1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

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The Rally Continues

Financial Markets

It has been a remarkable start to the New Year. Through the first two weeks, most financial markets have been ebullient compared to what many analysts expected. This past week, the Dow gained 2.00%, the S&P 500 gained 2.67%, and the NASDAQ gained 4.82%. Looking internationally, the MSCI EAFE[1] and MSCI Emerging Markets indices gained 2.11% and 2.91%, respectively.

We wrote last week that investors were converting from inflation bears to recession bears. Their argument is that the Federal Reserve has been too aggressive in combating inflation, raising interest rates at a pace that will cause a recession. To investors' delight, there have been more and more signs that inflation is easing. Investors took these reports as a sign that inflation would dissipate further, allowing the Fed to slow rate increases. They have gotten some mild encouragement from some Fed members. The news has been encouraging, but, in the economics section, readers will find out why it may be too early to dismiss a possible recession. In fact, one of the nation's leading economists, Larry Summers, believes the U.S. will suffer a recession late this year.

We will write more about the economy but want to emphasize that a lot of what has been encouraging is also speculation, so caution remains the mantra for investors.

Economics

This week all eyes will be on two things, both political. The first is the continuing saga about classified documents. This should have nothing to do with the economy, except that it is a wonderful distraction for politicians to use in avoiding the very difficult work that actually needs to be accomplished. This leads us to the second issue. Last week, Treasury Secretary Janet Yellen notified Speaker of the House Kevin McCarthy that the U.S. will reach its statutory debt limit this coming Thursday. The other highly charged battle will be the budget battle. Happily, that won't come for a while.

The debt ceiling should be simple. The United States government will run out of money at some point. The money is not needed to pay for new budget items, but rather for past purchases that have already been approved. So, this is not a vote that will curtail future spending but one that will release funds already spent. However, it has become a political bargaining chip. The debt ceiling increase will almost certainly be approved, but markets will likely behave poorly during the process. The debate will likely continue into the third quarter.

The budget process is a very different matter. While the debt ceiling represents the past, the budget is for the future. It represents the hopes and aspirations for the future and deserves to be debated. It is easy to confuse the two. While debating the debt ceiling is almost always a political tool, the budget debate is a legitimate one concerning the future of the country.

[1]EAFE stands for Europe, Australia, and the Far East.

Weekly Market Insights (cont'd)

Internationally, both Russia and China remain important players—Russia, because of Ukraine and its influence on the price of energy, and, China, because it is a very large global economy that is slowing and its resurgent battles with COVID could have aftershocks. We will have more about both next week.

Conclusion

Although there has been positive news for the U.S. economy, it would be a mistake for investors to place a particularly high level of confidence in any one outcome and should instead wait for more evidence.

As we wrote earlier, the debt ceiling will almost certainly be increased. The budget debate is far more interesting.

The Fed remains the most important factor in determining the direction for financial markets.

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