

Weekly Market Insights

September 14, 2020

Volatility, more on China and a great opportunity

Equity markets

Financial markets suffered a bout of extreme volatility this past week. The Dow fell -1.66%, the S&P fell -2.51% and the NASDAQ fell -4.06%. Although the daily market movements have been extraordinary, short-term periods of volatility should be expected given the shock and uncertainty of the pandemic. The equity markets have been on a remarkable journey under very trying circumstances. The markets' timely rebound occurred because the Fed, the Administration and legislature acted rapidly and in unison to combat the economic and financial market reactions to the pandemic.

The Fed

The Federal Reserve, as was the case in the Great Recession, was the first to react in an attempt to prevent an economic recession. They continue to lead today. As politicians debate how to continue to fight the economic effects of the pandemic, the Fed has come forward and extended their support of the economy, announcing they will be more tolerant of inflation as the economy comes out of the recession in an attempt to play a bit of catch up. The financial markets took this as a disregard of the Fed's task of controlling inflation. We don't agree. Just because they have told us they will continue to provide easy money for longer than markets expected, it doesn't mean they will allow the economy to enter an inflationary spiral. As we have written in the past, for inflation to become a problem, one of two things must occur—along with an excess of money, excess demand or the approach of production capacity, which are two sides of a coin. We believe the Fed will view demand approaching its limit as a sure sign they should reverse policy. In any case, the elephant in the room remains the pandemic.

China

China, the second largest economy on the globe, is not only vital to the health of the global economy, but, very specifically, to the health of the United States economy. We write about China frequently for that very reason. Elbridge Colby and Robert Kaplan wrote an insightful piece in the September 4 *Foreign Affairs*. The premise of the article is that the U.S. is making a mistake if they think the real competition between the United States and China is ideological. The U.S. should not be in an ideological struggle with China, but view it as more political and economic. They emphasize that the United States should be vigilant in condemning China for human rights violations. There is more to it than that. Although many in the Communist Party and Politburo may have a deep sense of ideology, their goals are not particularly ideological. The competition is about economic dominance and regional hegemony, and the United States should concentrate on these two areas of competition. Many of the countries in the region have no desire to have China be the dominant force in the area, Australia, New Zealand, Vietnam, Thailand and India, to name a few. The U.S. should have an active role in the Pacific region. The United States is, after all, a Pacific as well as an Atlantic nation. As far as economic power is concerned, our view follows that the United States should not try to fight an ideological battle in a commercial arena.

A great opportunity

In the midst of a national election and an economic crisis caused by the pandemic, public attention is naturally focused on solutions to the immediate problems. While this is logical, it is also a good time to think about long-term problems and how to solve

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them. Although the United States remains the largest economy in the world, a lot must be done to maintain and expand our economy. Solving some of these problems are long term and expensive, but they can be done. A lot has been written about income inequality. The great divide has been along educational lines. It doesn't make any sense that a country as rich and economically successful as the United States should have so many who don't have a high school diploma. Company recruiters complain that even those who have diplomas aren't prepared to handle the jobs being created by the new economy. During the last election, Mr. Trump suggested that community colleges should increase their efforts into vocational education. They should partner with corporations to form a sophisticated apprenticeship program. A startling statistic, the U.S. ranks sixth in the world in the percent of population having a degree after high school. Clearly, there is a lot that can be done.

Corporate America should be encouraged to reinvent itself into a more high tech environment. Combining incentives for stepping up technological innovation and developing a modern highly skilled work force will drive down production costs, so companies can be highly profitable.

Two other areas for government action are infrastructure and basic research. Everyone knows there is a great need for infrastructure programs. Not only do infrastructure programs create jobs, but they also prepare for the future economy, and, as a bonus, over time pay for themselves. Basic science, as infrastructure spending, tends to be long-term. The long-term nature is a problem, as it doesn't match up with any election cycle. Therefore, it is difficult for any politician to actually initiate either. It takes a great effort to educate voters as to why they should spend money now for great results years from now. If we want to move toward income equality, then the U.S. shouldn't waste time and political ammunition in an attempt to encourage low paying jobs, but help the workforce of tomorrow become the most efficient on the globe.

The last two subjects argue that international trade and globalism are not dead in the twenty-first century. Movement toward these goals has been going on for centuries. Yes, there have been fits and starts, but progress continues. It is foolish for any country to attempt to break the trend. The only positive return will be fleeting and debilitating in the long run. As we wrote, the United States remains in the ideal position to lead the parade. We only have to recognize what we must do and build the right popular consensus. Politicians work very hard to get into a position to lead. Now is the time to do it.

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