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Greetings,

We have just either experienced the briefest (and one of the deepest) bear markets in history or we are in the midst of a ferocious bear market rally. We will know for sure before the end of the year. My money is on the former. As bad as the drop in the market was from mid-February to late March was, I find the recovery over the past three months more remarkable.

I have been asked by numerous people over the past couple of months (including a few clients, thank you for the question) how come the stock market is doing so well while the economy is doing so poorly? That question cannot be answered in just a few sentences. Sorry to those who prefer a brief response. The market tends to overshoot both on the downside and the upside. Simply put, the market should not have dropped as much as it did. The market indices dropped six times as fast as it did during the financial crises in 2008/early 2009. The market is also forward looking as it looks past this recession. You could make an argument that the market is looking too far ahead. I personally wouldn't make that argument but I see some pessimistic people attempting to make it. The stimulus/relief act passed by the government has also helped as I wrote in the previous investment letter.

By far and away the biggest reason for the market's recovery are the actions taken by the Federal Reserve. Not too many people, including the President are taking pot shots at Jay Powell anymore, the chairmen of the Federal Reserve. It isn't just a matter of zero interest rates and nowhere to invest other than the stock market. Jay Powell has already indicated in very certain terms that not only will the Fed not raise interest rates for at least 2 years, they aren't even thinking about thinking about raising rates. Those are Jay Powell's exact words. They are saying very clearly, even if the economy picks up next year (and not everyone thinks it will), they will let the economy run hot for a while. This is unprecedented because historically, the Federal Reserve has wanted to err on the side of caution and looked to raise rates at a sign of strong economic growth because they feared inflation.

The biggest factor in what the Federal Reserve has done, is this unprecedented quantitative easing as the Fed continues to pump trillions of dollars into the financial system. In a nutshell, the Fed is propping up the entire bond market. Propping up the bond market increases confidence in all markets so the confidence spreads to the stock market. All these companies that are in trouble and not receiving direct government aid are being supported by the Fed. Instead of companies going bankrupt, they are issuing debt and if the bond market isn't purchasing the bonds, then the Federal Reserve is. There have been a few noted bankruptcies such as Hertz and JC Penny (which has been in trouble for years), but not many. The cruise industry is shut down until the fall. They have issued enough bonds to give them liquidity until well into next year. Macy's also avoided possible bankruptcy by issuing debt. I don't believe the Federal Reserve purchased all the debt issued. The fact that the Fed was even willing to purchase bonds of companies in clear trouble gave the financial markets much needed confidence, during a dire economy.

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A concern of mine is that someday, the chickens may come home to roost. Companies that had decent balance sheets not long ago are now laden with debt. One reason I am not extremely concerned is that since the interest rates on the debt issued is so low, the interest expense won't hurt that much. The reason for my concern is that generally, when a company increases debt the cash is used for something that will produce income such as purchasing a company or expanding capacity. It is not a good thing to issue debt to simply increase liquidity to pay operating expenses. However, these are not normal times.

There has been some chatter about some "inflation down the road". Dr. Jeremy Siegel of the Wharton business school recently said on CNBC that he has some concerns about inflation either next year or in 2022, because of all the liquidity in the financial system. Inflation hasn't been a problem in over 30 years. With the unemployment rate just under 14% and expected to stay over 10% through the year and the 10 year Treasury bond yield still below 1%, the last thing that I am concerned about is inflation. 2022 is still a ways off. I will deal with inflation if or when it occurs. Since the labor market isn't supposed to rebound for many years, as much as I respect Dr. Siegel, in this instance, I disagree with him. I do not see inflation as a problem down the road.