



Update

Perspective on Taper Talk

Following last week's series of new record highs for the major averages, investors have now turned their focus to news of slowing retail sales and the spread of the Delta Variant. The general view is that consumers have bought all the "stuff" they want and are now moving on to buying experiences. That might explain Amazon's recent descent into correction territory. However, the travel and hospitality stocks aren't responding yet to that general view and are telling us that a resurgence of COVID might dissuade some from pursuing those experiences as we enter into the Fall. This week's drawdown in the market has so far failed to attract the significant buying interest that has usually followed such dips in recent months. That might have to do with what the Fed has in store for us.

Taper Talk is the prevailing narrative in the financial media these days. Tapering is a first step in ending Quantitative Easing ("QE"), better known as life support for the economy. QE is a means of infusing more cash into circulation to stimulate economic recovery. It was a necessary antidote for the damage inflicted by COVID on the economy in 2020. Tapering is the gradual removal of that life support in the form of a reduction in purchases by the Fed of treasury and mortgage-backed bonds. The precedent for this was set in 2013 as the Fed reduced QE that followed the recession of 2008. The resulting "Taper Tantrum" in the stock and bond markets was a short-lived selloff triggered by a temporary spike in interest rates. Investors soon realized that tapering was a good sign, indicative of an economy that could sustain further expansion on its own. That's where we believe we are headed.

This week's release of the minutes from the recent Fed meeting points to it remaining data-dependent in responding to the recovery. If the economy continues along its current trajectory, we could see the Fed announce before year-end its *intent* to taper, well in advance of actually implementing it. We could get a clue as to *when* as Chairman Powell takes center stage at next week's Economic Symposium in Jackson Hole. While it's unlikely he'll be explicit on the subject of tapering, the media will seize on any intonation in his comments that hint of an outcome from next month's Fed meeting and the markets will likely react.

If the past is any indication, the initial reaction to tapering will be a drawdown in the stock and bond markets as interest rates are expected to rise. However, with the huge amount of stimulus emanating from Washington, any tangible effect of tapering could be diminished. We're nearing the point where *fiscal* policy effects are sufficient to allow the Fed to reduce its *monetary* support. We'd view any selloff triggered by a *gradual* shift in Fed policy to be an opportunity for investors who see themselves as under-exposed to equities. They might discover some bargains in certain Cyclical sectors and in some former market leaders that have seen their whimsical valuations return to more rational risk-reward levels.

The Fed will, at some point, remove life support because the patient (the economy) will not only survive but thrive. Meanwhile, investors will have to navigate through an economic landscape defined by the course of the Delta Variant. Stay tuned.