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Has the stock Market de-coupled from the economy?

The economy is moving ahead adding 2.3 million jobs over the last 12 months. Consumer sentiment is running close to its highest level since before the recession. And the overall economy is growing at a modest rate of 2.1% during the same period.

Dow Jones Industrial Average, on the other hand, peaked at 18,351 in May 2015 and then dropped to a low of 15,503 in February of this year, a drop of more than 15% during a period of relatively steady economic growth. It is of course possible that the market was making a correction after rising by 157% between February of 2009 and February 2015, during a period when the economy expanded by only 13%. The stock market clearly rose significantly higher than any thing resembling rational expectations of future financial values. So at the time many people in the market argued that the stock market has de-coupled from the economy, as if the market is an entity all to itself. This provided a lot of entertainment for economists.

What made the market rise so rapidly and then made it slowdown and for a while even drop?

What made this recovery cycle for the stocks so different from all the previous ones was the FED's almost direct intervention in the stock market. While the FED didn't actually purchase stocks, by buying bonds from the major brokerage houses, it significantly increased their liquidity. To balance their portfolios, those brokerage houses, purchased more stocks. This is a monetary policy engineered to push up the stock market. And it worked! There are, however, always unintended consequences. The unintended consequences of that much almost free money being pumped into the market were not only the excessive growth of the stock market but also that fact that continuation of that growth became dependent on the continuation of the FED's super sized expansionary monetary policy.

The stock market and the monetary base grow rapidly and almost in-step from the end of the recession through 2014 when the FED put a stop to its unprecedented rapid monetary expansion. The FED not only stopped its historical monetary expansion, it started to reduce the monetary base, albeit very slowly. The stock market, more or less, followed the same path, after its rapid expansion it started to move almost sideways. In December 2014 DJIA closed the year at 17,823, the index then dropped by 2% in 2015 and as of the end of June 2016 it is up less and 1% over its 2014 close! This is not to say that slower growth in China, the drop in oil prices and Brexit had no impact on the market, but those impacts pale in comparison with the FED's defacto declaration of the end of its involvement in actively pushing the stock market up.

The reality is that the market goes up and down, however if we take a long-term view of the DJIA and adjust it for inflation we can see that between October 2007, before the start of the recession

and the end of 2015, DJIA, adjusted for inflation, rose by 10.5%, very close to the 9.9% increase in the inflation adjusted GDP during the same period.

In the long-term the market does not appear to have “de-coupled” from the economy, and almost all non-permanent monetary attempts to move it in one direction or another eventually prove temporary.