Weekly Market Insights

October 21, 2019

What a mess!

It would be understandable if investors just threw up their hands and gave up. The world seems to be in an awful mess. But, hope springs eternal, and investors are showing their resilience to look past the current malaise, and we believe them to be correct.

This past week, the equity markets lost a little ground. The Dow Industrials fell 0.17%, the S&P 500 was down 0.54% and their smaller brethren, the NASDAQ, fell 0.40%. Not a bad showing, given the headlines investors were faced with.

The Headlines

The most blaring headlines, of course, are about the efforts to impeach the President, followed by the outrage of many concerning the United States withdrawal from Syria. While these points are very important, it probably makes more sense for investors to pay more attention to the economy and corporate earnings.

The World Bank and the International Monetary Fund have just ended their joint annual meeting. They, as expected, lowered their projections for global economic growth. They have many reasons to feel that way: the inability of the EU to stimulate growth, China's well published slowdown, Brexit, political instability and a very expensive U.S. dollar. Add to that, for U.S. investors, what will the Federal Reserve do next?

Brexit appears to be heading toward some sort of conclusion. Whether it is good for all parties is unknown. Time will answer that question, but it is unlikely that the struggle over Brexit will be very damaging to the U.S. economy or financial markets. In fact, it may just reinforce the U.S. markets as a safe haven.

The European economy remains stuck in the doldrums and as good intentioned as the European Central bank's efforts at monetary stimulus are, they are not likely to succeed. As we have written in the past, the time for monetary stimulus has passed and the solution lies in fiscal policy.

Closely related, is the view that the U.S. dollar is too expensive. That argument surprises us, whether it comes from the U.S. Administration or Europe. The classical economic answer to that is the U.S. dollar should be strong and that is part of the solution. We have written about this in the past so we won't beat a dead horse, but as one country's economy grows at a faster rate than the rest of the world's, its currency grows stronger. This makes the rest of the world's products more attractive and their economies start to grow. So, the U.S. Administration should be happy because it signals both strength in the U.S. economy and faith in the soundness of the dollar. The rest of the world should be happy because it makes their products more financially attractive. They need a stimulative fiscal policy to give them a boost, but that does not appear to be in the near future.

What about the Fed?

Investors are, as always, concentrating on the Fed. Although there are differences of opinions within the Fed about the wisdom of another cut in the Fed Funds rate, it seems to us that the Fed will ease one more time this year, most likely at their next meeting.

China!

As always, China appears to be the elephant in the room. There has been a lot of speculation about what is happening in China. That question deserves a paper by itself, but here are a few remarks.

China has just announced the slowest economic growth rate in decades, 6.2%. We and many analysts think that number is far too positive. China is suffering from a number of problems. They have started pouring money into the country, mostly through State Owned Enterprises. That is throwing good money after bad. Many believe that most of these companies are failing and beyond salvation. Debt is growing at a rapid pace and returns, for many, are well below costs, and the vaunted Belt and Road initiative is both expensive and losing money. We and many China watchers believe what is necessary to reinvigorate China's economy is a relaxation of President Xi's Mao-est efforts and go back to Deng's capitalism with Chinese characteristics.

What should investors do?

As always, investors should be acutely aware of their asset allocation. The U.S. appears to be the place to invest. We would avoid being overweighted in foreign securities and favor U.S. small cap and large cap companies.

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