Weekly Market Insights

November 2, 2020

Markets decline, globalization marches on and the election!

Financial markets

Just about all financial markets fell dramatically this past week. As you will read in Ryan Schutte's analysis of this past month's economic releases, there was no shocking pure economic problem that would make one expect a severe sell-off. There were, however, a lot of stories about the spread of the pandemic. In our view, that was the primary reason for the sell-off. We continue to shy away from commenting on the medical issues other than noting that the recent surge in case counts has shaken financial markets. The Dow was down 6.47%, the S&P 500 down 5.64% and the NASDAQ down 5.51%.

October Economic Update

Economic indicators continued to improve in October, albeit at slower pace, as the recovery lost some momentum from the fiscal stimulus enacted earlier this year.

Reports concerning the housing market remain a bright spot with housing starts increasing by 1.9% from the prior month and the NAHB Housing Market index[1] rising to 85—marking another all-time high. New and existing home sales continue to be a strong point, while the FHFA and S&P/Cash-Shiller Home Price Indices both signaled rising home values.

Retail sales increased 1.9% in September and 5.4% year-over-year. While the month-over-month growth rates have slowed from those seen off the April lows, the results of October's sales report marked a full recovery in absolute levels, slightly exceeding those seen in January of this year. The retail sector's recovery has been far from equal, however, with bar and restaurant sales still down over 20% from 2019 and online retailers up more than 20% over that same period. More timely data from OpenTable reiterates this point with restaurant reservations down over 50% year-over-year. Clearly, in-person service sector businesses are still being heavily impacted by COVID-19 and the restrictions in place to stop its spread.

As we have stated many times before, the consumer is of crucial importance to the U.S. economy and, therefore, its recovery. Personal income has shown remarkable strength, growing 0.9% month-over-month and sits higher now than it did this time in 2019. This may be somewhat misleading, however, as it includes income replacement measures enacted earlier in the year as part of the CARES Act, as well as the patchwork stimulus from President Trump's executive orders in July. Furthermore, low wage earners[2] have experienced greater job losses compared to their high-earning counterparts, artificially inflating income levels. More to this point, consumer sentiment data continues to move sideways, with the most recent reading of 81.8 falling well short of the pre-pandemic levels that exceeded 100.

Taking a closer look at the labor market, October began with another decrease in the unemployment rate to 7.9%; however, payrolls data indicated employers added fewer jobs than expected and less than the prior month. The employment picture has remained unclear throughout the month with unemployment claims continuing to tick lower week to week but remain elevated relative to pre-crisis levels.

This week's release showed 787,000 first-time filings for unemployment benefits with 8.4 million continuing claimants.

Third quarter GDP grew 33.1% at a seasonally-adjusted annual rate following the second quarter's record-breaking 31.4% decline. This jump captures the continued economic reopening that took place following the drastic lockdown measures in place throughout much of the second quarter. Despite the magnitude of the quarterly growth, GDP levels still sit 2.9% lower than this same period in 2019. Expectations are for growth to continue into the fourth quarter at a slower pace with an eventual recovery to pre-pandemic levels sometime in 2021. Looking closer at the details of the report, personal consumption was a key contributor, up over 40% year-over-year, annualized. Consumption of goods rather than services drove the rebound. Residential investment also bounced back, another indication of the housing market's strength, while non-residential investment improved but still sits below pre-pandemic levels.

The U.S. economy continues to improve; however, it is too early for the "all clear" signal. Simply put, there are just some sectors of the economy, like in-person services, leisure activities, and aviation that cannot recover until there is a vaccine that is widely available. It is evident that there are pockets of the economy needing further support. To this point, discussions in Washington continue, and we will likely see more progress after the election.

<u>The election</u>

We tend not to comment on political matters, but if there is something that helps our readers better understand the economic views of a candidate, we will report it. This past week, *The Economist* played a story about one of the front-runners for Secretary of Treasury if the Democratic candidate prevails. Her name is Lael Brainard. Dr. Brainard holds a doctorate in economics from Harvard, served in both the Clinton and Obama administrations and is currently on the Board of Governors of the Federal Reserve. It is a very interesting article and anyone interested should read it.

<u>Globalization</u>

Globalization is a relatively new term to describe something that has been going on from the beginning of man. Globalization started when the first human walked out of Africa looking for a better life and has continued almost uninterrupted through the ages.

Globalization has begot many wonderful and bountiful blessings on humanity, but it has also caused some disruption. By any measure, the good far outweighs bad. The bad is often the result of poor political, economic or business policies. The debate about the nature of globalization has been going on for centuries. The first scholars to try to isolate globalization were David Hume, Adam Smith and David Ricardo in the late 18th century. The argument, for and against, has often raged between economists and politicians.

One of the great, and perhaps most eloquent, debates for and against free trade lasted decades. It took place in the English Parliament between Gladstone and Disraeli. In the United States, possibly the most eloquent opponent of globalization was William Jennings Bryan.

The debate between politicians and economists is most interesting. A lot revolves around time sequences. As we have written in the past, economists revere efficiency and normally think in the long run in order to achieve this. Politicians, by the nature of the election process, tend to think in the short-run. They want to avoid short-term economic difficulties for their constituents. After all, they have to get reelected if they are to continue to help their district. To quote Upton Sinclair, "It is difficult to get man to understand something when his job depends on not understanding it," so they are inclined to think in more dynamic terms. What will occur between the time a piece of legislation is passed and the benefits accrue to their constituents? Both sides of the debate have important points. The obvious need is for the two to come to an accommodation. There are ways to handle job and income loss, but the country must consider its future well-being as well.

What are some of the benefits? A great diversity of products for consumers to choose from force more efficiency in production. Lower prices and global employment increase wealth creation. Rapidly expanding product availability leads to competition to create new and better products.

The downside is worker displacement and elimination of jobs. What should be done? The highly industrialized countries should realize that their future is not in low wage labor but in the highly skilled arena. Countries like the United States should not be in the business of preserving low paid jobs but creating a better educational system including vocational training. Furthermore, they should implement a tax structure to encourage technological progress and investment and create a sound and fair system to help compensate those workers who lose their jobs.

The government should reinstitute basic research, which they could auction to commercial entities. The job of the government is not just to care for the immediate needs of the citizenry, but also to insure a vibrant and healthy future.

Internationally, the U.S. should work with global institutions to equalize corporate tax rates. It is highly inefficient for corporations to relocate because of lower tax rates.
Interestingly, the American people appear to generally favor globalization. Robert Zoellick, former president of the World Bank, recently published an article in *The Financial Times* titled "Americans are still internationalists at heart."

Mr. Zoellick quotes from a 2020 survey of American public opinion by the Chicago Council on Global Affairs. A few observations make the point: "68% favor countries taking an active part in world affairs, two-thirds believe globalization benefits the U.S., three-quarters believe international trade is good for the economy . . . 59% believe it creates jobs at home." Even if these numbers are a bit off, they are indeed compelling.

None of this argues that following a regime of free trade is easy. It is difficult. Dealing with China is a fine example. Countries are opening their eyes to the difficulties of trading with China. Less developed countries are now questioning both the motives and wisdom of participating in the vaunted "Belt and Road" program. China, the second largest economy in the world, is still considered a developing country by the WTO and also uses that designation for benefits under The General Agreement on Tariffs and Trade (GATT). These benefits are meant to help poor countries pull themselves out of economic distress. Clearly, international trade agreements need to be updated.

It puts a lot of pressure on corporations for innovation and efficiency. That may be difficult but excellent for the economy and future generations.

[1] The National Association of Home Builders (NAHB) Housing Market Index (HMI) is a gauge of builder opinion on the relative level of current and future single-family home sales.
[2] Low wage earners deemed those making less than $60,000 annual salary.

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