Weekly Market Insights

July 22, 2019

Investors focus on a 25 basis point Fed Funds rate cut, good economic news, reasonable earnings and the equity market loses ground!

U.S. equity markets ended the week with a loss. The Dow Industrials fell 0.85%, the S&P 500 was down 1.23% and the NASDAQ fell 1.18%.

Economists and market strategists have gone back and forth over the past few weeks as to whether or not the Fed's Open Market Committee (FOMC) would lower interest rates 25 bps or 50 bps. The difference may seem miniscule to most readers, but in actuality the difference is quite large. That difference is a guide to the Fed's concern about how much help the economy needs. There is, actually, a reasonable argument that the economy is in good enough shape and that it does not need an extra boost of liquidity from the Fed, although that argument has fallen on deaf ears. The most likely path the Fed will follow is to lower rates by 25 bps. Not long ago, a 25 basis point move would have been a boon to the markets, but since expectations rose to 50 bps, it may not thrill investors. It is interesting that there should be so much desire to lower interest rates. The U.S. economy seems in very good shape, consumer confidence is strong, retail sales remain very much intact, interest rates are already very low and, as we pointed out last week, there are other ways for the Fed to stimulate monetary policy and still keep their powder dry.

Trade. There would, of course, be no need to consider an interest rate cut if the trade issues could be resolved. We have argued long and hard that both sides need to and will achieve a satisfactory conclusion to this dispute. Once that occurs, not only will the economies of the U.S. and China improve, but so will the global economy. The weakening of the U.S. economy, if it is indeed weakening, is more of a reaction to artificial problems than any cyclical downturn. Monetary policy is a useful tool to alter cyclical changes rather than trade disputes.

The Budget. As we wrote last week, the Administration and Congress almost certainly will come to some agreement on both the budget and the debt ceiling before they recess for the summer. We explained our reasoning in last week's paper.

Once these questions are resolved, both the Administration and Congress should start working on how to manage the country with a sustainable budget. Just about everyone feels the budget and U.S. government debt has been growing out of control. Polls indicate that 70% of likely voters think these two issues are among the three most important issues facing the country. The budget now has almost become a campaign tool. There may be, and are, some very good reasons to increase the budget deficit and add to government debt. Infrastructure investment, which over time adds to a country's wealth and income, is one. Education and R&D do the same and there certainly are more. Rising debt also makes a country less flexible to respond to crises. This is certainly not a call to just cut spending, but to be more accountable to how money is spent. No one complains when a strong corporation issues bonds to fund an enterprise which will be profitable in the future; so it is with countries.

These are just a few of the important issues facing the country. It will be interesting to see if any are discussed in the electoral debates.

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