Wall Street demands still more Fed money

By Nick Beams
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When Wall Street receives a major boost from the US Federal Reserve it can always be relied upon to come back and demand more. This phenomenon, one could say a law of political economy, has been on display again this week.

On Wednesday, the central bank's Federal Open Market Committee (FOMC) set out its new framework for monetary policy. It committed itself to maintaining interest rates at near zero levels, for as far as the eye can see. It would also maintain its purchases of financial assets, at least to the tune of $120 billion a month—nearly $1.5 trillion a year—and intervene even more aggressively should there be a return of financial turbulence.

Since the market freeze in mid-March, the Fed has pumped in more than $3 trillion, sending the stock indexes back to their record highs in August. But this month, the markets have been on a steady decline. In the past three weeks, the S&P 500 index has lost 5.4 percent, and the tech-heavy NASDAQ has dropped by 7.7 percent—its biggest decline since March.

Market indexes have dropped over the past three days, with the Dow, the S&P 500 and the NASAQ all down by around 1 percent yesterday.

With expectations of lower profits in the third quarter—analysts have forecast a 22 percent decline in earnings, compared to the same period last year—and the prospect of further government corporate stimulus packages being tied up in Congress, Wall Street was looking for more action from the Fed in order to push shares prices higher.

The FOMC's decisions last Wednesday were in line with Wall Street's demands for "strong and powerful forward guidance," to use Fed chair Jerome Powell's words. But they were deemed to be insufficient.

James Athey, senior investment manager at Aberdeen Standard Investments, told the *Wall Street Journal*, following the FOMC meeting: "The Fed said it would keep rates low for ages. But that's not enough. Not taking away is no longer sufficient for this market. You need to do more, more, more."

Another hedge fund manager told the *Journal*, "you need fiscal policy to come through." This is a demand that Congress pass legislation to extend the more than $3 trillion provided in corporate bailouts under the CARES Act.

The director of equity trading at KBW, R. J. Grant, said the Fed had acted swiftly and decisively, but now "people are kind of pivoting to see if Congress can step up to the plate here and get something done."

The concern of the financial markets is not over the economic devastation being inflicted on millions of workers. It is that, with the deep recession in the economy set to continue for the foreseeable future, corporations must have still more support.

Dissatisfaction with the Fed's pronouncements extends across the board. The *Financial Times* (FT) reported that when the Fed massively intervened in financial markets in mid-March, "investors took comfort from knowing that the Fed and its chairman Jay (Jerome) Powell had their back. But this week they were frustrated by his reluctance to promise more specific actions."

The main cause of dissatisfaction is that, apart from saying that the Fed would maintain its asset purchases, at least at their current level, there was no indication of how it would adapt its balance sheet.

"That was something the market was hoping to get clarity on and they failed to deliver it," Michael Kushma, chief investment officer of global fixed income investment at Morgan Stanley, told the FT.

According to the newspaper, one cohort of investors wants the Fed to shift the focus of its asset purchases of long-dated Treasuries, in order to ensure that borrowing costs remain low, "while another subset thought a larger program was warranted."

Krishna Guha, vice-chairman at Evercore ISI, told the FT the Fed's current approach to bond-buying was "weak." He said the Fed had to "deploy all its instruments."

In other words, the Fed's massive expansion of its balance sheet from $4 trillion in March, to more than $7 trillion by June, is deemed to be insufficient. Still more money must be pumped in.

That is because of complete uncertainty about the direction of the economy. In its economic outlook, the FOMC's median prediction for contraction this year was 3.7 percent, compared to its forecast of a 6.5 percent contraction in June. Its median jobless rate for the end of the year is now 7.6 percent, compared to 9.3 percent in June.

A *Wall Street Journal* editorial scathingly commented that "even discounting for the uncertainties of COVID-19 these are large misses" over the space of 90 days. The large variations underscore the fact that none of the official bodies, including the Fed, has any clear idea about the economic future.

Under these conditions, the demand is being made that whatever the state of the underlying economy, the Fed must expand its intervention so that money can continue to be raked in.

This week, the FT published a report revealing how the increase in corporate debt, made possible by the Fed's ultra-low interest rate regime, is being used.

Private equity groups were "taking advantage of blockbuster demand for corporate debt by loading companies they own with fresh loans and using the cash to award themselves a bumper payday."

So far this month, almost 24 percent of the money raised in the US loan market had been used to fund dividends paid to private equity owners. This was up from an average of less than 4 percent over the past two years.

The numbers involved are not small. The article reported that just over $4 billion of the $15 billion borrowed in the loan market so far this month would be paid out in dividends, with a further $2 billion to come in the next two weeks.