

Weekly Market Insights

December 21, 2020

An End in Sight!

Equity Markets

Investors have been encouraged by the emergence of at least two vaccines to help prevent the spread of COVID-19. They also anticipated a new stimulus bill from Congress. All things considered, it was a good week for equities setting new records.

Legitimate questions exist on whether the equity markets are overpriced. All things being equal, they may appear to be so, but, as always, all things are not equal. Interest rates have been falling since 1980, a very long bull market for bonds. Now, with interest rates being at historic lows, the Federal Reserve appears to be in no hurry to reverse this trend. We have argued that once a vaccine is available and widely distributed, the recovery will be V-shaped and earnings should rebound quickly. Markets are anticipatory structures, so as hiring begins in earnest when the pandemic starts to subside and earnings accelerate, P/E ratios will appear far more justified.

The DJIA closed the week up 0.44%, the S&P 500 up 1.25% and the NASDAQ up 3.05%.

The U.S. Economy

The direction of the U.S. economy, and all Western economies for that matter, follow the course of the pandemic and the prohibitions that it entails. No one should be shocked by discouraging economic growth statistics while much of the world is in shutdown. As we wrote earlier, Fed policy remains supportive of both markets and the economy, and by the time readers are looking at this, a stimulus bill may have been passed. Will there be differences in the pre and post pandemic economy? Yes, surely.

The adjustments inspired by the pandemic along with the advent of the new Administration will mean change, perhaps not startling, but change nonetheless. More about change next week.

Europe

Europe, particularly the European Union, continues to deal with difficult problems. The most obvious is Brexit. There does not appear to be a solution in the near future. Problems abound. As in all major political confrontations, egos can easily get in the way of solutions, and when dealing with heads of governments, egos can be bruised easily. We have no real insight on how the separation works out, but two questions stick out in our minds: does London remain the financial capital of Europe, and if the UK is successful in leaving and suffers no economic hardships, what does that mean for some of the poorer members of the EU? Do they also exit? No one knows the answers, but we can make educated guesses. On the first, we believe London remains the financial capital. Moving a financial center is not the same as moving a factory. There are all sorts of laws and regulations, along with institutional relationships, corporate relations and understandings that have taken centuries to establish. If the financial capital were to move, we would be left with at least two important questions: how do they duplicate the above and where? In our view, only two countries outside of England make sense—Switzerland and Germany. Switzerland is out because it is not a member of the European Union and there almost certainly would be serious objections to Germany. The reality is that Germany is unlikely to accept anyone else.

Weekly Market Insights (cont'd)

As to the second question, if Britain's departure is successful, it leaves the door open for those countries, mostly in the South who feel aggrieved, to leave. Therefore, it appears in the EU's best interest to make a hard bargain with the UK. These questions represent true dilemmas in the truest definitions of the word.

These are two important questions that may be considered macro or political. There also exist more micro problems, such as an overwhelming amount of bad debt.

There is also a philosophical problem. Although very similar, there are real differences between Anglo American economics and European economic thought. Anglo American is highly influenced by Scottish Renaissance thinking led by Hume, Smith and Ricardo. While Europeans are also heavily influenced by those thinkers, they are also influenced by the philosophers of the French Revolution like Voltaire and Rousseau, who both argued for a more egalitarian economy. Clearly, there are many obstacles to overcome to reach a satisfactory conclusion to Brexit.

From all of us at 1919 to all of you, we wish you a joyous holiday season!

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