Weekly Market Insights

April 17, 2023

Banks, Earnings, the Fed, and the Dollar

Financial Markets

U.S. equity markets closed an unexciting week with gains. The Dow closed up 1.20%, the S&P 500 gained 0.79%, while the NASDAQ gained 0.29%. Market participants were clearly focused on bank earnings, and, thus far, the takeaway has been so far so good. The focus for banks will go beyond earnings and will extend to deposit composition. We expect to see that there has been some movement in deposits from small to large banks, but nothing dramatic. Of course, as concern over the recent bank failures continues to recede, Fed policy will remain the primary focus. Investors appear to be in a wait and see mood.

The Economy

There are a lot of interesting points to ponder concerning both the domestic and global economies. It is important to note that these economic issues will draw even more attention when election season ramps up. As we wrote a while back, those running for reelection may not be anxious to address these problems. Short term, in this case 12 months, inflation versus recession is the paramount issue. Although they may have started late in the game, the Fed appears to be winning the battle against inflation. As it currently stands, the Fed will continue the fight against inflation even though it is likely to slow the economy. Inflation may well be a nagging problem, but it is likely on the way out.

Fiscal policy will be an important and contentious problem for years to come. The first fiscal policy issue, which we have written about previously, is raising the debt ceiling. Unfortunately, the debt ceiling is a political bargaining chip that will be debated in Congress, but we believe it will ultimately be raised.

In the longer term, the country has some important problems to solve. First and foremost, the growing budget deficit must be addressed. Unlike some, we don't believe the country is yet in crisis mode, but we are approaching it. How to solve this issue will be difficult and politically divisive, but we believe it is solvable. The dividing line is whether to focus on spending reduction, tax increases, or both. Most economists will argue both should play a role, with the major contribution coming from raising tax rates. That is most likely what will happen, but not without a bitter battle. It will be worth the pain because it will relieve a lot of the tension on the economy, particularly on the dollar.

The country must reinsert itself as a major player in the global economy. No matter what investors and pundits may think, globalism is not dead in the twenty-first century. As we have written many times, globalism doesn't die, it just metamorphosizes. Right now, countries are looking at regional trading groups and reviewing supply chains, among other reactions, to both the effects of the pandemic and the aggressive posture of China in the global economy. Our old friends Adam Smith and David Ricardo would be neither surprised nor offended by this. Increasing efficiency is not anti-globalism but part of globalism. That is the purpose of globalism—to force economic efficiency. In fact, that is the redeeming feature of capitalism. It is not supposed to be easy, but, rather, a constant struggle.

We have written in the past that we think there will be an important tradeoff between capital and labor in the not-too-distant future. Like all big changes, it will not come without pain and struggle. We will write about this truly interesting change soon.

Our last point has to do with the International Monetary Fund's (IMF) global meeting which recently concluded in Washington D.C. The discussions will be well-publicized over the next week or so. In a nutshell, they forecasted slower economic growth and a return to low interest rates over the next decade. As readers digest these reports, they should keep two important facts in mind. First, it is extremely difficult to accurately forecast the next twelve months, much less the next decade. Second, the IMF deals primarily with the low income and underdeveloped countries, and this may very well unduly influence them.

Conclusion

We don't expect anything particularly dramatic to occur over the next quarter. The banking issues appear to be receding, and inflation, although sticky, seems to be slowing. Both matters need more time to play out.

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