Weekly Market Insights

June 29, 2020

China vs. India, again

Equity markets fell sharply during the past week. Just a week earlier, investors were encouraged by the apparent reopening of businesses across the country. This past week was a different story. All the news about the pandemic was bad. Coronavirus cases started to increase rapidly, making investors believe their hopes for a more vibrant economy were premature.

The Dow fell 3.3%, the S&P 500 fell 2.9% while the NASDAQ fell 1.9%. Year to date the S&P 500 is down 6.9%.

Volatility was high during the week but rose to extreme levels late Friday. A major reason was that Friday was the annual rebalancing of the Russell 3000 Index, which is used by many index funds as a benchmark. The NASDAQ reported record trading the last few seconds of the day due to rebalancing. About 1.6 billion shares traded, setting a volume record.

The U.S. Economy

Although the economy has shown growth, investors' fears continue. Despite May's Consumer Spending coming in at a robust 8.2% versus a record drop in April, most of the concerns stem from the apparent surge in coronavirus cases. There could be a number of reasons for this increase, not all damaging to the economy, but investors are very alert to a resurgence. We will have to wait and see what the story is.

Two weeks ago, Fed Chairman Powell delivered a speech highlighting the Fed's concern that the slowdown may last longer than expected. This may be true, but he reiterated that the Fed stands ready to do whatever is necessary to keep the economy moving forward. There is also a legitimate concern about debt accumulation, both government and private. We covered sovereign debt last week. Although we do not agree with proponents of "Modern Monetary Theory," we believe the government's rapid debt creation is justified and not inflationary at this time. Corporate debt levels are very high. There was a substantial accumulation of debt in anticipation of the downturn, which, of course, raised a red flag for analysts looking at corporate balance sheets. Much of the proceeds from the new debt remains unused. If this debt is indeed precautionary and is not entirely used, it is not a great concern. Another form of debt that shows up on corporate balance sheets is money borrowed from the government for the Payroll Protection Program. That debt must be discounted, for much of it will be forgiven by the government as it was used to maintain jobs.

This past week, Christine Lagarde, President of the European Central Bank, spoke. Her tone was decidedly downbeat about the European Union. She said the recovery in the E.U. may be strained by consumers' desire to save rather than spend. Ms. Lagarde felt the recovery would also be weakened by a slow recovery in global trade, with lower productivity caused by less efficient supply chains. We agree that the E.U. should have a slower economic revival than the United States.

China and Emerging Markets

Although one would expect emerging markets to suffer the most during the pandemic and the economic slowdown, that has not necessarily been the case. It appears that the countries' equity markets react to what is happening in the developed countries' economies and the Fed. Many E.M.'s economies are commodity driven and the developed nations are their biggest customers. Therefore, if the developed economies are starting to grow, can the E.M.'s be far behind? Why the Fed? Simple, the Fed remains the banker to the world and had promised to keep the money faucets on. If that is the case, the U.S. dollar should not rise vis-à-vis their home currency and not raise interest payments due to relative currency changes.

China faces off with India again, but why now? For the first time in quite a while, 19 years, China and India have faced off militarily at their common, but oft-disputed border in the Himalayas. There are a few possible reasons. First, President Xi is facing some difficulties at home, and this has long been a common way to deflect domestic difficulties for both countries. Those difficulties are: disappointment of how he and the Party handled the pandemic, mounting economic problems with the "Belt and Road" initiative, and a general economic slowdown. Also, India and the United States are tightening their relationship. Additionally, President Xi is facing growing political problems with Hong Kong, Taiwan, Vietnam, and Australia. It could be all or none, but it seems apparent that President Xi is trying to deflect blame for these problems. A specific issue is Pakistan has announced that they are looking to renegotiate the "Belt and Road" payments. Pakistan claims they were overcharged by billions of dollars. This is not the first complaint about the "Belt and Road" pricing. Complaints about the whole program have come from African nations.

It is interesting that these complaints of overcharging by Pakistan should come at this time. As we wrote earlier, China is engaged on the border with India. Pakistan has always been China's ally against India. It just adds some more political difficulties to President Xi's plate.

All of these challenges are important, as any of them could weaken China's ability to continue the trade war with the U.S. and E.U.

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