time high of $7.56 trillion with no signs of reversing anytime soon. Powell, in fact, recently said, “We’re not thinking about shrinking the balance sheet, to be clear.”

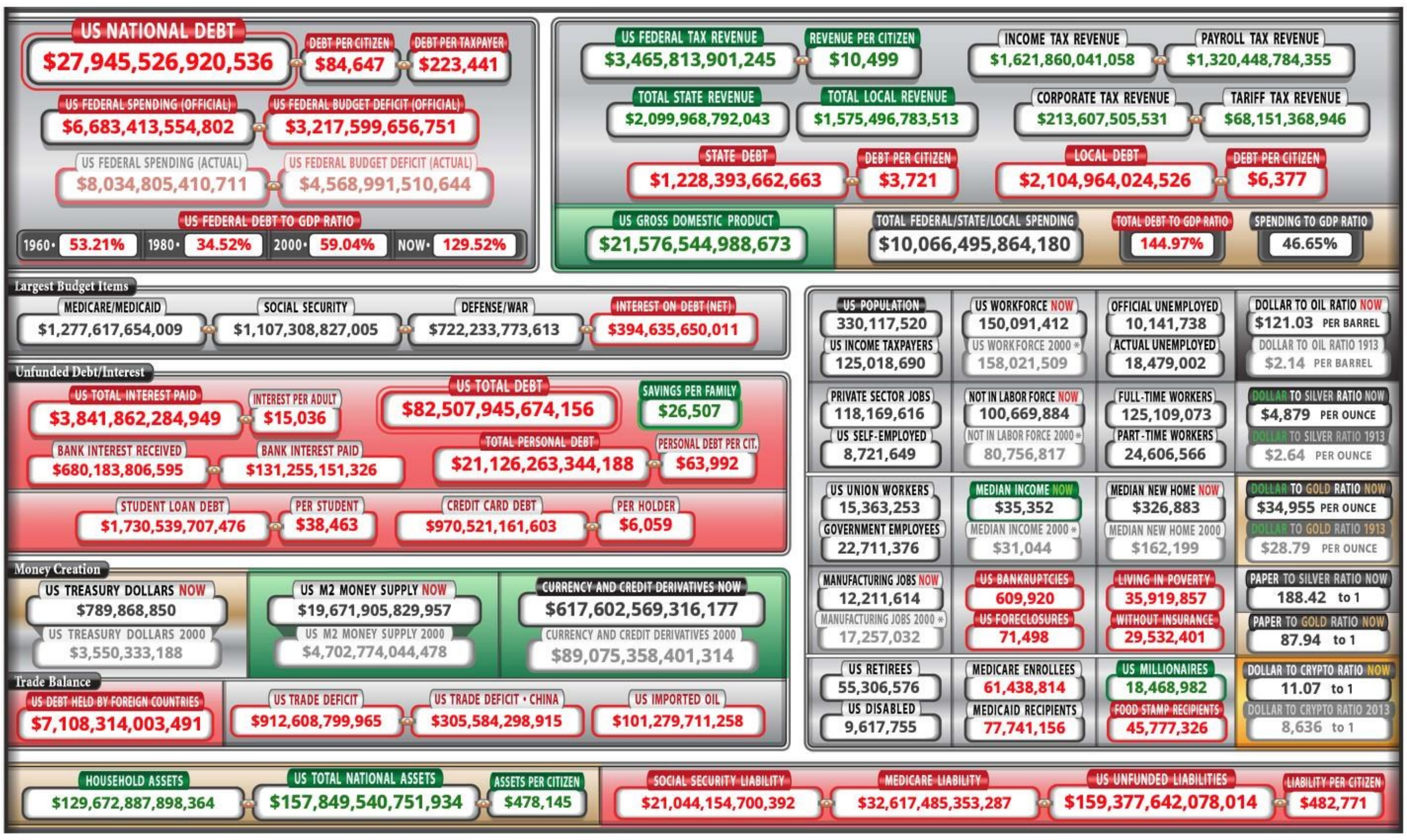
In the 1960s, Everett Dirksen, a member of the House of Representatives and the Senate for 34 years, reportedly said, “A billion here, a billion there, pretty soon, you’re talking real money.” Substitute a billion with a trillion (even while adjusting for inflation) and now we’re talking BIG money. It is easy to conflate a million with a billion and a billion with a trillion but each “ion” is one thousand times the amount of the previous “ion.” While inflation has increased nearly eight times since 1960, our government is throwing money around at a thousandfold clip!

To say government spending is out of control is not a talking point but a reality given that the annual deficit is running in the trillions of dollars and the national debt is at a record 1.5x gross domestic product (see chart below).

Based on the above, why has the stock market performed so well, you ask? Well, the economy has been awash in liquidity and the combination of near-zero interest rates and excess cash has driven up asset prices (from stocks and bonds to real estate to commodities and, yes, to cryptocurrencies like Bitcoin) to levels unforeseen in the midst of the pandemic.

Although inflation may not be showing up in the productive side of the economy (or in the government data), it is alive and well in asset prices. With the goal of staving off a recession and returning the economy to its pre-pandemic levels, Congress, the Federal Reserve, and the Treasury have been pouring money into the system, pumping up assets more than employment thus far.

The “Don’t fight the Fed” adage suggests that stock valuations are likely to remain high until opposing forces — such as less stimulus or rising bond yields, individual and corporate tax rates, and anti-business policies and regulations — emerge. In the meantime, the spigot is likely to remain wide open, encouraging risk-on investing for the foreseeable future, perhaps leading to a bubble “up around the bend” (with a tip of the hat to Creedence Clearwater Revival).



Source: USDebtClock.org

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