Weekly Market Insights

October 18, 2021

Good earnings create good markets. Where are we headed?

Equity Markets

U.S. equity markets registered excellent performance this past week. In fact, it was the best performance since June. Investors should be encouraged because stocks rose for the right reasons—better earnings and positive economic reports, which is a signal of future economic strength. The Dow closed the week up 1.58%, the S&P 500 closed advancing 1.82%, while the NASDAQ closed up 2.18%.

The Economy

We wrote earlier about positive news on the economic front. Although investors and analysts have been concerned that consumers may be holding back because of COVID-19, inflation, and less than thrilling employment numbers, retail sales rose. Investors will remember that consumption is a very large part of the U.S. economy, and the consumer dominates consumption. This is why analysts follow both consumption and labor markets so closely.

In past papers we have written about two, of many, interesting economic futures. The first is domestic and the second, global. Neither is necessarily a forecast, but are factors investors may want to keep in mind.

The continual advance of technology may be the dominant factor in the economy. Readers of the financial press are well aware of projections of a shrinking work force and how that will hinder production. We will argue perhaps not.

Robert Solow and Trevor Swan first introduced the neoclassical growth theory in 1956. The theory states that economic growth is the result of three factors—labor, capital, and technology. While an economy has limited resources in terms of capital and labor, the contribution from technology to growth is boundless. We are going to be bold enough to make a small adjustment to professors Solow and Swan's definition and separate technology into two parts—technology and innovation. The reason we do this is that technology has made extraordinary advances, but businesses still have much room to go in implementing these technological breakthroughs. If that isn't enough, new technologies are coming at an increasing rate. We agree with Solow and Swan. The possibilities are endless. There are things that the country can do to hasten adoption. The infrastructure bill, which has bipartisan support, will go a long way in advancing this, and the country must work on improving its educational system. The jobs that will be created will be excellent, well-paying jobs, but a decent education is a prerequisite.

Is this scenario a sure thing? No, but with just a bit of luck it is possible.

Global

Global inflation has been a common topic in the financial press lately, and the International Monetary Fund (IMF) had some interesting comments in their biannual economic report. As the headlines stated, they are concerned about the dangers of inflation. They remind central bankers to be vigilant to the dangers of inflation. They have been concerned about supply-demand problems. These have been caused mostly by supply chain disruptions and difficulties in bringing goods to market. Their view suggests higher inflation toward the end of 2021 and then moderating. They forecast global growth to be 5.9% in 2021 and 4.9% in 2022. They are dire about emerging market countries. Excluding China, they expect low-income countries' GDP to be 10% smaller by 2024.

We wrote earlier that we had a growing concern about China. Nothing has occurred to change our view. Evergrande's financial problems continue to expand. We want to remind readers how, to a degree, this crisis is a bit reminiscent of the 2008 financial crisis in the west. The Evergrande events have started to trickle down the economic ladder to the common man. This trickle down can turn into a current in a hurry. China does not have the tools that the west had. China does not have an independent central bank and all idea flow comes from the Communist Party. Since there is only one party in China, there is only one place for the population to direct their anger. This is something President Xi cannot tolerate. What he would do about it, no one knows.

Conclusion

Our view remains the same. We are guardedly optimistic about both the economy and equity markets. The great difficulty is predicting the path of Delta and the implications if another variant follows it. Portfolio rebalancing is an important risk management tool.

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