[View as Webpage]

Market Comment:

Reinflating credibly

In January 2012, the Federal Open Market Committee (FOMC) issued a "Statement on Longer-Run Goals and Monetary Policy Strategy." The statement was part of Fed Chairman Bernanke's efforts toward additional policy transparency, and included, for the first time, an explicit 2% long-term inflation target. The target, as interpreted by market participants and also as executed by the Fed, lacked credibility. Market participants never priced in an average forward-looking inflation of 2%, and the Fed began hiking the Fed Funds rate in 2015 when inflation was well below their target. For better or worse, inflation has undershot the Fed's stated target since 2012.

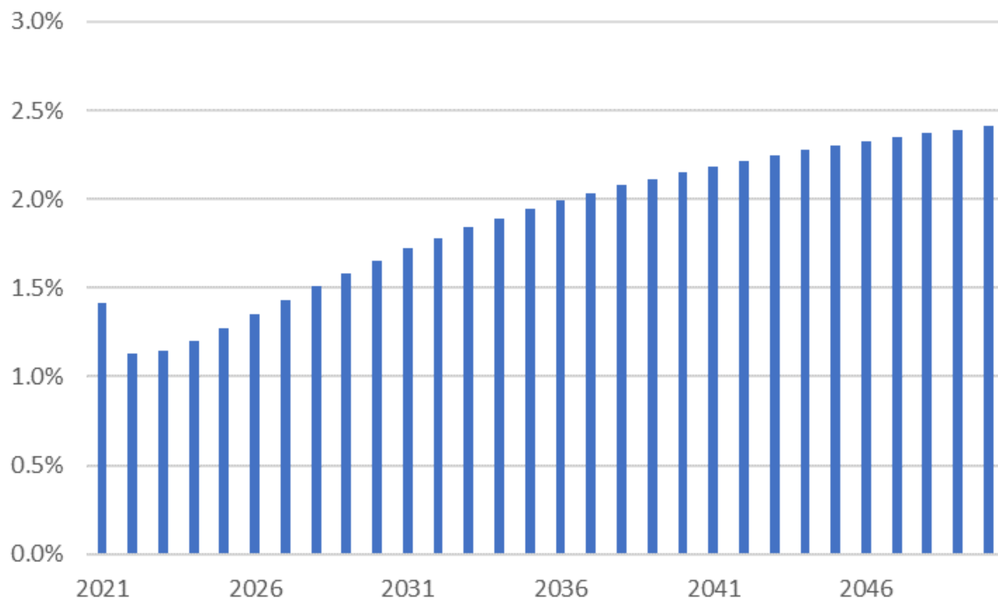
In their post-COVID response the Fed announced an important update to their inflation policy.

"...the Committee seeks to achieve inflation that averages 2 percent over time, and therefore judges that, following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time."

This is Fed speak for "we really mean it this time." By explicitly targeting an *average* inflation rate of 2%, the FOMC can allow inflation to run above 2% until they believe full employment has been achieved for the broad economy. Subtle language, but it's hard to overstate the ramifications. As a counterfactual, the FOMC would almost certainly not have raised rates in 2015 if this new policy had been in place at that time.
What does this mean for investors? Expect the Fed to do exactly what they say they are going to do as inflation moves toward and above 2%: maintain the Fed Funds rate near zero, use quantitative easing to anchor long-term bond rates, and let the labor market continue to heal for however long it takes. Most investors have heard the adage "*don't fight the Fed*," but

inflation expectations imply the Fed will not see 2% inflation for 15 years (Fig. 1). The Fed will be happy to prove them wrong.

Fig. 1: Market implied inflation (year-over-year), 2021-2051



Source: Cleveland Fed, Mill Creek

Updated Benchmark Performance:

Benchmark Performance by Asset Class			
	Week-to-Date	Month-to-Date	Year-to-Date
U.S. Large Cap Equities	1.76%	2.24%	18.65%
U.S. Small Cap Equities	2.04%	4.01%	14.84%
International Developed Equities	1.02%	2.32%	5.41%
Emerging Markets Equities	1.66%	3.82%	14.42%
Global Equities	1.53%	2.42%	13.79%
U.S. Bonds	-0.42%	-0.49%	6.84%
Intermediate Municipal Bonds	0.10%	0.05%	3.88%
High Yield Bonds	0.86%	0.79%	5.96%
Oil	1.82%	2.59%	-35.00%
Gold	2.90%	3.32%	17.42%
Key Rates	12/4/2020	12/31/2019	12/4/2019
U.S. 2 Year Treasury Note	0.16	1.58	1.58
U.S. 10 Year Treasury Note	0.97	1.92	1.77

Week in Review:

- Lawmakers in Washington DC made progress on a $900 billion coronavirus relief bill last week aimed at helping small businesses and boosting unemployment benefits. A weaker than expected jobs report, which showed that the economy added far fewer jobs than expected in November and that the labor force participation rate declined, helped spur politicians to restart negotiations.

- Enterprise cloud computing solutions provider Salesforce has agreed to buy messaging software developer Slack Technologies in a cash-and-stock deal worth $27.7 billion. The deal, Salesforce's largest acquisition yet, is a bet on the continuation of the remote work surge and creates a legitimate competitor to Microsoft and Google in cloud computing.

- Oil prices reached a nine-month high last week as OPEC and its allies agreed to increase production, but more gradually than initially planned, and the dollar reached a two-and-a-half-year low. Despite the higher prices, oil companies have laid off thousands of workers, written down billions in assets, and gone bankrupt at unprecedented levels this year.

- Airbnb, which is poised to go public this week, has reportedly decided to increase its proposed IPO price to a range between $56 and $60, valuing the vacation rental marketplace between $39 billion and $42 billion. Food delivery company DoorDash, also expected to begin trading this week, is expected to fetch a valuation near $36 billion.

Economic Calendar:

- Consumer Price Index – Thursday, December 10th
- Weekly Jobless Claims – Thursday, December 10th
- Producer Price Index – Friday, December 11th

This week's contributors: Michael Crook, CAIA and Dusko Jankovic, CFA, CAIA

Indices Used: U.S. Large Cap equities: Russell 1000 Index, U.S. Small Cap Equities: Russell 2000 Index, International Developed Equities: MSCI EAFE Index, Emerging Market Equities: MSCI Emerging Markets Index, U.S. Bonds: Barclays Aggregate Bond Index, U.S. 10 Year Treasury Note: Bloomberg 10 Yr. Treasury Note, Municipal Bonds: Barclays Intermediate Municipal Bond Total Return Index, High Yield Bonds: Barclays U.S. High Yield Total Return Index, Oil: Bloomberg WTI Crude Sub-Index Total Return Index, Gold: Bloomberg Gold Sub-Index Total Return Index