Weekly Market Insights

April 13, 2020

Coronavirus remains the dominant theme, a powerful crisis expands fissures

COVID-19 remains the dominant theme for investors. This past week, some evidence of a flattening of the curve, along with more assurances from Congress, the Administration, and the Federal Reserve, that they will do what it takes to both restart the economy and keep consumers and businesses as whole as possible, were taken as encouraging signs.

The equity markets had a banner week. The Dow rose 12.67%, the S&P 500 increased 12.10% and the NASDAQ was up 10.59%.

The Economy

The economy, at least for the time being, will be dependent on two things—the path of the virus and the speed that government actions reach their targets. The efforts of the Federal Reserve have taken hold and are helping by increasing liquidity in the system, keeping interest rates low and banks sound. The Fed's efforts have reached the market much faster than the fiscal policy stimulus that the Administration and Congress have approved. A lot will depend on how fast these programs reach consumers and businesses. Neither are famous for being fast moving, as we saw in 2008. Right now, much is being held up by confusion over how to administer the programs. We do feel that the severity of the situation will force quick action. Neither program, by itself or together, will bring the economy back to recovery, but they will go a long way in keeping it going and consumers and businesses above water until a solution to the virus is found. Investors should try to analyze how well coordinated these programs are. The more coordinated, the less fragmented the economy will seem, which will give investors a greater degree of confidence.

The European Union and China

One of the interesting themes unfolding is how this is playing out in political arenas around the globe. Economic crises are inclined to deepen political fissures. It is very difficult to untangle just what is related to the current crisis and what isn't, but it is reasonable to argue that the crisis has deepened many political and social problems.

The European Union has been having considerable internal strife almost from the introduction of the common currency. We have discussed this in the past and made the argument that it is very dangerous to have a common currency and disparate fiscal policies. The gulf between the northern and southern members is widening. One side, the North, being creditors and the population inclined to thrift, came into the Union fiscally sound with a powerful export base, while the other, the South, joined as creditors without a large export base. Tensions have been rising in Italy. A founding member of the EU, Italy has now elected a government hostile to being a member. A worst case scenario is, now that England is on its way out of the EU, Italy follows. If this occurs, can Spain and other southern members be far behind? A likely event, no, but it does illustrate how an epidemic like the coronavirus can escalate a crisis.

China, where the pandemic started, is another example of how something like the virus can escalate or compound other problems. Since Mr. Xi has become president, he has steadily moved to make himself an imitation of Chairman Mao. Heretofore, Mao's successors have downplayed individual leadership and had a united front with the CPC, the Communist Party of China. If something went wrong, the blame could be shared. China has increasingly had internal problems.

Weekly Market Insights (cont'd)

They are well documented—a rapidly slowing economy, the high expense and pushback from the "Belt and Road" program, unrest in Hong Kong, oppression of the Muslim Uighurs, debt problems in the shadow banking community and state owned enterprises, and now growing criticism of serious underreporting of the coronavirus. All of this could create a pushback against President Xi.[1]

Conclusion

Unfortunately, at the moment, there is no sure way to forecast exactly how this will end, but we can make some inferences. The U.S. economy appears to be in the best position for the recovery. The economy was strong, with both employment and wages in good shape before the virus struck.

Europe went into the recession in a weak state and was showing few signs of a coordinated recovery effort, all while still having the above-mentioned political problems to solve.

China, although not in a recession, was having an economic slowdown. There remain questions concerning Asian supply lines, and whether European and American businesses will start to diversify their supply lines. If that is the case, then there will be a large hole in the Chinese economy that must be filled.

All in all, it appears as if the U.S. markets are the place to be.

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[1] Thanks to Derek Scissors and Minxin Pei for data and insights into China

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