First Trust Portfolios Canada®

Monday Morning OUTLOOK

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Don't Watch "Cash on the Sidelines"

As we have written…The Era of Easy Everything is ending. Part of this involves bringing inflation back to the Federal Reserve's target of 2.0%. We could debate that number, but the Fed is getting closer.

Nonetheless, like kids who had lifelong learning loss because of school closures, the legacy of COVID money printing will never go away. The Consumer Price Index is 13% higher today than it would have been if inflation had stayed at its pre-COVID trend of about 1.8% per year.

In other words, we might go back to normal on the rate of inflation, but there is a "new normal" for the price of all things.

This adjusting has been going on since the Fed was created in 1913. Because of the bank failures that went along with the Fed's mistake of "deflation" during the Great Depression, Congress created the Federal Deposit Insurance Corporation (FDIC). The initial level was $2,500 per account. It was lifted many times. The last was in 2008, to $250,000 per account. In other words, "inflation" has been at work for a long time.

And that brings us to today. The M2 money supply has nearly tripled since 2008. Yes, people have multiple bank accounts, and, yes, some people have more cash than others. But if the M2 money supply has tripled, that means, all else equal, the average checking account tripled as well. In other words, if we adjusted for this increase in M2, deposit insurance levels should be $750,000.

That's how much money the Fed has created!! In just the past 18 years. We look at this as a negative, but others talk about "cash on the sidelines" that could lift stock prices.

The basic problem with this theory is that it treats the stock market as if it were some sort of sinkhole for liquid funds, which it is not. The theory is that if investors or potential investors have big fat bank deposits or money market accounts, they could put these funds into stocks, which would send equity prices higher.

But if one investor decides to draw down their bank deposits or money market funds to buy stocks, the person whose shares they buy will end up with fewer shares but more money in bank deposits and money market funds. On net, the amount of cash on the sidelines doesn't change.

Does this mean that cash on the sidelines is completely irrelevant? Not really. Growth in the money supply not only causes inflation, but also causes the "price" in dollars of all things to go up. But just because the price of stocks, or gold, or houses goes up it does not mean we are "richer." We must factor inflation into all things. So, while the Fed can increase the amount of "cash on the sidelines," and that may lift prices initially, once it is "in the system" it no longer has an ongoing impact. Cash on the sidelines has been rising since 1913.

Yes, US stocks are down from their peak earlier this year. But equities are still modestly overvalued and can go down further in spite of all that "cash on the sidelines."

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-30 / 7:30 am	Q1 GDP Advance Report	+0.3%	**+0.1%**		+2.4%
7:30 am	Q1 GDP Chain Price Index	+3.1%	**+3.3%**		+2.3%
8:45 am	Chicago PMI – Apr	46.0	**45.4**		47.6
9:00 am	Personal Income – Mar	+0.4%	**+0.4%**		+0.8%
9:00 am	Personal Spending – Mar	+0.6%	**+0.5%**		+0.4%
5-1 / 7:30 am	Initial Claims – April 27	224K	**221K**		222K
9:00 am	ISM Index – Apr	48.0	**48.1**		49.0
9:00 am	Construction Spending – Mar	+0.2%	**+0.2%**		+0.7%
afternoon	Total Car/Truck Sales – Apr	17.2 Mil	**17.1 Mil**		17.8 Mil
afternoon	Domestic Car/Truck Sales – Apr	12.4 Mil	**13.2 Mil**		13.6 Mil
5-2 / 7:30 am	Non-Farm Payrolls – Apr	133K	**145K**		228K
7:30 am	Private Payrolls – Apr	118K	**130K**		209K
7:30 am	Manufacturing Payrolls – Apr	-5K	**0K**		1K
7:30 am	Unemployment Rate – Apr	4.2%	**4.2%**		4.2%
7:30 am	Average Hourly Earnings – Apr	+0.3%	**+0.3%**		+0.3%
7:30 am	Average Weekly Hours – Apr	34.2	**34.2**		34.2
9:00 am	Factory Orders – Mar	+4.5%	**+4.5%**		+0.6%