Weekly Market Insights

June 21, 2021

Equities fall, Fed news, and transatlantic economics

Equity Markets

U.S. equity markets closed last week with the Dow having its worst performance since October. The Dow fell 3.45%, the S&P 500 fell 1.91% and the NASDAQ fell 0.28%. There were several reasons for the markets' weakness. The most obvious was the Federal Reserve's apparent change of heart following the recent burst of reflation. Rather than raising interest rates in 2024, it seems more likely they might move in late in 2023—a modest change. This signal was followed by remarks from James Bullard, president of the St. Louis Federal Reserve, saying he expects the first rate increase to be in late 2022. It is important to remember that the St. Louis Fed has the reputation as the most monetarist of the twelve reserve banks and President Bullard is not presently a voting member of the Open Market Committee. These two events clearly frightened investors, but market participants should keep in mind that 2023 is a long time from now, and a lot can change. Another reason investors may have been skittish is that many have accumulated a lot of gains over the past few years, so they were incentivized to preserve some profits at the first sign of danger. It does not appear to be the end of the economic expansion, and the related equity market advance.

The Economy

The U.S. economy continues to expand. Of course, there are and will be disappointing statistical releases, but that is to be expected as the economy continues to recover.

The Conference Board's recent release confirms our view of positive growth for the U.S. economy for the foreseeable future. The Board's leading indicators were reported as rising 1.3%, a very strong number.

There has been concern about the shortage of labor and the fear of rising wages. Complaints from companies have been loud and clear about this. We, like many others, have argued that the continuation of the supplemental unemployment pay has kept many lower-wage workers out of the market. This is perfectly logical and conforms to economic theory, as people are behaving rationally. This is in no way a pejorative comment. The problem should be short-lived, as supplemental benefits end this September.

G7 and the Atlantic Alliance

The conclusion of the G7 meeting left us thinking about the much-discussed transatlantic relationship.

As most of us are aware, the G7[1] has been meeting in Geneva for the past week. Headlines have proclaimed an atmosphere of renewed cooperation. An example is the apparent global corporate tax agreements, but there remain powerful underlying differences that will not be settled easily.

The idea of capitalism has a similar but slightly different meaning in Anglo-American countries than in Europe. Both have their genesis in the ideas of Adam Smith and the Scottish Enlightenment.

[1]The G7 is an informal grouping of seven of the world's advanced economies: Canada, France, Germany, Italy, Japan, the United Kingdom, the United States and the European Union.

However, the Scottish and European enlightenments took different paths. The Scottish Enlightenment was led by David Hume, Adam Smith and Edmund Burke, and concentrated on benefitting the consumer. The European Enlightenment was influenced by DuPont, Voltaire, and Rousseau[2] and had a slightly different view with more attention devoted to workers. This is interesting because even small differences have caused some difficult situations.

There has been some press about the U.S. wanting Europe, particularly the E.U., to not use Chinese technology. Europe, to some degree, has balked at this. We were curious why. Europe has fallen well behind both the United States and China in both technology and the development of large tech companies. The question is why? Interestingly, one answer is sources of capital. The U.S. has developed a highly efficient system of venture capital where ideas can incubate, and if they appear successful, move on to the capital markets to receive more funding rapidly. China, as we know, uses state funding. State funding tends to be inefficient, but at least it is available. Furthermore, both China and the United States are very large, highly populated countries that can develop companies and have them grow to a large size domestically before expanding to other countries. Europe does not have the same ready sources of capital as the United States, nor does it state fund enterprises as in China. It would appear the E.U. could match either China or the U.S. in size, however, there still remain barriers and borders in the E.U. that make certain union-wide investments difficult.

What the G7 meeting has done is reestablish a much warmer and cooperative relationship between the U.S. and Europe. This, of course, is very positive.

Conclusion

Although corrections will come and go, investors should not give up on equities. The economy remains strong, and there are positives in the future. We sound like a broken record at this point, but be sure to check your portfolio allocations.

[2]Turner, Frank M. European Intellectual History from Rousseau to Nietzsche, 2014.

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