Weekly Market Insights

September 9, 2019

Markets advance, trade remains paramount and global economies slow

Equity markets did well this past week. The DJIA rose 1.49%, S&P 500 increased 1.83%, and the NASDAQ gained 1.78%. Although economic releases for the week were not stellar, investors were encouraged by the news from the Administration that U.S.-China trade talks may begin again in October. Market participants, at least for the moment, appear to be myopic about trade. But economics are important, with the three major global economies, the United States, China and the European Union, either moribund or slowing.

On a positive note, every major Central Bank has signaled its intention to do all that is necessary to boost economic growth. We have heard from Chairman Powell that the Fed will continue to lower interest rates if necessary to keep economic momentum positive. Mario Draghi, current head of the European Central Bank, and Ms. Christine Lagarde, the future president, have both signaled their readiness to keep interest rates in negative territory and, if necessary, use Quantitative Easing to reinvigorate the E.U. economy. China is also using monetary policy to stimulate their economy, but they are also using fiscal policy. So, the world will remain awash in liquidity. The question is will that help? There already is surplus liquidity, as demonstrated by the extraordinarily low interest rates. It may very well inspire investors to boost equity positions, but the jury remains out on whether this will substantially advance the E.U. or the U.S. economies. Money will always find a home. Whether it finds a home that helps economic progress is a different question. In the United States, the economy appears to be slowing, but not in danger of recession, although inflation remains well below the Fed's target. The European Union's members, other than Germany, never fully recovered from the great recession and are now in danger of falling back in to recession. Europe and the United States are in need of different solutions. Europe needs a burst of fiscal stimulus. It appears as if they are in a classic Liquidity Trap, where a Keynesian solution is in order. A major problem is there is no common fiscal policy agent and certainly no agreement on how, or even if, to use it.

The United States could use infrastructure spending. We have written quite a bit about that. But there is an interesting phenomenon going on. Interest rates are at historical lows, corporate tax rates have been substantially reduced, labor costs are rising, and profits are fine, so why isn't there a burst of investment? It appears that much of the liquidity that accrues to U.S. corporations is used to fund stock buybacks and dividend increases. Why not a burst of investment? If an open global trading system is going to be in question, why not invest in the most efficient technologies, such as robotics? To us, it is the million dollar question. Perhaps it is the problem of short termism? A good question for another paper.

In any case, it appears the U.S. economy is at least a year away from a recession, which should keep equity markets in positive territory.

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