19/19 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

September 21, 2020

The markets, the economy, the Federal Reserve and the rest of the world

Equity Markets

The U.S. equity markets have been weak over the past few weeks. There are a number of reasons for this: the Fed moderating its tone when making announcements, lack of significant developments concerning progress against the pandemic, a rapidly approaching election, no fiscal stimulus package coming out of Congress and some slowing in economic growth numbers. There could be another far simpler explanation. Perhaps the market as a whole is close to being fairly priced. No one really knows, and it wouldn't be a market if we did. We are trading on either side of where we were before the pandemic, when unemployment and interest rates were very low but certainly not as low as they are today. Many analysts thought valuations were high then, so if we return to where we were, it can be argued we are at a fair price. If investors are looking for a return to previous earnings levels, the market appears to be correctly priced. But bears can say there should be a discount for time and uncertainty. We emphasize again, no one knows! Either way, it is an interesting thesis that investors should at least bear in mind.

Central Banks

Central banks around the globe are doing what they can to keep their respective economies buoyant, or at least on an even keel. As we have written in the past, due to delays in governments' fiscal response, central banks have had to bear a large portion of the fight against an economic collapse. For the most part, they have done a good job. The U.S. central bank, the Federal Reserve, has been in the forefront. The equity markets appear to have grown dependent on increasing Fed stimuli, and investors have been disappointed in the Fed's response the last few weeks. It is a positive that the Fed does what it believes is correct for the economy and not what equity investors expect. As far as financial markets are concerned, the Fed has three duties: conduct monetary policy, ensure orderly markets and provide financial stability. Nowhere does it suggest its job is to ensure profits for traders.

The U.S. Economy

The U.S. economy continues to grow, albeit at a slower rate than earlier in the recovery. Investors should expect growth to come in fits and starts and not read too much into it if economic indicators are disappointing for a few months. Given the difficulties and a bumpy recovery, contradictory reports may be with us for a while. Actually, it is a fairly common occurrence in most economies, but we tend to concentrate and read more into it during dramatic times such as this.

A future problem

Once the country gets past the economic problems caused by the pandemic, we should start thinking of another problem lurking in the future. The problem we should be thinking of is retirement incomes. The United States essentially gave up on traditional defined-benefit pension plans years ago. It was a time of positive equity market returns and high interest rates. It is clear now that the economy can go for long stretches with very low interest rates.

The self-funded pension fund was not conceived with this in mind. The idea of IRAs and 401(k)s was conceived with the best of intentions. The concept as it stands now appears to have broken down. We have asked people to act beyond their reasonable skill sets. We can't expect everyone to

be skilled money managers. Something must be done to create a reasonably stable principal and a decent return. The folly of thinking everyone can be a money manager is shown in several studies by consultants such as Brookings and Peterson. A recent study centering on wealth inequality highlighted some interesting points. It showed one of the principle reasons for wealth disparity between families with different educational levels is portfolio construction. After the 2001 market crash, the less educated remained out of equities, while those with higher levels of education reinvested in equities. The results are very dramatic in favor of those who reinvested.

Besides principal value, the other problem is income. In the 18th century, England was heavily in debt, which led to the invention of the perpetual bond. A perpetual bond is a bond with no maturity date but does, of course, pay a coupon.

No one can argue that the United States is not deeply in debt. Can a program be enacted where the government issues perpetual bonds at above current interest rates for retirees? Many problems must be worked out. They should be sold to retirement accounts only, non-tradable and puttable back to the government at the death of the retiree. More work is necessary to prevent arbitrage and other sorts of uses outside of retirement.

The cost of a very long period of paying interest would be made up for by not repaying principal.

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