

Weekly Market Insights

May 4, 2020

Globalization is far from dead

The Markets

April was a great month for the equity markets. The Dow closed up 11.08%, the S&P 500 +12.68% and the NASDAQ +15.45%. Unfortunately, the first of May did not follow the same happy path. The Dow as an example lost 2.55%. What happened to change investors' minds? A combination of events. There are two hurdles investors have been facing. First, the assault on globalism epitomized by the tariff war and later, the pandemic. When the pandemic struck, investors' concerns about a trade war receded and of course, the pandemic became the prime concern. There started to be positive stories about the coronavirus, so equity markets rallied. Then those stories started to come to earth and at the same time, the trade war began to resurface. These two factors turned investor sentiment around.

The Federal Reserve

As regular readers are aware, we believe the Fed has done as much as they can. They, before any other part of the government, realized the severity of the threat and acted. But just about all monetary tools are at work. The Fed has come as close as possible to using fiscal policy tools. Fiscal policy is reserved for the Administration and Congress.

The Danger

Aside from the obvious dangers that the pandemic lasts much longer than anticipated, and/or government efforts fail to turn the economy around, there exists another, perhaps worse, danger. People think the relief programs went to the undeserving. Many still believe the rescue effort to combat the recession of 2008 went to banks and the wealthy. It did appear that way, but it was a problem of communication, or no communication. Government representatives must spend time explaining exactly what is being done, why it is being done and how it works through the economy and will benefit all.

Globalization is not dead in the 21st century

The pandemic has inspired some analysts to claim globalization is dead. Many who claim this assume globalization is a relatively new phenomenon. Nothing could be further from the truth. The initial globalization process began "when in the late Ice Age, a tiny group of our ancestors walked out of Africa in search of better food and security."¹

Perhaps that is overstating the case, but not by much. Written history of trade traces back to 100 BC in the countries surrounding the Aegean Sea and earlier than that in the East. There is little to believe globalization will stop now. But trade and globalization do evolve. Globalization follows modernity. As societies progress, their needs and abilities change. This can be most obvious in economics. New inventions, new social skills and better education can shift the production functions. Globalization, just as modernization, does not advance at the same pace over time, but it does advance.

So, the argument about the future of globalization is not whether it continues, but what new form will it morph into?

Yes, supply chains will change. Some will move out of China and go to other countries. Others will move back to the United States, and they will be successful if the capital is spent in technology where the U.S. has comparative advantage. This will be a positive but not a panacea for the U.S.'s economic problems. Some jobs will be created and some will be repatriated but not nearly as many as people expect. The reason many jobs are brought back is superior technology, and one reason technology works is because it substitutes capital for labor. When studying U.S. labor statistics, it becomes obvious that the U.S. economy is producing jobs, but our education system is not producing graduates who fit into the modern economy. That, the country can change.

Weekly Market Insights (cont'd)

Adam Smith and David Ricardo are alive and well in the 21st century.²

¹Bound Together, Nayan Chanda, Yale University Press, New Haven and London, 2007.

²Adam Smith and David Ricardo were both economists during the Scottish enlightenment, late 17th to early 18th century. They were the first to argue for free trade. While Adam Smith is known as the father of modern economics, David Ricardo was the first to use the term “comparative advantage.”



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