1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

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A powerful equity rally, the promised fiscal policy and what about the Fed?

Financial Markets

This past week was an excellent one for equities. All major U.S. exchanges had their best week in months. The Dow gained 4.07%, the S&P rose 2.64% and the tech heavy NASDAQ rose 3.09%. It is interesting that just about every sector benefited this past week. The big questions are why and will this broad-based advance continue? The easiest answer to the first question is investors gained confidence that interest rates and inflation are stable. The second is far more complicated, but the next section should shed some light on the question.

The Economy

Last week investors were treated to a barrage of information, almost all of which was interpreted well. There was a lot of good news concerning the pandemic in the United States, the most positive being the improved rollout of vaccinations. Clearly, any news that indicates a return to normal is a great comfort.

At long last, the anxiously awaited relief bill has been passed, and many will be cashing checks in the near future. Embedded in the bill are two important cash flows that will be forth coming. First, are the enhanced unemployment checks which will be cashed and completely spent as they come in. This will be good for the economy and great for those who suffer the most. The second is the $1,400 checks being distributed to those earning $75,000 or less. It is an open question whether this is good for the economy or not. Many recipients receiving checks are working and don't need the money. Past history tells us they will save all or most of it, and much will go to the stock market. This alone will not be any great boost to the economy but will certainly help stock prices. The program in its entirety makes sense and can have a great impact. If we have a concern it is the $1,400 checks being sent out to those who don't truly need it. At some point, this can be inflationary and certainly will add unnecessarily to the federal debt. Some polls show a large majority of Americans, whether Democratic or Republican, are in favor of the program. It's hard to dislike a program that gives you free money. Anyone interested in why voters vote the way they do should read, The Myth of the Rational Voter.[1]

The next fiscal policy move investors should be following is infrastructure spending. We have written frequently about this. If allocated wisely, the money spent will be repaid many times over. We, of course, will follow it closely and report, but as we have written in the past, this is a great opportunity which can be easily squandered.

Additionally, we have written quite a bit about the Federal Reserve in the past for two reasons. One, they are a vital part of the machinery that governs the pace of the economy, and for the past few years, they are the principal source of economic stability in the western world.

[1] The Myth of the Rational Voter is a book by Bryan Caplan.

Weekly Market Insights (cont'd)

Investors pay an enormous amount of attention to what the Fed has to say. Shareholders temporarily abandoned the equity markets when Chairman Powell was misunderstood as predicting higher inflation, which of course he didn't. Investors are well advised to pay close attention to the Fed but should remember to read their reports in their entirety.

The Fed has been abundantly clear. They are not about to tighten monetary policy and want inflation[2] to rise to about 2%. If it runs above the 2% target, they will tolerate higher inflation until they are sure the economy is on solid footing. They are concerned about inflation and interest rates being too low for a couple of reasons. First is the Effective Lower Bound which is the point beyond which further monetary policy is counterproductive, so they would have no tools to boost the economy if needed. Second is the fear of deflation, which is both more difficult to combat and far more damaging to the economy and consumers.

So far, the Fed has done an excellent job. It will be more difficult when the time comes to tighten. It is almost always the case that when it is time for the Fed to tighten, they are at odds with both the President and Congress.

Conclusion

All that we have written above argues for a continued positive equity market and a strengthening economy. Certainly, one can talk of possible excesses of stimulative policy, both fiscal and monetary, but there is enough slack in the economy to avoid problems of high inflation and seriously rising interest rates for some time to come. A more current and interesting question that our analysts and portfolio managers are debating is what we queried last week. Is there a rotation going on? Specifically, are growth stocks giving way to value stocks?

[2]The FED uses the price index of consumption expenditures rather than the CPI.

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