

Mystery of the Markets Solved

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The S&P index rose 16.3% in 2020, the Dow 7.2%, and Nasdaq a whopping 43.8%. At the same time the economy went into recession in September 2019 and then tanked altogether when Covid-19 got serious in early 2020. The result – a frozen economy, huge unemployment, and for a brief spell the markets moved in a way that reflected real conditions.

Then a reasonable turnaround came when a large stimulus package included extra funding for the unemployed, money big business to retain their workers, and cash payments to all Americans that filed a tax return and earned less than \$75,000. But this did nothing more than prevent total collapse. The surprising thing is that markets went from a steady state to explosion of record breaking closes, including the last market day of the year. Very freakish conditions in the markets – very bad condition in the real economy.

The origin of the boom was in the actions of the Federal Reserve Bank system, particularly the NY branch, and the US Treasury Department. Emergency money sent to the Fed can be multiplied over many times back up businesses by purchasing debt, and especially in creating specialized financial instruments for helping businesses in more positive ways.

Unknown to many the NY Fed has its own trading desk that does business from 4:30AM to 6:30PM just like any stock broker except that they are not trading for the benefit of particular persons or business entities. Instead they are creating an artificial gloss in the markets that can be enhanced into a positive illusion relating to the economy as a whole.

Financial crises occur when something scares the markets and causes short term loan rates to shoot sky high. The last one liquidity crisis occurred September 17, 2019. The big market casino players: banks, hedge funds, mutual funds, etc., secure their stock transactions with short repo (repurchase) cash loans secured with pledged collateral of various types. Money market funds usually make the loan. Should a downturn cause the value of the collateral to weaken, the lender will demand more financial backing. Normally loans for borrowers were around 2% but on September 17 they jumped up to 10%. That froze many transactions and caused a market crisis that suddenly brought in

the NY Fed as a lender of last resort. Later the Fed set up the 24 primary dealers (includes all the big banks) to take over emergency lending. Those banks also own a majority stake in the NY Fed. Holdings in domestic securities by held by the NY Fed at the end of 2008 (peak of the GFC) stood at \$576 billion. As of December 9, 2020 it was \$6.59 trillion.

The key point is that the markets can be booming even when the economy is close to crashing because many 'investors' are closer to being gamblers. They have no more knowledge of the future than a gambler calling a dice throw knows what will come up. But with the help public officials and the media always trending toward positive news in the bleakest times the markets will also trend up because investors follow their cues. Eventually the deceivers and the willingly deceived will deviate so far from reality that real conditions assert themselves ending the game while causing massive harm to the millions who weren't participating in the scheme.

The Obama administration had legislation passed that gave the Treasury more control over Fed use of resources. The current Treasury secretary recently ordered the Fed to return a large sum to Treasury because external financial conditions can crash world trade denominated in US dollars. Having the dollar as the standard trading medium is of critical importance to this country. Thus the US through the Treasury also backs up foreign banks that deal primarily in dollar denominated transactions. Again, another artificial prop, a delaying action in hopes that somehow things will get better.

Economic Info

China is gradually developing schemes to makes its RMB as good as the dollar for trade and investment transactions. It is offering bilateral swaps denominated in RMB with the borrower's currency being used as collateral. The RMB was declared the 5th freely usable currency by the IMF in 2016. The borrower can use the RMB for transactions requiring a stable currency and after usually three years will return the borrowed amount in RMB and get its own currency in back having paid a portion as a fee. It's a first step.

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