

Weekly Market Insights

November 5, 2018

Election Date is Nigh, the Market Rebounds, and Consumers Remain Confident!

The equity markets began the past week continuing its swoon. But sentiment turned on Tuesday and the market ended the week up. The Dow closed +2.36%, the S&P 500 up 2.43% and the NASDAQ +2.65%. This, of course, is good news for investors but why did investors' mood shift? There are as many opinions as there are investors, some sound, some not so sound. An obvious one is October tends to be a difficult month for equities and it is coupled with a mid-term election, which is also viewed as bearish. Both may be sound reasons why the market swooned in October and rallied during the last week. But there are other reasons, perhaps more steeped in economics.

The first, was the market retreat overdone? Certainly, it was a dramatic and rapid retreat. But there are other concerns. We wrote last week that economic progress in the United States remains quite positive and earnings continue to show strength. As our regular readers know, we are happy to hang our hat on earnings. Gross Domestic Product continues to be strong and as one would expect, employment continues to expand, and now wage growth has picked up steam. An observer does not need a degree in economics to appreciate that more jobs and higher wages adds economic stimulus and leads to economic growth. All this adds to consumer confidence. This appears to be a positive outlook for both the economy and financial markets. But, there are clear concerns.

The trade deficit is probably the most written about economic variable since the last presidential election. Just last week, the government reported the trade deficit expanded, particularly with China. There are two ways to look at this statistic. One is the late 17th to early mid-18th century mercantile view which says the object of any trade is purely to have a positive cash balance. This theory has some following today, although not with

many students of economics. The other more modern view is that trade deficits are not damaging. Actually, a deficit is a sign of strength for a country, particularly a country with full employment and rising wages. But investors are concerned not so much by the fact that there is a deficit, but that it is a leading cause of the nascent trade war, most importantly between the United States and China.

Investors were encouraged last week when Mr. Trump said he had a good talk with Mr. Xi and they would follow that with a face-to-face meeting and private dinner at the upcoming G30 meeting. We are less concerned about an all-out trade war, as it appears neither side is really stepping over the boundaries. Mr. Xi is not as bellicose as he started out and Mr. Trump has not taken advantage of opportunities to strike hard at China. A good example is Mr. Trump relaxing the Commerce Department's sanctions on ZTE. These sanctions could have been very damaging to the Chinese economy, but the Trump administration backed down to avoid escalating the tense relationship.

Another legitimate concern for investors is rising interest rates. Our view is the Federal Reserve under Chairman Powell will be cautious and not raise rates too high or too fast.

At the moment, the elephant in the room is the mid-term elections. It is always an interesting and sometimes fun event. It is less so now because of the vitriolic speeches and ads run by both sides. But, they are important and we must follow them carefully. Everyone enjoys making predictions, so we will make ours. We agree with the pollsters that the House will go Democratic and the senate will be Republican by the narrowest of margins. As it is obvious, we agree with almost all the pollsters. After the last election readers

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may ask why? Well, they actually got the popular vote right, just not the Electoral College. In this election, only the popular vote counts. Do we think that a change in the House will make dramatic changes? Not really, most likely it will mean a stalemate. Besides some of the interesting and coldly fought House and Senate races, there are some general election results that may influence legislation for years to come.

Democrats will be following which of their candidates do well and which don't. Who are the big winners and who squeaked by? This most likely will determine which

wing of the party has the most influence in choosing the next Democratic candidate for President. Will it be the Biden branch or the Warren/Sanders group? Equally important will be the results for the state legislatures and governors. The reason we place so much emphasis on these races is that it is the state house that controls reapportionment. If there is a change, the country may see a wave of reapportioned districts which can dramatically change presidential election results.

Clearly, this is an important mid-term election.



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