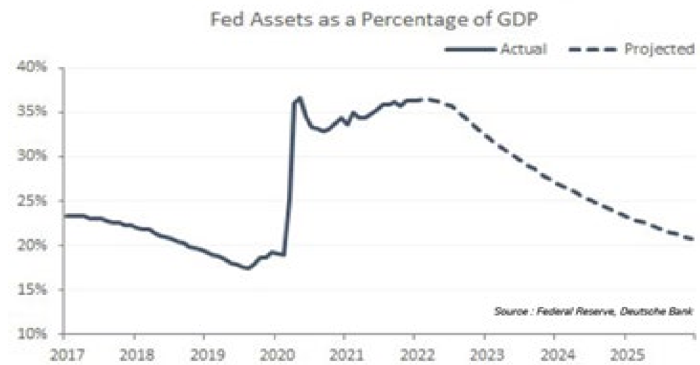
Fixed Income – Buyer of Last Resort

The biggest concern most fixed income investors have given the Feds' pivot to end their bond buying binge, is who becomes the proverbial 'buyer of last resort?' The chart below shows how swollen the Feds' balance sheet has become and their forecast for reducing the balance sheet over the next 5 years to the level it was prior to the pandemic. I am not the first to be skeptical the Fed will ever achieve success reducing their balance sheet as forecasted. First of all, if the Fed steps away from bond purchases entirely, it could create a demand vacuum that if not filled would cause interest rates to move rapidly higher. Not only would this be devastating for the consumption economy, it could require a much larger share of Federal revenue to be used to service future debt issuance.



Technical – Riding the Wave

If anyone wanted to throw shade on the idea that risk assets have benefitted substantially because of Central Bank largesse, they would have to contend with the chart below. The FANG+ index represents the largest capitalized stocks that are predominately technology companies. As the assets held on the five largest Central Banks have grown exponentially, so has the price of these stocks. When Central Banks create excess liquidity, that money finds its way into risk assets such as stocks and real estate, driving the prices often much higher than fundamentals could justify. Most worrisome for growth equity investors is what happens to stock prices if and when the Central Banks eventually begin to reduce their balance sheets. If correlations hold true, and I expect they will, some of the stocks in this index are likely to come crashing back down to much lower prices.