Weekly Market Insights

April 8, 2019

A strong Market, encouraging economic indicators, what can go wrong?

The U.S. equity markets continued to forge ahead this past week. The Dow Jones Industrial's gained 1.91%, the S&P 500 gained 2.06% while the NASDAQ gained 2.71%, impressive indeed.

Investors have been encouraged by solid economic reports, particularly this past week's employment numbers. They went a long way in convincing investors that the previously released dismal labor report was an aberration and not a trend. That report along with strong signals from the Federal Reserve that interest rate hikes were on hold reinvigorated investor confidence. Investors were also encouraged by indications from the Administration that trade negotiations with China were going well. We have argued in the past that both the economy and the equity markets should continue to prosper throughout 2019 and into 2020. There are still powerful forces pushing the economy ahead: strong employment, wage growth, low interest rates and consumer confidence to name a few. All the above strengthen our view that this expansion will continue into 2020.

As always, in an expansion, there are clouds building on the horizon. Unfortunately, it is impossible to know when they become powerful enough to bring down the economy.

Our job is to always worry and be skeptical. This is the reason we feel obligated to point out storm clouds which are on the horizon.

Very clearly, the most immediate is if the trade negotiations fall apart. Although it is far from conclusive that this alone would lead to a recession, it would clearly hurt the equity market. A surprise bout of inflation may cause the FED to raise interest rates. Another case where a 25 or 50 basis point move would unnerve market participants but may not cause a recession. A crisis in the debt market is another threat to market and economic stability. As interest rates have fallen and remained low, many investors have reduced their standards for credit quality and, of course, there are always funds willing to accommodate them. This is another area to watch very closely.

There is more to be concerned with! The Federal Reserve has, almost always, been shielded from undue politics. The president has nominated two new Fed governors. Stephen Moore and Herman Cain. Both seem unorthodox choices. Normally at least one of the choices would be an economist. In this case, neither. The Federal Reserve being nonpolitical, it is highly unusual for a nominee to have been a campaign worker for the President. FED watchers' will be glued to the Senate hearings.

Just to add to the confusion over monetary policy, "Modern Monetary Theory" has entered the picture. This is a highly controversial theory and if it gains credence can make great changes in how we view monetary growth and deficits. A much abbreviated part is deficits don't matter that much because the government can always print more money to pay off the debt, and all liabilities create assets elsewhere. Clearly this is not a true representation of the theory, but we will spend more time on it next week.

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