Weekly Market Insights

April 26, 2021

A volatile market, positive economics and a lesson from history

Equity Markets

U.S. equity markets displayed great volatility this past week. Investors were moved by a resurgence of COVID, rumors of much higher capital gains taxes, and strong economic growth. The Dow fell 0.46%, the S&P 500 fell 0.13%, and the NASDAQ closed down 0.25%. The performance numbers, from Monday's open to Friday's close, appear docile, but they hide the considerable movement that took place throughout the week. Many analysts consider this volatility a harbinger of bad things to come. They point not just to the volatility of the established market, but also to the lottery type behavior of some over-the-counter market stocks. An interesting but perhaps atypical example was given by Michael Mackenzie in this past weekend's *Financial Times*. He points out stock performance of Hometown International, owner of a humble deli in New Jersey, which topped the market at a stunning $100 million valuation, up nearly 5,000%, since the beginning of the year. In 2019, the deli had $21,772 in sales. Can price movements like this be just a strange anomaly or are they signaling something dire? At this time, we believe that the U.S. economy remains strong and has the growth potential for further gains.

The Economy

As we have often written, the path of the pandemic has an enormous influence on both the financial markets and the economy. Fears have been subsiding as of late, but concerns about vaccine distributions and the significant resurgence of COVID-19 in India revived investor uncertainties this past week. While the health crisis in India continues, market fears have abated.

The other thought that spooked investors is the view that the new administration would raise capital gains taxes to a very high level for high income individuals and families. The proposed maximum rate would align with the income rate tax rate for earned income. We doubt it will come to fruition as outlined. Even if the administration does propose it, which we doubt, it will be an opening gambit which is fully expected to be changed in negotiation. But, as both parties have pointed out, something must be done about raising funds to pay off the federal debt, and a moderate increase is certainly not out of the question. A moderate increase should not throw equity markets off track.

A variety of positive economic reports came to the market's rescue this week, showing continued strength of the economy. We would argue that there is nothing in the reports that justifies great concern for the U.S. economy for the next 6 to 12 months. Ryan Schutte will analyze the releases in more detail at the end of the month.

There have been a number of comments by analysts and in the press expressing concerns about the tightening of the labor market. Although there is a positive correlation between an extremely tight labor market and inflation, we don't believe the labor market is so tight that inflation from that aspect is close. A lot of positive forces can happen from a tightening labor market. As labor costs go up, so do household incomes and consumption. This encourages businesses to invest in new productive capacity, and this investment works to hold down prices. As more people are hired, the government gets more in taxes and spends less in welfare payments. This, of course, sounds like a Pollyanna story. This virtuous cycle won't last forever but for the foreseeable future, the U.S. economy seems in good shape.

Conclusion

Although we are positive on the economy and the markets, we would urge investors not to get caught up in the euphoria that often accompanies strong markets. Remember, as equity markets grow, portfolios get out of balance and have an added risk of being over weighted with equities. Portfolio rebalancing is done to manage risk.

Addendum – a Great Read

One thing that unsettles markets and moves investors and business managers to make moves that they ordinarily would not is a feeling that things are changing and they have no control. In some ways this is happening now. Many commentators are speaking and writing about the level of political factionalism taking place and are questioning if the country can recover. A lot of the concern is the fear of change and uncertainty over whether the country can rebound and go back to normal. That feeling is based on a romantic nostalgia of what America's past was. Pascal Bruckner cleverly wrote, "The contrary of memory is not forgetfulness, it is history."[1]

Thomas E. Ricks has written a wonderful book, *First Principles*, Harper Collins, 2020.

He discusses how the country started by analyzing how the founding fathers worked together and compromised in order to write the Declaration of Independence, created a government and nation with the Articles of Confederation, then transitioned from a loose confederation to the Constitution and a tightly knit nation of states. Through all of this, these very different men cooperated and compromised. When the war was over and Washington was firmly in place as president, factionalism came in full bloom. In fact, factions became so evangelical many thought the "Great Experiment" would not last. Factionalism has been with us periodically for nearly 250 years. Somehow, the country makes its comeback to reason. In order to view the future correctly, we must view the past as it was.

This is a fascinating read and would be a great educational tool for both adults and younger readers alike.

[1]The Tyranny of Guilt, Pascal Bruckner

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