Weekly Market Insights

August 5, 2019

An amazing two days, the primary battles continue and where are the risks!

United States equity markets suffered their worst week of the year and who could blame them! The Dow closed down 2.6%, the S&P 500 decreased 3.1%, while the NASDAQ lost 3.92%. The most dramatic market volatility took place on Wednesday and Thursday, hence the two amazing days in the title.

What happened?

Investors, for some time, have believed the Federal Reserve was going to ease monetary policy by lowering interest rates. The only questions were by how much and how often. Would the Fed make its initial move 25 or 50 basis points and would they signal that this is just the beginning? Investors appeared to be centering on a milder move by the Fed, perhaps a July move of 25 basis points, with one or two more before the end of the year. When it came time for Chairman Powell to announce their decision, he gave a reasoned presentation. He spoke of the positives, that the domestic economy was indeed slowing but from an unsustainable rate of growth. The unemployment rate was hovering at near record lows, job creation was strong and American workers were beginning to see increasing wage rates. Consumer confidence was at a record high and the economy was enjoying strong retail sales.

Were there concerns? Certainly: a tit-for-tat tariff squabble between the United States and most other countries, a rising U.S. budget deficit, an economic slowdown in China and the European Union stuck in economic doldrums. The Fed was also concerned about the U.S.'s inability to get its inflation rate above 2%. All in all, a sound economic report for the U.S. domestic economy. But acknowledging the dangers abroad and the tariff problems, the Federal Open Market Committee (FOMC) voted to cut the Federal Funds rate by 25 basis points. By all appearances, a solid vote of confidence for the U.S. economy, but the report acknowledged some concerns and acted to preempt them. The Chairman told the country that they did not expect to continue to lower rates but if the economy did weaken more, they would ease once more. It seems as if they gave the domestic economy a B+ and investors would be, if not happy, quite satisfied.

But no, investors were disappointed in both the level of the cut and the realization that this may be the last, and the equity markets declined. The next day it appeared as if cooler heads prevailed and the market began a significant rally regaining all of its previous day's losses. This rally was most likely caused by investors' realization that they were selling equities into a strong economy. The high volatility was complicated by trading funds liquidating the positions they had built up in anticipation of a more dramatic Fed move.

Then the bomb!

On Thursday the President, surprising everyone, announced he was going to engage in another round of tariffs. These tariffs would exceed the past round. This took the investing community by surprise and the market declined once again. There is much speculation about why and the timing of this action. It has not been popular and the timing seems odd. The tariffs are supposed to go into effect in September, so no one really knows if they will be used or not. Most businesses and almost all economists feel this is an inappropriate move for the U.S. economy, so it was no surprise that the equity markets reacted as they did.

The Primaries

This past week the American public was treated to the second week of great debates. It is always hard to say who wins and who loses these debates, but one clear winner was Joe Biden. He did not handle himself very well in the first round, but he did make a strong comeback in the second. He was strong enough to remain the front-runner. There were some clear losers

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who should drop out so the more deserving candidates will have more time to explain their ideas and not have to spend as much time defending themselves. Beto O'Rourke, Mayor de Blasio and Sen. Kirsten Gillibrand don't add much and should call it a day.

There is a lot of concern about the extreme positions many of the candidates are taking. This should not be an overwhelming surprise to anyone. It has happened in the past, all having to do with financial crises. Andrew Jackson ran in 1828 against hard money and the 2nd United States Bank, William Jennings Bryan ran in 1896 against high interest rates and hard money. He made, perhaps, the most famous and eloquent campaign speeches of all time, "You shall not press down upon the brow of labor this crown of thorns, you shall not crucify mankind upon a cross of gold." Again, against hard money and high interest rates. After the depression of 1929, there were many socialist and even communist politicians that had varying degrees of followings. It is a normal reaction to a financial crisis.

The risks!

The Fed has it right. Of the four greatest risks to the U.S. economy, three are international. The first, the growing budget deficit, is not an immediate danger, a danger certainly, but not now. The economic slowdown in China is unlikely to be large enough to make a big difference to the U.S. The same is true of the E.U. Readers may wonder why we left out BREXIT; it's because we have included it in the E.U. problems. The escalating tariff war is the elephant in the room. It can get out of hand and the leaders of each country can lose perspective and treat the disagreement as personal. At the moment, we are sanguine about the U.S. economy but, as always, things can turn rapidly.

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