

Weekly Market Insights

November 19, 2019

Another Record

U.S. equity markets continue to make record highs. This past week the Dow Jones Industrials gained 1.17%, the S&P 500 was up 0.89% and the NASDAQ rose 0.77%. The U.S. markets remain the most attractive for investment.

Investors remain optimistic about progress in the U.S.-China trade dispute. This, coupled with continued positive consumer, employment and wage reports, have kept U.S. investment markets on an upward trend. We are also coming to the end of earnings season,¹ and reported earnings are better than anticipated. It is interesting to us that investors appear almost indifferent to the impeachment proceedings.

China and “The End of History”

China remains in a state of turmoil. Anyone who read and interpreted Francis Fukuyama’s famous 1992 book, written two years after the Berlin Wall fell as the end of communism and totalitarianism in favor of democracy and free markets, must be deeply disappointed. We wrote about China’s problems in the past and they have only intensified. Hong Kong is in disarray and nowhere near a solution and the Chinese treatment of Muslims in Xinjiang Province is creating serious tensions. China has three problems to deal with: a slowing economy, Hong Kong, and Xinjiang Province. Each is a difficult problem in its own right and none seems close to a solution. President Xi must feel the pressure from all sides.

As we wrote in the past, one of China’s and Mr. Xi’s great economic fears is capital flight. As he faces these dramatic domestic crises, he must deal with the economic risks. Alas, they are closely related.

If Hong Kong falls as a “free” territory, then capital flight will intensify dramatically. There are only a few ways to combat this. The first is to dramatically raise domestic interest rates. This is an unlikely solution because China’s economy, both domestically and globally, is weakening and a major way to reverse that is by lowering interest rates. It appears as if China may severely crack down on Hong Kong and already is damaging its reputation in the treatment of its citizens in the Province of Xinjiang. At the moment, China is in an unpleasant box.

Europe

The European Union’s economy remains sluggish. The European Central Bank (ECB), under the able leadership of Christine Lagarde, wants to increase monetary stimulus, but is getting strong resistance from members in the North, most notably Germany. We would agree with that policy except the EU has flooded the market with liquidity already. What is needed is a strong dose of fiscal stimulus, but the E.U. has no common fiscal policy so a concerted fiscal stimulus policy appears out of the question. Monetary stimulus seems flawed but is the only available route. It is not clear how or when the E.U. will get out of the economic doldrums.

The United States - a plan for the ages?

The United States is in an advantageous position. Its currency is one of the strongest on the globe and interest rates are at an historic low. The economy now must be the envy of most countries. China has economic problems with wages on the rise and, as we have suggested in the past, they may be in the “Middle Income Trap.”

¹The end of each quarter when companies report their quarterly earnings.

Weekly Market Insights (cont'd)

The U.S. is in a position to embark on the third Industrial Revolution. A few things will be necessary. First, take on one of Mr. Trump's campaign recommendations: convince the extensive network of community and junior colleges to devote more time to high level vocational training. Next, negotiate a serious apprenticeship program between these colleges and industry, effectively increasing labor productivity. Having done that, the government should do all that is possible to get industry to start an aggressive

capital investment program building the most modern and efficient factories. This would offset any wage advantages other countries may have. Last, the government should restart its formerly very successful efforts to sponsor basic research, and redirect its immigration program to allow more skilled workers into this country.

This would probably not do much to increase manufacturing jobs, but would dramatically grow the economy.



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