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Delta Insights
a weekly commentary on investing

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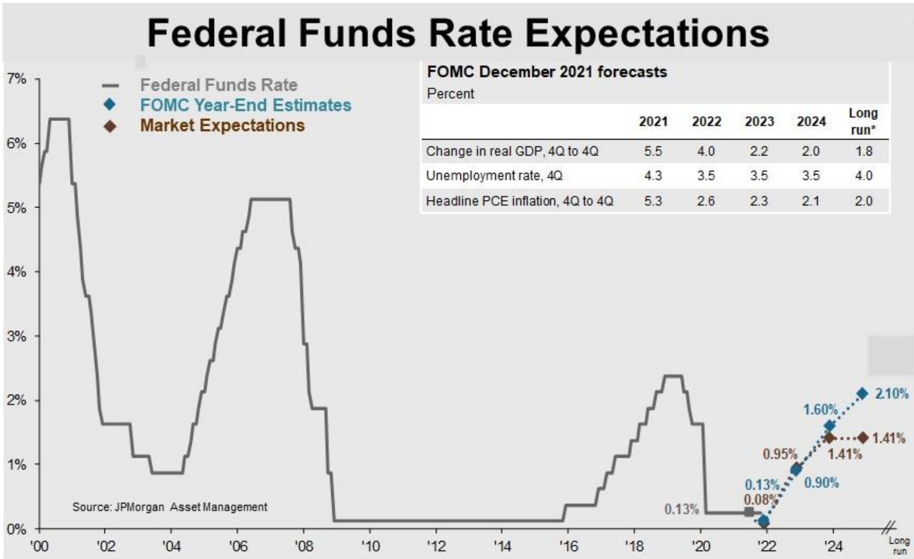
Higher Rates, Higher Stock Market

This week, the Federal Reserve announced that it will double the pace of tapering to $30 billion per month in January and the expectation is for three Fed Fund rate hikes in 2022 and 2023. The normal reflex stock market reaction to tightening of the money supply and rising interest rates is to trade lower. In this case, the stock market jumped higher on the announcement on Wednesday afternoon. Why?

The reason for the positive reaction is the announcement was filled with good news and the promise of addressing the significant emerging negative of high inflation. First the good news. The Fed expects the economy to growth 5.5% in 2021, 4.0% in 2022 and 2.2% in 2023. When GDP growth has been averaging roughly 1.6% per year for the past twenty years, the Fed's current growth projections look robust.

On the employment front, job gains have been "solid" and the unemployment rate "declined substantially" – currently at about 4.2%, down from 14.8% in January of 2020. The Fed is projecting a median 3.5% unemployment rate next year.

The rapid pace of economic growth, easy money supply and Covid related supply disruptions caused inflation to spike higher. For the past twenty years, inflation (measured by the core PCE) has been averaging below 2%. The Fed believes the median core inflation (PCE) will be 4.4% this year. With the accelerated tapering and the projected rate hikes, the Fed is projecting core inflation to be about 2.7% next year and 2.0% long-term. [Chart shows headline PCE versus core PCE]



The Fed's message this week is economic growth is significantly higher than trend and inflation is being managed lower. The stock market can be fickle in the short-term. But, the strong positive response from the stock market in the wake of the announcement says equity investors believe the Fed outlook is reasonably accurate.

More importantly, it appears bond investors believe the Fed message is accurate. The 10-year treasury rate traded down from 1.48% to 1.42% following the Fed meeting. Long-term interest rates reflect both growth and inflation expectations. The down move in 10-year rates is appropriate relative to the Fed projection of slowing economic growth over the next several years and diminishing inflation. One might even interpret the move in the 10-year treasury as a statement that the Fed's inflation outlook is too high. Normally, nominal rates (1.43%) less inflation (2.1%) equal a positive number. Today, real interest rates remain negative.

Zero interest rates are a sign of economic weakness. When the value of money is placed at zero, the Fed is trying to strongly encourage banks, corporations and individuals to "put their money to work." For banks, that means lend to clients. For corporations, that means invest in productive assets. For individuals, it generally means consume more whether it be housing, cars, clothes, etc.

Zero rates for too long can create inflation and asset valuation bubbles. If money has little to no value (from a yield standpoint), investors are much more willing to buy houses (very low borrowing costs) and stocks (some return is better than no return).

Today, the stock and housing markets are near all-time high valuations and we are experiencing inflation rates not seen for the past forty years. It is encouraging that in what appears could be an "inflated" economy, the market is able to rise on higher interest rate announcements. This suggests that valuations relative to expected growth and long-term inflation rates are sustainable and continue to warrant investment.

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We have unique and sophisticated investment methods that seek to capture the stock market's gains while minimizing drawdowns in bear markets. If you would like to learn more about how we manage money, we invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com.

"Not on the list? I invented the list!"

Delta Stock Market Dashboard

MARKET SENTIMENT IS

BULLISH

THIS WEEK'S NUMBER IS

60.6

Our technical indicator increased from 54.6 to 60.6 this week

INDICATOR STATISTICS

Consecutive Bullish Weeks:	9
Cycle Inception Date:	10/21/2021
Range:	51.0 – 71.4
Mean:	61.6
Bullish Weeks YTD:	45
Bearish Weeks YTD:	5
*S&P 500	3.5%
*DJIA	1.4%
*NASDAQ	0.7%

** Percentage change during current cycle*