Weekly Market Insights

March 29, 2021

Equities end higher, President Biden's spending plans and what about globalization?

Equity Markets

U.S. equity markets concluded this past week on the upside despite a great deal of volatility. The Dow closed up 1.36%, the S&P 500 up 1.57% and the NASDAQ down 0.58%. Investors had a lot of things to contemplate, many of them interrelated. These are what appear to us as the dominant concerns on investors' minds—the economy overheating, higher bond yields, excessive liquidity, the coming spending bills, rotation within equities, and, of course, the path of the pandemic. It does appear that there is an equity rotation taking place. The high fliers of yesteryear are giving way to the more cyclical stocks. It is certainly happening at the moment, but we caution readers that these moves can be deceiving and often revert.

We have covered most of the above in earlier papers, but because of the ever changing nature of the markets we will cover them again.

The Economy

Has the Federal Reserve overstepped, and is it time to stop or at least slow the expansion of the money supply? Probably not. Yes, it does appear that the U.S. economy is coming back to life, but the signs are not conclusive and the fear of a resurgence of the pandemic are real. Although interest rates have been rising, we remind readers that they are still extraordinarily low from a historical standpoint. At this point, inflation and interest rates are not a great danger. Of course, wise investors are less concerned about today than they are about the future. The Fed does not depend on a legislative body to act. Instead, Fed action can be immediate. We believe the U.S. central bank will live by its principal mandate—price stability. They will fight inflationary pressures just like they fought recent deflationary ones. There is a fear that, as the pandemic recedes, consumer demand will rapidly strengthen and outpace production. This, along with an excessive amount of liquidity in the system will bring on inflation. Unless the United States gets into an all-out trade war, this is very unlikely. There is quite a lot of idle productivity around the globe to moderate any excess demand from the United States.

We come now to where we think there may be legitimate concern. Last week we discussed the President's stimulus bill. We wrote that we were in favor of the bill but quite concerned about sending checks to those who don't need it—employed individuals earning up to $75,000 and families up to $150,000. Our concern remains.

We have long argued for a more aggressive fiscal policy that emphasized infrastructure spending and education. The President is now preparing another stimulus bill. We, of course, don't know what will be in it, but sources indicate that infrastructure, education, climate, and broadband are very likely to be included. What we would like to see added is a push for government sponsored research in pure science. In our view, none of these are inflationary. There are a number of reasons we feel this way. There is not a lump sum payment for any of these projects. Instead, the payments will be spread out over many years. Also, they should all pay for themselves over time with education topping the list.

The payoffs will come from increased efficiency, a U.S. industry and transportation base that increases its global competitiveness, an increase in skilled labor demand, a better educated U.S. work force, and, because of increased education, a skilled work force, and a significant reduction in automatic stabilizer costs (unemployment, welfare). It is not lost on us that this has a Pollyanna flair to it, but, if just part of what we wrote materializes we are well ahead of the game. Interestingly, most of these were part of President Trump's original campaign promise.

The danger is that the bill may double down on social spending. At some point the country may find more social spending is necessary. If that turns out to be the case, then it should be done, but right now, it makes sense to allow the social spending already imbedded in the system to do its job.

International and Globalization

We repeat, globalization is not dead in the twenty-first century. It is facing challenges just as it has for centuries. The coming together of the world's trading partners has slowed for a number of reasons. It always appears to slow when recessions occur, but globalization regains traction as recessions dissipate. The world's economies have been integrating with fits and starts since the end of World War II. The need to rebuild Europe, then the reemergence of Japan as a low cost manufacturing center, and, finally, perhaps the largest boost came in 1978 with the ascendency of Deng Xiaoping to the leadership of China. Deng began to allow capitalistic market mechanisms into the communist Chinese economy. For the next 34 years each system tolerated the other and benefitted. The election of Mr. Xi in 2012 brought an end to that cooperation. In 2016, Donald Trump became the president of the United States and trade friction accelerated. So began the slowing of globalization. The reason was not just the U.S.-China dispute, but the U.S. felt it needed to protect itself from Euro trade and instituted tariffs against European products as well. It was no surprise that Europe responded with tariffs of their own. Four years later, we have a new president and a new policy. Mr. Biden has been reinstating the special relationship with Europe. Trade barriers are falling with both Europe and Asia, and the U.S. is regaining leadership positions in international trade and legal organizations.

The problems with China remain, but they are more far reaching than economic. This is a subject of many books, but China's behavior has helped bring better relations between the U.S., Europe and much of Asia. We expect globalization to return to its upward path. Admittedly, it may take quite a while for China to come back into the fold.

Conclusion

In the West, the United States is leading the economic recovery. It appears that recovery is ongoing and is most likely accelerating. Inflation will be tame at least for the next twelve months.

Investors should not be overly influenced by sudden and rapid movements in markets and should maintain their allocations.

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