1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

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An amazing week, an amazing market

The equity market

The President contracted the virus, there is no vaccine in hand, political turmoil is raging, high unemployment persists, GDP is quite low, and the equity markets had their best week in months. Interesting indeed. What is happening? Have investors lost sight of reality? We don't think so. In the past week or so we wrote that the market might be approaching fair value. There is a cogent argument centered on the fact that this recession was not a normal one. We didn't see the imbalances that one normally expects to precede a recession. Certainly, high interest rates were not the cause, and the consumer was not stretched. In fact, the consumer was in an excellent financial position. Corporate balance sheets were strong, and banks were well within the bounds of safety.

As we all know, an outside force, the pandemic, stopped the economy in its tracks. Investors were well aware of this and were of the opinion that once there is a cure or vaccine, the economy will advance rapidly to its former path. In all likelihood, the economy will indeed rise rapidly, but it will certainly face some difficulties as it approaches its former height. This could explain investor confidence. Of course, we have left out what we have written about in the past—Federal Reserve intervention and the stimulus package, both boosting the financial markets. As many analysts have pointed out, a vast majority of the market gains have come from a few stocks. If investors agree with our thinking outlined above, this leaves many stocks with compelling relative valuations.

The Federal Reserve

During the market recovery since the pandemic began, the actions taken by the Federal Reserve have been significant for the behavior of the financial markets. That, in a way, is one of the most important levers of monetary policy. It relies partly on the trickle-down theory. The Federal Reserve buys financial assets which raises the price of those assets. In turn, owners of financial assets become, or at least feel, wealthier and spend more, stimulating the economy. Of course, there are far more complex reasons the Fed enacts these policies, but clearly there is a direct effect on financial assets.

The Fed has let it be known that they will continue these policies until the economy returns to normal.

The economy

The economy continues to progress, with pockets of significant weakness. It is doing so in fits and starts, sometimes growing rapidly and sometimes disappointingly slow, but, so far, the trend remains upward. We wrote in the earlier paragraph about the stimulus package Congress and the administration passed a few months ago. It was an important part of the nascent economic recovery. It has now expired and its replacement is stalled in Washington. In our opinion, the continuation of the stimulus is paramount to the progress of the recovery. The sad truth is no matter how strong or fast the recovery, the country can never make up the lost production and wages caused by this or any recession.

International

Economic reports from China are positive, but there remain serious debt problems, particularly those debts related to the real estate boom. The government is also facing increasing problems with the Belt and Road initiative. The problems lay in both halted payments and complaints about the projects, while the host country is complaining about the low utilization of indigenous labor. The EU is still bogged down in the dispute between the rich north and the poor south. Interestingly, there is conflict between the E.U. leadership in Brussels and the political leadership in the home countries.

The UK, of course, is mired in a non-existent exit agreement.

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