XCEL WEALTH MANAGEMENT
A REGISTERED INVESTMENT ADVISORY FIRM

# Palacios' Perspectives

June 18th, 2021

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## From Wall Street to Main Street

*Highlights from the past week*

**Market / Macro Economic Summary**

Markets this week were relatively flat heading into Wednesday's Federal Reserve Open Market Committee (FOMC) meeting and subsequent decision on interest rates. Now, it has been a very light week in terms of earnings, so I am going to take this opportunity to analyze what Fed Chair Jerome Powell said, the implications and subsequent market response. To start, let's first discuss what the Federal Reserve controls which is the Federal Funds rate. This is the set rate to which commercial banks can borrow or lend excess reserves to each other overnight. Changes in the Fed Funds rate will have an indirect impact on all sorts of other loan rates from home/auto/credit cards and even commercial loans. This in turn will also affect the rate of growth in our economy as higher lending rates will at some point equate harder to qualify loans and thereby slow our economy down as businesses will have lower access to capital to grow.

One other item that the Fed is currently controlling is the bond purchasing program. This is done to support the economic recovery by controlling our economy's money supply. If the Fed buys bonds in the open market, it increases the amount of cash in circulation as it is essentially buying the bonds and putting more cash in the hands of investors. If the Fed sells bonds, then it is taking money out of circulation as they would be exchanging bonds for cash. Now that I have covered the basics, let's work on what the Fed said this week and some interpretation.

Fed Chair Jerome Powell and his 18 "FOMC" members maintained the target Fed Funds rate between 0%-.25% and will continue to buy $120 billion dollars per month of bonds, $80 Billion worth of treasuries and $40 Billion worth of mortgage-backed securities. Thirteen of the eighteen members did change their sentiment of seeing higher rates in 2023 instead of 2024. Lastly, the Fed announced an increase to the expected Gross Domestic Product expectation for our economy to 7%.

Now, at first glance I notice that there are mixed signals here. The Fed is telling us they expect our "GDP" which is in effect the rate of growth of our economy to increase. So, why maintain the "stimulus" of the bond buying program or low level of interest rates? Here is where the Fed has tried to signal that they will be very cautious in getting us back to full employment while keeping an eye on inflation and allowing our economy to grow at a measured pace. Jerome Powell has said that while inflation factors have risen, for example commodity prices like aluminum, copper, steel, oil and lumber……he believes those are transitory or short term in nature. Now, recent data have proven him to be correct. Here are where prices started the year, got to a high and are currently:

| Commodity | Start of the year | Year High | Currently |
|---|---|---|---|
| Lumber | $668 | $1,670 | $904 |
| Copper | $3.51 | $4.736 | $4.18 |
| Aluminum | $2024 | $2,553 | $2,420 |

This should give market participants some confidence that Jerome Powell and the FOMC members have a very good grip on the economy, and we should trust their judgement/decision making.

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So, now that I have given you some background into what the Fed does, controls and is monitoring……. what should be our main takeaway from last week on rates, inflation, and gross domestic product projections?

Here is my take. We have been told that the Fed is not worried about inflation, will keep rates at low levels through 2023 (2 years away) and that the economic support (bond buying program) will continue. While I am not a fan of the bond purchases continuing……. all these factors add up to be a "greenlight" for investors to remain invested and add more. For starters, wealth creation has been quite positive in the last couple of years, but also the cash reserves (money on the sidelines) have grown to trillions of dollars. Where is this money going to go in order to be invested?? Sure, some will go towards new business startups, more will continue to go towards real estate, but I submit that the majority will get tired of sitting in cash at banks and will go into the stock markets. This dry powder should help provide more support for the markets in addition to have moving into more quarters where the earnings reports should continue to impress. It will be a stock picker's market as some sectors of our economy will report good numbers but will be impaired a bit since Covid helped them tremendously last year. The comparable numbers (quarter over quarter or year over year comparisons) will get harder to match. All in all, I am not in the camp of any impending doom as I feel the Fed will do a good job to manage expectations and keep supporting our economy.

**Company Specific / Micro Economic Summary**

Adobe (ADBE)
Stock rose as it reported stronger than expected numbers. Earnings per share of $3.03 were well ahead of the projections of $2.81. Revenue of $3.84 billion was stronger than the $3.72 billion Wall Street had been looking for. Digital media revenue was up 25%, Creative Cloud revenue 24% and cloud revenue was up 30%. CEO Shantanu Narayen also raised forecast for the remainder of the year.

**Parting Thoughts**

I hope you enjoyed the discussion on a topic that I believe is key to how our economy functions. As Americans, we put a lot of trust in the Federal Reserve to help guide our economy and knowing what they do is paramount. I believe the current Fed deserves credit for their work and they continue to be transparent on their actions to ensure the markets aren't surprised.

We welcome an opportunity to discuss the above detail and wish you much success in the rest of your week!

Regards,

E. Palacios

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