Weekly Market Insights

November 26, 2018

Weak Market, Political Turmoil and an Interesting New York Times View on China

Equity markets ended the Thanksgiving week with large losses. Analysts can find a score of reasons investors soured on the market. Interestingly, none are really new. The continued uncertainty about tariffs and the trade war has riveted investors to the news services. We agree that investors should be very concerned but, as we have written in the past, trade is so important to the global well-being that trade settlements, in our view, will be reached. U.S. investors should be the least affected if a trade war breaks out. As we have reported many times, the United States is the least dependent country on trade. This in no ways means a trade war won't be damaging; it only means it will be less damaging. This puts the U.S. in a good bargaining position. Of course, this good bargaining position is a double edged sword. It can easily lead to over-confidence and a collapse of the talks. As we wrote earlier, the greater probability is that this does not happen.

Some analysts are warning of an economic slowdown in the United States. It is true that recent statistics have not been particularly robust, but it is far too early to think of this as a trend. All economic cycles are made up of mini-cycles.

This, of course, leads us to the Fed "to tighten or not to tighten!" The Fed and its chairman, Jay Powell, have been under some pressure from Mr. Trump lately. Mr. Trump is mightily against any tightening move. Of course, no President facing an election in two years looks favorably at monetary tightening, only most are less public about it. As to whether the Fed will or won't tighten, it depends - a very unsatisfactory answer. We have continually written that investors should take the Fed at its word. They have said repeatedly what the plan is, to continue to tighten. They also told the public that these plans can change if the economy changes directions. This is exactly what investors should be happy to hear. Our view remains the same: the Fed will raise rates in December.

It is important not to rush to judgment.

Another international concern is the slowing Euro economy. The European Central Bank (ECB) President, Mario Draghi, is unlikely to watch a slowdown develop without taking action. Brexit remains an unknown and investors await some kind of settlement.

Adding to the confusion is the apparent economic growth slowdown in China. It seems clear that China's decades-long growth spurt is slowing.

The New York Times ran a supplement this Sunday about China. It is a long piece and very interesting, but I think in many ways is misleading. I refer most particularly to the article on page 9 of the supplement authored by Javier Hernandez and Quoctrung Bui. This article addresses the massive movement of the Chinese population out of poverty. The entire Times issue is welcome for a number of reasons. It focuses all of us to face China and its growth in a measured manner. It should help U.S. citizens make better decisions and it forces us, as analysts, to focus more on China.

The article correctly praises China's rapid growth out of poverty and does say that China remains much poorer than the United States. In the very first line of the story, the authors say, "China has risen so rapidly that your chances of improving your station in life there {China} vastly exceed those in the United States. In the second paragraph they write "the Chinese have taken a commanding lead in that most valuable economic indicator optimism." They end the piece with an example or two of some dramatic stories of individuals raising themselves from rags to riches.

Here is an ideal case where it is important to dig a little deeper into facts. Clearly, China has done a great job of trying to eliminate poverty. Here is a case where absolutes count! To be in the poverty range in China a person earns $2.00 a day, while in the U.S. it is $33.61 a day. The increase in incomes for China has been rapid, but it came from a desperately low level. Economic output per person in China is $12,000 and in the United States it is $53,000.

A major thesis of the supplement is the American Dream has been replaced by the Chinese Dream. This is highly unlikely! If that were so, why do Chinese authorities have to prevent educated, wealthy Chinese from leaving the country and far more important, if opportunity was so great, why does the government fear capital flight so much?

The United States and the world should welcome China's rise from poverty! It is and will continue to be a good thing for all. But it can lead to grave errors if misinterpreted.

- Michael Olin Clark
moclark@1919ic.com