Weekly Market Insights

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Global markets defy the pandemic, debt levels continue to rise and Europe remains in a quandary

Equity Markets

Given the pandemic, equity markets around the globe have behaved exceptionally well this year. Infection rates of Covid-19 have reaccelerated, sovereign debt levels continue to reach dramatic levels and Europe is still faced with an unsolved Brexit problem—the internal struggles between the rich north and poor south. The United States awaits the results of a highly contentious election. Why do investors appear oblivious to what appear to be obvious dangers to both the economy and equity markets?

None of these questions can be answered with a great deal of confidence, but for most we can give qualified answers. The first, and perhaps most important, concerns the pandemic. We have written many times that we are not scientists and we will leave pandemic questions to qualified medical experts.

Debt

Governments, whether through central banks, fiscal policy or both, have been pumping money into their economies and creating sovereign debt. Under most economic circumstances, investor concerns of impending economic overheating, severe inflation and, ultimately, a recession would be justified. These, of course, are not normal economic circumstances. As we have written in the past, it takes more than excess money supply to create inflation. There must be a corresponding increase in demand. Excess demand is not in the cards. As everyone is aware, the global economy has suffered a severe slowdown because of the pandemic and it is not likely to reach capacity for some time. Private and corporate savings remain strong, along with their balance sheets. Is there a danger of an overheating/inflationary environment in the future? Of course, but wise budget policies and careful money management can go a long way in avoiding these problems. Inflation appears to be a long way into the future.

An important point to keep in mind when judging central bank and fiscal behavior is, what was the alternative? The world was facing a catastrophic economic collapse, possibly leading to a rash of debt repudiation and widespread poverty. Governments and central banks provided a widespread safety net which prevented a much worse economic situation.

Europe

As we wrote last week, a solution to Brexit continues to defy the parties involved. It appears that the separation will occur without an agreement. If this does happen, it will create disruption and keep Europe's recovery on a very slow path. At the moment, the two engines of the world economy, the United States and China, appear to not be heavily impacted by a lack of an agreement.

Conflict within! As we and many others have written, the E.U. has been trying to resolve basic philosophic and economic differences between the north and south. It is deeper than just debt. It is about a view of life. These differences are not new and have been apparent for decades. Are they resolvable? Can these two sides coincide with an organization like the European Union? Perhaps yes, but changes must be made—either consolidate fiscal and monetary policy or revert to independent currencies. These, of course, appear to be very dramatic solutions, and there are undoubtedly others, but either of these would go a long way in resolving the differences. Neither one appears likely.

The Coming Election

We haven't written much about what will happen post-election. One reason is that election rhetoric tends to be an inconsistent guide to future behavior. We have had four years of Mr. Trump's, so we do have a sense of what a second administration would be like. If Mr. Biden is elected, some things are likely to occur. The U.S. would become far more attentive and involved with international organizations such as the WTO. Given Mr. Biden's history as both Vice President and head of the Senate Foreign Relations Committee, we think it likely that there would be far more congenial relations with Europe and most of Asia. The reason we say most of Asia, is that Mr. Biden has indicated his resolve to keep pressure on China. It is also very possible that the United States would join the Transpacific Partnership (TPP) under a Biden presidency, which would be an interesting change indeed.

Right now, the election does not appear to be in the forefront of investors' minds. Given the uptick of coronavirus cases, that seems to make sense.

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