Weekly Market Insights

February 3, 2020

Britain bids adios to the E.U., the virus continues etc., etc.

Many things occurred last week to spook the equity markets and the markets reacted as one might expect, they fell.

The Dow Jones Industrials dropped 2.73%, the S&P 500 was down 2.12% and the NASDAQ fell 1.756%.

The Virus

The most dramatic event was and remains the spread of the virus out of China to the rest of the world. It is spreading rapidly in China and cases are showing up in almost every continent. While there is no vaccination at this time, scientists believe the virus is not as life threatening as other viruses that have come out of China. Not surprisingly, it is the very young and elderly who are the most vulnerable. Of course, emerging market countries are at serious risk because they so often have sanitation problems and poor medical infrastructure. We have been through this before and the severe market reactions were unwarranted. Certainly, no one knows how this will end, but most likely, it will be less debilitating than investors' reaction.

Adios

It is now official, Britain has left the E.U. When markets fall in the midst of many events, it is difficult to distinguish which events are responsible. It appears to us that the health issues and apparent economic slowdown were more important to investors than Brexit. It will, most likely, be quite some time before the consequences of Brexit become clear, but even though many analysts are very concerned about the downside risks, which are many, the jury is still out and it will be a while before the results are known.

While most analysts concentrate on the economic effects, perhaps a more interesting question is, will this encourage other nations who feel they have been treated unfairly by Brussels to consider leaving? We think it unlikely but not out of the question.

The Economy

The United States economy, along with most of the world's economies, appeared to have slowed or held this past month.

The first estimate of U.S. Gross Domestic Product was released last week and it was not far from consensus expectation. Real GDP advanced 2.1% in the 4th quarter 2019. This is far from a powerful advance, but it shows the U.S. economy continuing to move forward. GDP is always difficult to analyze, particularly a first estimate, but this number is more difficult than most because of the effects of the trade war. Investors would be wise to wait for revisions. On the bright side, the U.S. initial jobless claims fell 7,000 last week.

The progress of the United States economy should keep the Fed's stance neutral. We would not expect to see the Federal Open Market Committee vote to either add reserves or reduce them. In other words, monetary policy remains as is, another positive.

Europe continues to have slow growth. We expect the European Central Bank (ECB) to maintain a stimulative monetary policy. As we have argued in the past, Europe needs fiscal policy, not more negative interest rates.

China remains in a difficult position. They are dealing with many problems that we have discussed before: a slowing economy, a serious debt fiasco, political problems with Hong Kong, a Muslim crisis, and now a health epidemic.

The Primaries - Iowa

Today is the real start of the political season, the Iowa caucus. The Democrats remain with a crowded dance card, with at least four hopefuls near the top. Although Iowa does not hold a lot of electoral votes, it is considered by some to be an important bellwether. In fact, due to the change in the rules instituted by the party, each electoral vote has become a little more important. The change we are referring to concerns superdelegates. Superdelegates are chosen because of their position in the party. Heretofore, they were free to vote for whom they pleased. In the last presidential primary, they voted overwhelmingly for Ms. Clinton even though the popular vote was close. This year, they will have no vote at all in the first ballot unless there is a clear winner.

A word about primaries and caucuses. There is a very important distinction that people should be aware of when analyzing results. Primaries are analogues to an election which we are all familiar with. They have relatively large turnouts and represent a broad spectrum of the party. Caucuses, on the other hand, have much smaller turnouts of the party faithful and almost always represent the extremes of the party. It will be important to keep that in mind when analyzing results. The caucus framework should help Ms. Warren and, particularly, Mr. Sanders. The primary should help Messrs. Biden, Bloomberg and Buttigieg.

Consumer Confidence Index (CCI)

The Consumer Confidence Index (CCI) is released on the last Tuesday of every month by the Conference Board. As the name implies, the CCI provides a gauge of consumer confidence in the United States and reflects consumers' attitudes towards business conditions, the labor market, income prospects, and overall perception of their expected financial conditions. Given the importance of the consumer to U.S. economic growth, the index provides a valuable look at the current state of the economy and insight into its possible path forward. The Conference Board itself calls the index a "barometer of the health of the U.S. economy."[1]

Usually, we would not delve into the specifics of index methodology, but the Consumer Confidence Index is relatively straightforward and easy to understand. It is based on the results of a random sample survey of 5,000 U.S. households, with the survey itself consisting of just five simple questions. Respondents are asked to: 1) assess the present situation of businesses and employment; and, 2) provide expectations for businesses, employment, and family income in the next six months. Survey participants may give three possible answers—neutral, positive, or negative. The Conference Board then scores these answers to calculate a "relative value" for each question by comparing readings to the 1985 base—the year the index was created. The resulting index values for each question are then averaged together to form, the total index reading.[2]

The CCI is used as both a lagging and leading indicator. That is, economists view this reading as either an assessment of how consumers reacted to events that have already occurred, or as an indication of what is to come. In the case of the CCI, that may be consumer optimism, future consumer spending, and consequentially, expected economic growth. Rather than subscribing to one methodology over the other, we urge you to consider both the leading and lagging perspectives in combination with what other economic indicators are saying. As we have repeatedly stressed, economic indicators should seldom be viewed in a vacuum and can often be revised from their original readings. So, approach each release pragmatically and resist the urge to make any pre-mature conclusions.

When interpreting the index reading, pay attention to its change from the previous month and overall trends over multi-month periods. A decreasing trend suggests consumers have a negative outlook on employment and business conditions, while an increasing trend indicates the opposite. Businesses factor CCI data into their decision making processes, and may plan for investments in new projects or increase production and hiring with positive trends. January's reading came in at 131.6, an increase from 128.2 in the prior month, marking three consecutive month-over-month increases.

[1]The Conference Board, Consumer Confidence Survey Technical Note –February 2011. https://www.conference-board.org.
[2]Ibid.

Michael Olin Clark moclark@1919ic.com Ryan Schutte rschutte@1919ic.com

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