Weekly Market Insights

March 4, 2019

An Amazing Start, Accommodating Fed, Ok Economics and Perhaps Positive News from Overseas

U.S. Equity markets closed the first two months of 2019 the strongest ever. For the year, the Dow Jones Industrials closed on Friday +11.6%, the S&P 500 +11.8% and the NASDAQ +14.5%. Truly impressive. There were some encouraging releases and announcements that spurred investors on, two domestic and two international. First, of course, was the National Bureau of Economic Analysis's announcement that year over year growth in U.S. GDP was 3.1%, well over projections. While it is true that fourth quarter growth was slower than the earlier three, that was mostly related to slowing growth in both Europe and China. But toward the end of the week, there was encouraging data from both the E.U. and China. It is hard to say exactly what is happening in China. As we and others have written in the past, there have always been measurement and credibility problems when analyzing economic reports from China, but the market has chosen to accept the recent reports at face value. No such problem with reports from the E.U; they are quite reliable. The problem with the E.U. is the numbers remain somewhat inconclusive, which tells us more data is necessary to form a solid conclusion. Perhaps the biggest boost to the financial markets was Fed Chairman Powell's discussion on Fed policy. Mr. Powell, as always, told the world that the Federal Reserve will remain cautious and if the economy appears to be weakening, they would not tighten into a weakening economy. Why that may surprise investors we are not sure, but each announcement by the Fed, no matter how logical, seems to surprise market participants.

An interesting question is, have the U.S. equity markets made most of their run for 2019 or is there more to come? An unanswerable question, but we can supply some educated thoughts to help us along the way.

I have spent the past week in Washington and here are some questions investors should keep in mind as they watch the year unfold. First, as readers can imagine, last week Washington chatter was dominated by the testimony of Michael Cohen. Even with all the distasteful behavior over the past two years, it is hard to imagine something as difficult and sad to follow as the Cohen testimony. Almost no one distinguished themselves. Most did quite the opposite. If there was anyone who tried to bring this fiasco up from the gutter, it was Chairman Elijah Cummings, the Chairman of the committee. He struggled to have the committee operate with dignity and patriotic purpose. His closing remarks were a gem! No one knows how this will end, but it clearly is not over and will continue to affect markets. As we wrote earlier, the Fed has a powerful effect on the economy and markets. We believe the Fed will do the right thing and maintain a moderate position, but mistakes do happen, so we should continue to maintain a vigil.

China, as our readers are well aware, is a very large question mark for us. Ever since President Xi redirected the economic liberalization policy started by Mr. Deng after Chairman Mao’s death in 1976, China’s economy has seemed to be slowing down.

Weekly Market Insights (cont'd)

The E.U. has not grown out of the economic doldrums and the specter of BREXIT hangs over both the E.U. and the U.K. There appears to be no solution. Perhaps the best thing that could happen is a second referendum.

The deficit was one of the most discussed problems in the economy. The Gross National Debt exceeds $22,000,000,000,000. To give a startling example of just how large that debt is, it is almost as large as the economies of China, Japan and Germany combined. We used the long version on purpose to emphasize our point. Interest costs are skyrocketing and, if analysts are correct and interest rates rise over the next few years, interest costs will be higher. Rising government debt means lower incomes for Americans. Soon there will be very little room to protect our safety nets such as Social Security, Medicare, and Medicaid. It is news to no one that a solid fiscal foundation leads to economic growth and prosperity. The American people know this; nearly 75% of voters agree that the national debt should be a top three priority for the country.[1] You would think under these circumstances Congress and the voters' interests would be aligned. So why doesn't Congress do something, because that alignment is an illusion? The illusion lies in the mismatch in timing. Just as it is in a sitting legislator's self-interest to institute a tax cut now, because he or she will probably not be in office when it comes time to pay the bill. The reverse is true when cutting the deficit. The pain comes now and the significant benefit comes after the politician is out of office. Another problem is, politicians know that voters have short memories. Once the deficit cuts begin to take their toll, voters tend to forget how much they were in favor of cutting the deficit.

This paper answers none of the problems above, but we feel it was important to list the varies of good and not so good, so our readers are aware of our concerns.

Our view is there is more to run here but, as always, vigilance and making sure investors' portfolios remain properly aligned is very important!

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[1]Thanks to The Peter G. Peterson Foundation for the Data.