Weekly Market Insights

June 29, 2021

Equities recover and an agreement has been reached

Equity Markets

Investors came back to the market this past week, fueling its best performance in months. There are a number reasons for this. They appear to have gotten over the fright of the Fed's comments about tightening policy, or at least they sensed that 2023 is a long way away.

News was circulating that an agreement was to be announced about an infrastructure bill. This encouraged investors for two reasons. First, the bill is a positive for the economy. Second, it shows that bipartisan agreements can still come about. Ultimately, there appears to be a growing sense of optimism among investors.

The Economy

The discussion of an infrastructure bill has been bandied about for some time. After much debate, a compromise has been reached. We have written quite a bit about why an infrastructure bill is so important to the U.S. economy. Infrastructure spending will not just create domestic jobs, but will go a long way in making the United States a far more competitive economy.

There are least three outcomes if the bill is finally passed. The first and best sounds Pollyannaish. As many suggest, the country has allowed its infrastructure to lie fallow for quite some time. Bridges, roads, harbors, railways, and the electric grid system have all grown weak and, in some cases, obsolete. These detract from U.S. competitiveness. When construction begins, the country will have the opportunity to upgrade the systems in place to be as technologically advanced as possible. Countries with the most efficient, modern systems will be the most prepared for the future.

Although there will always be a need for global supply chains, this will go a long way in keeping much at home. More recently, the U.S. has not been the recipient of as much foreign direct investments as in the past. This can be reversed by making the country a more efficient place to invest.

This leads to other possibilities. The U.S. will need a highly competent, educated work force. An upgrade in the educational system, as both the Trump and Biden campaigns suggested, can be started. This will create a far more productive workplace, and the combination can significantly raise the country's potential GDP. A rising tide lifts all boats. Last, and what should make everyone happy, over time these changes should pay for themselves.

Of course, this sounds pie in the sky, but it is not the only possible outcome. The bill could pass, and approved spending could get divided up among nonessential projects. This would help politicians, but not the country. This has been the case in the past and must be guarded against.

The third possibility is the bill is passed and nothing is actually done. It sounds ridiculous but has also happened. Projects get debated until they just go away. A likely scenario would be some combination of one and two.

The Federal Reserve

All the above have serious implications for monetary policy. The first clearly argues for the Fed to end their bond buying and allow fiscal policy to be the prime motivator of the economy. This combination would give the economy a noninflationary boost while holding down future inflation.

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The second would require the Fed to do the same and perhaps raise interest rates. This is because fiscal policy would stimulate the economy but not really produce anything.

The third outcome would do nothing for the economy and the Fed should not react.

Conclusion

It is not out of the realm of possibility that the expansion may continue with just transitory bouts of inflation. Equity markets should fare well, but there will be corrections along the way.

There will be a two-week break in publication, so we will see you the week of July 19.

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