Weekly Market Insights

July 29, 2019

The week of the Fed, 95 days and counting, and another important anniversary!

U.S. equity markets had a good week. The Dow rose 0.14%, the S&P 500 increased 1.66% and the NASDAQ was up 2.26%. The positive returns were due to better than expected earnings and investors' continued expectations of a Fed Funds rate cut this week. Expectations have come down from a 50 basis point drop to a more responsible 25 basis point drop. Although it remains an open question of whether a rate cut is needed, it seems apparent that the Fed will cut rates this week. Ideally the Fed would not be motivated by politics or markets, but even the Fed feels pressure. No Fed Board wants to be in the unenviable position of being blamed for a recession. The economic case for easing is that the economy is coming down from the high growth rate of about 3.1% and inflation remains far below the Fed's desired rate of 2%. But corporate earnings have remained above expectations. As we wrote last week, the labor market continues to be strong, wages are growing and U.S. consumer spending and confidence remain buoyant. Also almost all economists felt that 3.1% GDP growth was unsustainable. It appears the slowdown of the economy is mostly due to corporate concerns about the path of U.S.-China trade negotiations. The Fed must remain concerned that if they do ease and the trade conflict comes to a satisfactory conclusion, they risk an economic over-heating. In any case, it is unlikely that a 25 basis point move will inspire the equity markets very much. After a powerful first half, we would expect moderate gains in the second half.

95 days and counting.

A few readers will recognize that 95 is the number of days until 31 October, 2019, when Britain leaves the European Union. Last week, Boris Johnson became the leader of the Conservative Party and Prime Minister of Great Britain. Mr. Johnson, a great supporter of BREXIT and a hard-liner about leaving the E.U. on 31 October, deal or no deal, has complicated matters to no small degree. No one, of course, knows what the consequences will be, whether the exit is hard or soft, but it seems clear that the biggest loser will be Britain.

Both Mr. Johnson's party and cabinet appear to be in disarray. Mr. Johnson must rely on the Democratic Unionist Party of Northern Ireland to maintain a majority and that majority is three. So, it is difficult to forecast how this will end, but we can speculate about some of the fallout. As we wrote, Great Britain, mostly England, will be the biggest loser. Next, the E.U. will suffer economically, but not nearly as severely as Britain. The biggest danger for the E.U. is, does Britain leaving inspire other disaffected countries to try to do the same? It may shake the very structure of the E.U. Two critical signs to watch for are: do signs of a softening stance on the part of the negotiators appear and, very important for Britain, do Britain and the United States arrange a unique trade agreement solidifying the Special Relationship? If this occurs, it will make the British departure far easier.

Happy Anniversary?

On 22 of July, 1944 at Bretton Woods, 44 nations concluded an agreement to form a new world economic order. They took the lessons from recent economic crises and the aftermath of two world wars and created an agreement that has led to the greatest surge of global economic prosperity the world has ever witnessed. The world's great economic institutions, the World Bank, the International Monetary Fund and the World Trade Organization were all formed at the Bretton Woods Conference. All these institutions are now under fire from both the Trump and Xi administrations. Oddly enough, the United States and China are the two greatest beneficiaries of these organizations. It would be a very sad day for the people of the globe if the guardian and progenitor of the greatest economic expansion in history should disappear.

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