Weekly Market Insights

March 23, 2020

Coronavirus and Response

Equity returns were addressed in our email this past Friday, but for those who may have missed it, here are the price changes for the week: the DJIA –17.30%, the S&P 500 –14.98% and the NASDAQ –12.64%. Startling numbers, indeed. Of course, the major story is the path of the coronavirus. The problem is, other than its spread, there is very little accurate information available. In two of our special reports, we gave our readers places to find the latest information, CDC.gov and coronavirus.jhu.edu/map.html. There is a lot of misinformation floating about. At least readers can have confidence in these reports.

What we can say with some confidence:

- How it is affecting consumers and business leaders
- Government actions attempting to combat the virus' effect on the economy
- Likely effects on the U.S. economy and financial markets, and
- Comparing it to other economic crises

Consumer confidence

As we all know, the virus has had a powerful effect on both consumer and business confidence. Morning Consult, a global polling firm, has been following consumer confidence related to the coronavirus on a daily basis since January 21, 2020. As one might expect, confidence has been falling continuously. A number of observations were record one-day drops. No one should be shocked by this, because there has been no shortage of publicity. This drop in confidence and the government's efforts to keep people at home has seriously slowed consumer spending and, therefore, the economy. Remember, the consumer is about 66% of the U.S. economy. Confidence was also shaken by a weak government effort to communicate in the beginning of the crisis. Interestingly, just in the past few days, consumer confidence in the Administration's efforts has picked up considerably.

Business confidence

Businesses confidence followed the consumer and fell along with it. After all, consumers are their life blood. Also, because of the global nature of the virus, businesses have seen their supply lines interrupted and cash reserves depleted. Their smaller brethren fear that they will go out of business. Help is coming.

Government to the rescue

After a slow and disappointing start, the Federal Government, following the lead of some states, has started to take decisive action. They have reinforced state requirements to keep most of the population at home in an attempt to avoid infecting others, started a massive campaign to increase the supply of respirators and health masks, and are now voting on massive fiscal plans to put cash in consumers' pockets and funds to keep businesses, both small and large, afloat.

The Federal Reserve was the first quasi-government agency to jump into the fray. They reduced the funds rate to near or at zero, added enormous liquidity to the economy, and let everyone know they would "do whatever it takes" to keep the economy afloat.

The equity market

It should come as no shock that that stock markets around the globe reacted so severely. They faced: the coronavirus, a leadership failure, in that the government was very late in taking action, an extraordinarily long bull market, and just to add insult to injury, a crisis in the oil markets. It is very difficult to predict the market behavior over the short run. We do know that there will be continued market volatility. The economy, in time, will regain strength and the equity markets will reflect this. In fact, equity markets will most likely anticipate the recovery before it becomes obvious in economic statistics.

Weekly Market Insights (cont'd)

2020 vs. 1929
We increasingly see comparisons to the Great Depression of 1929. We think it important to point out the very real differences and argue that the path of 1929 will not be the path of 2020!

1929
The world was ripe for a financial crisis in 1929. The First World War had ended and the Treaty of Versailles invited economic and political disaster. This danger was no secret. The peace was a model of foolish retribution. For those interested in reading more, please see John Maynard Keynes, The Economic Consequences of the Peace, 1919. In his book, Lord Keynes discusses the draconian reparations demanded of Germany and predicts its economic and political collapse. It started with the economic crisis of the Weimar Republic, when inflation in Germany reached 9,000% per month.

Central bankers were constrained by the Gold Standard, and each of the bankers, Montagu Norman (England), Emile Moreau (France), Hjalmar Schacht (Germany) and Benjamin Strong (United States), felt obligated to defend their country's position rather than join together and fight the financial crisis. In the Gold Standard, as trade imbalances occurred, gold was to be transferred from one country's account to the other's in order to create a financial balance and ease trade imbalances. During a trade crisis, Emile Moreau refused to transfer gold to England creating a Central Bank crisis.

There was no monetary easing process, because it is very difficult to be done with the Gold Standard, nor was there any fiscal stimulus.

The depression of 1929 was created by poor economic and political decisions, which threw the global economy into serious imbalance. The first attempts to combat the downturn were serious errors that just compounded the crisis.

Last, but certainly not least, there were no real automatic stabilizers, such as Social Security, unemployment benefits or food stamps.

The current economic problem is caused by an outside force. Central Bankers are united as governments are to use the correct economic tools to turn the economy around. Serious scientific research is being conducted which, of course, if successful, will end the crisis.

Can some good come out of this? Certainly. U.S. companies may strengthen and relocate supply lines. The government may resume financing and conducting basic research.

What should we be concerned about after recovery? How do Central banks return to monetary balance?

Help
From time to time, we have added a postscript to our readers asking them to let us know if there are topics or questions you would like us to address. That is the whole purpose of this letter, so please let me, your portfolio manager, or relationship manger know if there are topics or questions for us to address.

Thank you!

- Michael Olin Clark
moclark@1919ic.com

Please click here for the updated Economic Release Calendar - March 2020.