1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

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A fiscal and monetary policy switch. A positive for the economy, markets must adjust.

Equity Markets

Equity markets closed mixed this past week. The Dow closed down 1.38%, the S&P 500 closed up 0.32%, and the NASDAQ closed up 1.24%. There were a number of reasons investors were cautious. First was concern that the spread of COVID was once again gaining strength around the globe despite governments taking strong actions in attempts to control the spread of the virus. Also, oil prices fell in response. Reason being, as countries tighten travel restrictions, travel and retail commerce should slow. It will be quite interesting to read about travel over the coming holidays. Another reason for cautiousness is that investors, particularly institutions, may be waiting to see how the second leg of the President's spending legislation turns out. With all that is going on, legislatively and economically, markets were actually quite calm.

Economics

The move from monetary to fiscal stimulus will be the dominant theme for the economy for some time to come. For some time, the Federal Reserve has taken the primary role of stimulating the economy through monetary policy, bond buying, and keeping short-term rates abnormally low. Now a macroeconomic package is working its way through Congress. The infrastructure bill is now law, and investors should find out next week regarding the Build Back Better social spending bill. If done correctly, together they can be a powerful tool creating long-term growth for the United States economy. We have written extensively about the first half of the program, popularly known as the infrastructure bill. It deals with a dramatic increase in spending on infrastructure such as roads, bridges, and ports. These are all investments in the superstructure of the economy. These investments will create jobs immediately and add to economic efficiency. This, of course, is important and a positive, but far more important is that they create the tools for potential above average economic growth for a long time to come. It is always important to look at cost-benefit analysis. The cost, although high, will be spread out over many years and will pay for itself in economic growth, increased tax revenue, and lower automatic stabilizers.[1] We have written about the future of economic growth being tied to modernization and technology. This bill should create a fertile field for this economy to grow.

The second bill deals primarily with social issues and will come up before the Senate this week. The cost of this bill is much reduced from its original price tag. This, of course, was to be expected. There remain issues that must be resolved. Legislation that is primarily social is far more subject to ideological critique than purely economic legislation. We fully expect further changes.

[1]**Automatic stabilizers** are economic policies and programs, such as unemployment and welfare, that automatically help stabilize an economy.

When looked at casually, some provisions do not appear to be a positive boost to the economy, just socially beneficial, but, at closer inspection, are important to faster economic growth. Some examples are education, healthcare, and child care. One great difficulty with parts of the legislation, such as the child tax and earned income tax credits, is determining at what income level to draw the line. It will be interesting to follow the debate.

Although GDP is an imperfect statistic, it is useful to look at how particular legislation affects it, as well as who benefits and who loses.

The GDP formula is: GDP = private consumption + gross private investment + government spending + net exports.

The legislation positively affects each facet of the economy. The primary objection will concern government spending. The objections will be two pronged—ideological, meaning is the government overstepping its bounds, and economic, can the economy afford it? Economics can help answer the second objection, but politicians and philosophers have been arguing the first objection since John Stuart Mill tried to balance liberty and democracy.

In another very important news announcement, Federal Reserve Chairman Jerome Powell has been renominated for a second term. We and most of the economic and financial community have expressed an opinion. The view is overwhelmingly in favor of Chairman Powell. He has done an excellent job through two extremely different administrations, and led the Federal Reserve in a financial rescue mission, when political infighting prevented a fiscal policy rescue.

Conclusion

We expect the second part of the package to be passed in some moderated form. The Federal Reserve will continue to reduce its bond purchases, and the equity markets should continue to gain but in a less dramatic fashion.

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