Weekly Market Summary

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Financial Markets' Myths or Truths? Take Your Pick!
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A Big Lie is a propaganda technique usually used for political purposes (and lately for financial matters), defined as a gross distortion or misrepresentation of the facts, especially when used as a propaganda device by an official or "well-trusted" source. The German expression was coined by Adolf Hitler, when he dictated his 1925 book Mein Kampf, to describe the use of a lie so "*colossal*" that no one would believe that someone "*could have the impudence to distort the truth so infamously*". In the 21st century, the term was applied to Donald Trump's effort to discredit the results of the 2020 United States presidential election. "The big lie" in this instance was the false claim that the election was stolen from him through massive fraud.

In the same context, the illusory truth effect is the tendency to believe false information to be correct after repeated exposure. This phenomenon was first identified in a 1977 study at Temple University. When truth is assessed, people rely on whether the information is in line with their understanding or it feels familiar. The first condition is logical, as people compare new information with what they already know to be true. Repetition on the other hand makes statements easier to process relative to new – unrepeated declarations – leading people to believe that the repeated conclusion is more truthful. Similarly, in a 2015 study, researchers discovered that familiarity can overpower rationality and that repetitively hearing that a certain fact is right or wrong can affect the hearer's beliefs. Researchers attributed the illusory truth effect's impact to "*processing fluency*," asserting that it plays a significant role in such fields as election campaigns, advertising, news media and political propaganda.

How about its impact on financial markets?

For the nth time in past weeks, US Federal Reserve Chairman Jerome Powell said prices would eventually rise this year as the pandemic recedes and Americans start to go out and spend, but he played down the risk this would spur unwanted inflation. "*We do expect that inflation will move up the course of this year*," Powell told the House Financial Services Committee last Tuesday, citing pent-up demand, supply-chain bottlenecks and the comparison with very weak price pressures last year. "*Our best view is that the effect on inflation will be neither particularly large nor persistent*" (reminds me of Donald Trump's initial thoughts on the Covid-19 developing situation in early 2020 😊).

With the goal of accelerating the return to full employment, Fed officials have opted for a long period of highly expansionary monetary policy (on top of the government's recurring fiscal stimulus). That in turn has sparked a heated debate in the US on the risk that these highly expansionary economic policies will bring back inflation. Indeed, central bankers continue to reaffirm their commitment to ultra-stimulative monetary measures even though they have substantially revised up both their growth and inflation forecasts over the short term. As a result, market inflationary expectations are at multi-year highs, bond yields have risen, and the yield curve has steepened significantly.

Still, hoping to counter the upward pressure on yields, Fed Chair Powell has opted to double down on the FOMC's dovish messaging, noting that the recovery is far from complete, unemployment is still very high, and the Fed will continue to provide the economy the support it needs for as long as it takes. "*We have been living in a world of strong disinflationary pressures – around the world really – for a quarter of a century*," Powell noted. "*We don't think a one-time surge in spending leading to a temporary price increases would disrupt that*." This messaging puts investors in a bit of a bind:

On the one hand, it sounds reassuring because it suggests the Federal Reserve knows something investors don't and therefore is willing to be even more stimulative if needed; On the other hand, it amplifies concerns about financial and economic overheating (meaning high inflation), an issue lately highlighted by many prominent economists / investors (Larry Summers, Ray Dalio, Michael Burry). For this week though, traders seem a bit more reassured (the illusory truth effect finally taking hold? 😊), with 10-year US Treasury yields sliding down to 1.63% after briefly breaching the 1.75% resistance level last week.

Then there is Cathie Wood (not to be mixed with Cathy Guisewite, the creator of the Cathy comic strip 😊) - founder, CEO and CIO of ARK Investment Management seven years back. Ms. Wood is credited for being early on many successful themes, having a- embraced active management when investment seemed unavoidably tied to indexing, b- implemented her stock-picking in active ETFs while the largest asset managers said it couldn't be done and more importantly c- bought companies that others thought were overpriced, a joke, or both! Last year, five of ARK's seven ETFs returned an average of 141% and three were the top performers among all US funds. That has provided Wood with a large following on social media and fostered a sense of community and fandom akin to the Buffet mania. Her latest much awaited 2025 price target on Tesla stock? A bold $3,000 a share by 2025. If Ms. Wood is right, that means there is still nearly 370% in potential upside in Tesla stock from yesterday's close of $640; A gain that massive would make Tesla worth upwards of $2.9 trillion – more than any S&P 500 company is worth now. For years, ARK Invest has made daring pronouncements on what Tesla stock is worth; Their targets - usually well in excess of the prevailing thought on Wall Street - have been consistently proven right. Last year, Ark said Tesla stock would hit a split-adjusted $1,400 a share by 2024; And now, it is taking the target up more than 100% in a year? (Ark is currently the 20th largest holder of Tesla stock, with 4.1 million shares valued at roughly $2.63 billion).

Last, but not least, worth highlighting Goldman Sachs' firm standing on calls for an oil super-cycle and further rallies in equity prices: The past two weeks' sharp selloff and increased volatility in oil markets (Brent oil down roughly 15% from recent peak) have shocked markets and taken traders off-guard. The narrative heading into this unexpected turbulence was that OPEC+ discipline combined with accelerating recovery from Covid-19 and a dash of stimulus-inspired inflation would keep pushing oil prices higher. There was also general talk of a new "super-cycle" in commodity prices. However, a report released by the International Energy Agency (IEA) showed that oil does not look especially in short supply; Other negative factors quickly piled on: Chinese refinery maintenance was curbing demand for barrels there, whilst Europe's delayed and uncoordinated vaccination rollout was dimming hopes for a swift EU economic recovery. However, Goldman Sachs - amongst other top banks – has reiterated its long-term bull case for oil, saying the recent price decline is a "*buying opportunity*" as well as maintaining its forecasts for brent crude to hit $80 a barrel over the coming few months (last at $63.00 a barrel). On the equity front, Goldman Sachs strategists strongly believe that "*the fundamental factors that drive a market and the early stage of the economic cycle would suggest that equity prices are far away from a bubble or bear market, despite signs of complacency and heightened optimism in the market*."

Are the above successful market projections or simple illusory truth effects? Take your pick!

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