1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

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It's All About the Fed!

Financial Markets

Once again, as investors have repeatedly shown, it's all about the Fed. After a remarkably strong stretch, last week's returns were just the opposite. The Dow fell 1.96%, the S&P 500 fell 1.16%, and the NASDAQ fell 0.92%. The main cause of the reversal was the Federal Reserve Bank. They released the minutes of their last meeting, which argued for continued rate hikes in the remainder of the year. As you will read later, economic releases have been mixed, so it is difficult for analysts to make a powerful case either way. Looking forward, volatility will likely continue to be the name of the game.

Economics

Central banks around the world are vital to the progress of their respective economies. We have already written about the Federal Reserve and their apparent leaning toward further tightening. Both the minutes from the most recent FOMC meeting and the comments made by Fed officials indicate this desire, but the aggressiveness of those comments were subdued relative to recent remarks from central banks globally. For example, the European Central Bank (ECB) appeared far more intense in their comments. This is not surprising as Europe tends to lag the United States in their monetary policy. It will be interesting to see how and if this affects their respective currencies. A far more interesting banking question is—what, if anything, will change with the People's Bank of China? President Xi has appointed a new PBOC president, but we'll cover more about China when we discuss international matters in greater detail.

This past week, the financial press has written a lot about employment and wages. Labor market statistics provide vital information about the future strength of the economy. For example, payroll numbers offer some information about what companies are thinking in terms of future demand, but also provides information about consumer strength. As we have often written, the consumer is 70% of the economy, and a strong labor market helps to fuel consumption. One might say—so goes jobs and wages, so goes the economy. Friday's release showed that job growth slowed more than expected in June and was revised lower for the previous two months. It was still strong, but growth appears to be decelerating, which should give the Fed some comfort. Wage growth remains above historical averages, although it should come down if job growth continues to slow. Another interesting takeaway from Friday's employment reports is that the quit rate is slowing. This is a sign that workers do not feel as confident that another job may be waiting. It does appear that higher rates are slowing the economy. This in itself is not alarming, but the important point is, how fast and at what cost?

One of the most interesting questions concerning the global economy is what exactly is happening in China? China has been one of the most difficult countries to analyze for two main reasons. The first is that the country is very secretive, and the second is that the accuracy of their reporting is questionable. Despite these limitations, it is evident that the Chinese economic recovery is losing steam, with recent data on manufacturing, new home sales, and employment failing to respond to recent fiscal and monetary stimulus. One of the more serious issues the country is facing is a continued debt problem. China has used questionable real estate debt financing to stimulate its remarkable growth, and now it faces serious repayment problems. This is not new and many have written about it, but the severity of the issue continues to escalate. One of the obvious signs is China's weakening currency. In order to stimulate the economy, the People's Bank of China has lowered interest rates which has caused yet another problem. As China has been lowering interest rates, the United States has been raising them, causing a steep drop in the value of China's currency, the yuan. In an effort to combat this devaluation, President Xi has appointed a new central bank chief, Pan Gongsheng. Although Pan has a lot of international experience, he will be handicapped by the lack of the PBOC's independence that central bankers have in other major economies. Shuang Ding, a senior China economist at Standard Chartered Bank, aptly summarized China's economic problems. "If we look at the root cause of the weakness of the economy, it's not the lack of liquidity, it's not about the affordability of the credit, it's not about the availability of credit—it's just a lack of confidence."[1] We would agree with Mr. Ding.

Conclusion

At the risk of sounding like a broken record, the market continues to be at the mercy of the Fed. The economy and inflation appear to be slowing just as the Fed intends, but, at least for the moment, there is still more work to be done. The U.S. remains the place to invest. In 2022, the United States was the top destination for worldwide direct investment. Although these investments appear to be slowing in 2023, the U.S. remains the top destination. This exemplifies the confidence that the rest of the world continues to have in the United States.

[1]Shuang Ding, senior China economist at Standard Chartered Bank, *Wall Street Journal*, July 6, 2023.

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