Weekly Market Insights

August 4, 2020

Lots of confusion and a resilient market

Markets

Equity markets ended the week on a positive note surprisingly given the continued confusion about both the economy and the pandemic that remain. The Dow closed the week down 0.16%, the S&P up 1.73% and the NASDAQ up 3.69%. It is a bit surprising because just as nature abhors a vacuum, markets abhor confusion. There was, of course, some good news on the earnings front and positive reports from the tech sector but confusion concerning the progress of the coronavirus, particularly in the United States, remains. It appears, for the moment, investors chose to be optimists.

The Economy

At the end of July, the National Association of Business Economists published the, Business Conditions Digest. As usual, we will go over the report in some detail. Fair disclosure, I am a voting member.

Economists were more optimistic for the next twelve months than they were in the last survey. Two-thirds expect the economy to expand between the 2nd quarter 2020 and 2nd quarter 2021. Some confidence has returned from the depths of the April review. As a comparison, they reported that the past three months were the worst since the global financial crisis for sales, prices, and capital spending.

Firms reported that hiring had stagnated for the past two months, and a majority reported employment was unchanged. However, there was a significantly positive change in the view of a majority of respondents with 22% expecting an increase in employment for the coming 12 months. Last quarter, wages and salaries dropped into the negative territory for the first time since 2009.

Shortages in both skilled and unskilled labor declined keeping wage pressures low.

Prices charged were the lowest since 1987. Only 7% reported they raised prices, and materials costs dropped further into negative territory after four years in positive territory.

At first blush, this is dire reading, but we should remember that the dire numbers reflect the past three months. A vast majority of respondents across all sectors have much higher expectations for the coming quarter.

The Dollar

There has been quite a lot of publicity concerning the drop in the value of the U.S. dollar. We spent some time with it last week but think it is a good idea to spend a bit more time discussing why it is happening and whether or not we should worry.

The value of a country's currency is important with certain caveats. A currency should be allowed to float. It is the market's way of creating an equilibrium. Trade is a good example. Without floating currencies it very difficult to offset trade imbalances. We have used the internal problems of the E.U. and their common currency as an example, but for the United States there is an added problem—the U.S. dollar is the prime currency.

Why is the dollar falling? A good way to start is to ask why a country would want a weak currency, and what makes a currency weak or strong? Nathan Sheets said it perfectly, "In a world with weak aggregate demand, and with broad disinflationary pressures…a weaker currency seems attractive to policymakers and to others…(It) can be supportive of growth…(and) can help support corporate earnings through translation effects."[1] This is a sign of economic weakness in a country.

What makes a country's currency strong? Strong government policies and sound economics which produce increasing productivity and predictable government behavior together produce a strong national currency. A government should strive for a strong currency. Over the last 7 years or so the United States has followed that path. The dollar has become the world's primary currency. A strong dollar is a positive sign not a weak one. Where are we now? Currencies will float up and down. This is not a problem. Like all things it is a matter of degree. It is not hurting the economy at the moment, but it bears watching.

[1]Dollar, D., Sheets, N. A strong dollar: help or harm?. *Bus Econ* **55,** 120–128 (2020). https://doi.org/10.1057/s11369-020-00179-z

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