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Weekly Market Insights

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Mixed Signals, High Volatility and Yes, Virginia, There Has Been Progress

This past week has been characterized by dramatic volatility. On Thursday, the Dow Jones Industrial Average fell 660 points. The next day, Friday, it rose over 740 points.

The DJIA ended the week in positive territory, +1.6%, the S&P +1.86% and the NASDAQ +2.34%. Why has volatility come back with a vengeance? Why are investors so quick to abandon or buy the market? There are plenty of reasons, some very understandable and some not. We must first learn how a number of factors work together and make for a highly volatile environment. We have written about most of these factors in the past, such as the emergence of hedge funds and algorithmic trading. Readers can see our view on that subject by going to our web site, 1919ic.com, and reading last week's piece.

A series of seemingly contradictory economic statistics were released last week. During the first half of the week, the statistics that dominated investors' thinking pointed to a global economic slowdown. Auto sales slowed and far more important, the widely followed PMI (Purchasing Managers Index)[1] had its largest monthly drop since the recession. Unfortunately, these two pieces were compounded by Apple's early earnings warning. This warning emphasized the importance of the perceived slowdown in China as the prime reason. This, of course, added to investors' fears of a protracted, intensifying trade war. Adding to investor angst was the fear of the Fed tightening too much and too quickly. This made for a perfect recipe for investor panic.

The following day, as fear began to subside, a new and far more positive economic report was released by the government. It was announced that the economy had produced more than 300m new jobs, along with a positive adjustment for the past two months that were revised up 50m. Wages continued to rise, including, happily, some of that increase was going to low wage jobs. The labor participation rate is beginning to rise, which is an important positive. One of the reasons the participation rate is so important is a growing participation rate helps prevent wages from getting out of control and, perhaps most important, it adds to non-inflationary GDP growth. This was a remarkable improvement from expectations. This should boost consumer spending and, as we all know by now, the consumer makes up 65%-70% of U.S. GDP.

Adding to investor optimism, current Fed Chair Jerome Powell and former Chairs, Janet Yellen and Ben Bernanke, spoke at the American Economics Association annual meeting, and then Chairman Powell spoke to the Economic Club of New York and reassured investors that the Fed would act reasonably, and that they do pay attention to markets. This went a long way in reassuring investors. Of course, anyone paying close attention to the Fed's comments would not have to be told this. They have continually communicated to investors that the Fed's actions would be data dependent. Freely translated, if the economy falters, the Fed stops tightening! As an interesting side note, the Chairman said he would not resign if the President asked him to. This, perhaps, caused the greatest sigh of relief from investors, which speaks volumes about where investors' concerns lie.

The country has gone through many periods of confusing economic signals accompanied by political strife without so much angst. So why now? Is there an underlying problem that is making investors and citizens more sensitive than in the past? Yes, there might be.

[1]The **Purchasing Managers' Index** (**PMI**) is an indicator of economic health for manufacturing and service sectors. The purpose of the **PMI** is to provide information about current business conditions to company decision makers, analysts and **purchasing managers**.

Weekly Market Insights (cont'd)

Citizens, in general, have gotten used to shocks, but it becomes more difficult to adjust when their frame of reference has been shaken. Starting in the mid to late 1990's, the world saw a dramatic, but positive global change. The European Union was formed and not much later, the Euro currency appeared. None of this was threatening.

But in 2013, global change became more threatening and confusing. Xi Jinping came to power in China. Since 1949, The Peoples Republic of China (PRC) has been under the influence of two powerful leaders. Mao Zedong came to power in 1949 and led China until his death in 1976. He led China with an iron hand and was a devotee of Joseph Stalin. China fell into an economic death spiral. At his death, a diminutive Deng Xiaoping became the most powerful figure in The Peoples Republic. Unlike Mao, Mr. Deng had a much more worldly view of China and its place in the world of great powers. He counselled that China should concentrate on economic growth. To achieve this, he freed the economy and the people of many former restraints. He called this "Socialism with Chinese characteristics," which was a code for moving toward a market economy. From 1949 to 2013, the world had an understanding of what to expect from China. The year 2013 changed that. Mr. Xi Jinping (b1954…) became the Chinese's leader and, subsequently, supreme leader. He made a remarkable shift in China's public stance. He put the government/party back into the economy at a rapid clip. He has reignited the view that western imperialism has stolen China's greatness, and they must retrieve their rightful place in the world. This has been an enormous change for the developed world, both economically and politically. This alone would make investors skittish. But, it did not occur in isolation.

In 2016, Donald Trump was elected President of the United States. Presidential change occurs with frequency and explicit timing in the United States. Business is carried on as usual. Not this time. Mr. Trump appears to have changed the position of the United States within the global order. Heretofore, the United States acted as a benevolent leader of the free world. Mr. Trump appears to have a different view of what the United States stands for. The United States wasn't concerned that it ran a trade deficit with Mexico, a country nine times smaller than itself (as measured by GDP). That is but one small example. It is a dramatic change. The changing economic and political background makes investors and citizens alike far more cautious and uncertain. Investors have to regain confidence that the system is not broken and that this will pass.

I know I have readers who are more knowledgeable about the current situation in the PRC, particularly those raised in Main Land China. Please don't hesitate to let me know where I strayed!

And yes, Virginia, there is progress!

We read all the time about the problems and whether productivity will stay moribund and whether we will ever solve society's problems.

One night, July 20th, 1969, people in towns and cities across the country stopped their cars or stood outside their homes and stared at the moon. Everyone knew, of course, that they could never see, but they stared nonetheless, because that night, Neil Armstrong was walking on the moon. It was unbelievable. In fact, it was so shocking and unbelievable that Pravda reported it was a hoax. It was astonishing that man traveled 238,900 miles and landed on the moon. Just last week NASA 's satellite, having traveled past Pluto some 3 billion miles away, honed its powerful cameras and computers on a small piece of rock, another billion miles away. What is so shocking about this magnificent piece of science and navigation, is that it hardly caused a stir.

This is just a small example. Readers who are interested should read Greg Ip's wonderful piece in the Thursday, January 3rd Wall Street Journal, page 2 section A. It's a great read for the start of the year.

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