1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

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Equity prices fall as Covid-19 infections increase

U.S. equity prices fell again this past week. The S&P 500 lost 0.57%, the Dow lost 0.07% while the NASDAQ lost 0.47%. While there were several concerns on investors' minds, the dominant one was the resurgence of Covid-19 infections. We will address other concerns in our discussion, such as Fed posture, consumer sentiment, the future of tax policy, and, of course, the question of whether or not the market is in a correction.

The Economy

Although some economic indicators show signs of softness, this is not necessarily a signal that the economy is in trouble. Economic reports typically fluctuate during economic upswings. Investors should be a little skeptical about signals they get from models. Last week, we wrote about how the genesis of the recent recession was very different from past recessions. As we all know, Covid is the villain, and it has affected economic variables in very different ways, in both timing and order. The accuracy of models is dependent on the relation of variables remaining constant. In this case, that may not hold.

As always, investors look toward the Fed for signals of tightening or easing. The concern, of course, is whether the Fed will change its long-standing policy of accommodation. In our view, they will not tighten at this time. The Fed sees the same economic signals investors do and will wait for more indicators that the economy is strong and inflation is accelerating. It seems likely that the Fed would not want to make a move when there are so many economic issues confronting Congress and the President.

The last point, which will affect both the markets and the economy as a whole, is the question of what will happen in Washington. Investors face the possibility of tax rate increases, an infrastructure bill, and the debt ceiling. We wrote last week that raising the debt ceiling will happen, albeit with considerable posturing, but it will happen. The infrastructure bill will also pass. It is in both parties' interests, but it will be negotiated down in size. Tax policy is always on peoples' minds, and this year is no exception. There will be much wrangling and posturing. The consensus belief is that the President's bill will be trimmed.

The future, to a great degree, depends on Covid. Where will the Delta strain take us, and will another variant follow in its path? As Covid infections retreat, business investment and payrolls will accelerate. New supply chains will be built and job openings will be filled. This will put the U.S. economy back on a solid growth path. That, combined with company balance sheets that are flush with cash, may inspire a rash of investment. In our view, the most likely targets for investment are in supply chain and efficiency management.

Conclusion

At this time, we see no reason to alter last week's conclusion. Covid-19 will most likely play the dominant role in the economy and equity markets. We don't see any serious imbalances in the economy that signal a looming recession. Given the volume and variety of news out of Washington, equity markets are likely to remain quite volatile, and only time will tell if we are in a correction or not.

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