Basis Points – January 10, 2019

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Above the Fold

- Christmas Eve 2018 was a terrible day for the equity market, as the Dow dropped 653 points and the S&P 500 closed perilously close to bear market territory, down 19.6 percent from the recent high. However, since that day the S&P 500 has rallied 10 percent, crude oil has risen 23 percent and the FAANG index of large tech companies has rallied 16 percent.
- There is historical precedent for the prior year's lagging stocks to outperform in January. That's been the case thus far in the Russell 1000 large stock index, with the group of last year's worst-performing stocks outperforming last year's best-performing stocks by nearly 600 basis points in the early days of 2019. The sharp oversold rally in energy stocks is a large part of the rebound, with a turn in the homebuilder stocks also a factor.
- Although the stock market seemed extremely volatile in 2018, the trading activity was about normal. During 2018, 64 trading days were either up or down at least 1 percent. This is only slightly higher than the 40-year average of 62 days as volatile per year.

- As part of the very strong jobs report released last week, the unemployment rate ticked up a bit to 3.9 percent. Why did this rate rise in such a strong jobs market? Because more people are entering the jobs market. There has been a striking increase in prime-age labor force participation for women, driving the overall rate up to 82.3 percent, the highest rate in three years. This added labor supply will help keep wage inflation lower and extend the economic cycle. The labor force participation rate is also surging with those folks age 65 and older.

Three Things

- Amazon founder Jeff Bezos announced by tweet yesterday that he and his wife of 25 years, Mackenzie Bezos, have decided to divorce. The couple resides in the state of Washington which is a community property state, so all assets acquired after their marriage will most likely be divided equally. After the divorce, the former richest man in the world, with a net worth of $137 billion, will plummet all the way down the Forbes 400 list to number 4, tied with his ex-wife at $69 billion each. Most of the Bezos' wealth is tied up in Amazon stock, and Ms. Bezos would be wise to keep her stock and remain a large shareholder, as disposing of the shares would reduce the family's voting influence and control in Amazon from 16 percent of the outstanding shares to 8 percent. An Amazon that moved forward with far less ownership power and influence from Mr. Bezos may be valued lower by investors, so Mr. Bezos' right to continue to assert voting power on all their shares will be a key issue in divorce settlement discussions.
- The White House announced Tuesday that despite the ongoing government shutdown, the IRS will process and issue tax refunds on time. While just 12 percent of IRS employees are currently working, more will be called back from furlough to issue tax refunds and answer inbound calls from Americans seeking tax filing assistance this year. Any delay in refunds could slow the U.S. economy and consumer spending this quarter, as a large amount of tax refunds are usually spent in the first few months after receipt.
- If you pay for a Netflix subscription and have not watched Bird Box yet, you are by now most likely in the minority of all subscribers. The Netflix-original horror movie starring Sandra Bullock premiered on Dec. 21 and has scored a big audience in the short time since its debut. Netflix rarely releases data on viewership of its content, but the viewership for Bird Box is too huge to not promote. Netflix said a record-setting 45.3 million of its 137 million accounts (33 percent) watched at least 70 percent of the movie in the first week of its release, even prior to the film becoming a cultural and social-media phenomenon. The movie's $30 million budget is cheap by Hollywood's standards and the film may have displayed the power of releasing movies straight to a streaming service while bypassing traditional theaters. The success could also increase the flow of traditional movie screenwriters, directors and producers to create theater-quality content for streaming services rather than traditional theaters.

Did You Know

The topic of the Fed's balance sheet and its decision to slowly sell the bonds that it purchased earlier in the decade has been discussed by Fed policy watchers and policy wonks recently. The topic seems complicated, but it is a much simpler idea to understand than it would seem.

In addition to raising short-term interest rates, the Fed can also implement monetary policy by adding money to the financial system or by taking it away. The Fed can attempt to boost the economy by adding money to the financial system, and alternatively can try to slow the economy down by taking money away. In 2008-09, during the very sharp economic decline brought on by the financial crisis, the Fed injected money into the financial system, to lower long-term interest rates and boost economic growth. The Fed adds this capital to the financial system by buying bonds in the open market.

If the Fed purchases $50 billion in bonds, the Fed then holds the bonds on its books and the investors who sold the bonds to the Fed receive the $50 billion for the sale of their bonds. This transaction adds $50 billion to the financial system, that is then used by investors to purchase stocks, bonds or other securities, thereby supporting asset prices.

The addition of money to the system also helps to decrease long-term interest rates, which may also help spur economic activity. As with any product, if there is an abundance of it (e.g., water), then the market price of that product is low, and if there is a scarce amount of it (e.g., diamonds), then its market price tends to be high. During the financial crisis, the Fed purchased and held a large amount of bonds, thereby adding a huge amount of money to the system. With a lot of money sloshing around the system, the "cost" of money (the interest rate paid to borrow and use that money) tends to stay low, which can aid economic growth and recovery.

In 2018, the Fed began to reverse its policy, by selling some of the bonds it holds back into the market or by allowing the bonds to mature without buying more. When it sells $50 billion in bonds, the Fed receives $50 billion in cash from the market from its sale of the bonds, thereby taking $50 billion out of the system. Less money in the system tends to increase interest rates, and the Fed does this to ensure that the economy and inflation do not overheat.