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# Weekly Market Insights

**July 15, 2019**

## All eyes on the Fed, China and Europe in the doldrums and the market rolls on!

Equity markets continued to advance this past week with the Dow Jones Industrials rising 1.52%, the S&P 500 up 0.78% and the NASDAQ increasing 1.01%. The primary mover of the markets this past week continues to be the belief that the Fed will start to ease as early as the last week in July.

It is hard to argue with the bulls. Mr. Powell certainly appeared dovish in presentations to Congress. We think the jury is still out, but we run the danger of writing what we think the Fed should do rather than what the Fed will do.

**The pros and cons.** What has made both the markets and, apparently, the Fed feel as if the economy needed more liquidity? There are three major reasons, which most people are aware of: the dangers of a tariff war, most of the world in economic doldrums, and a scattering of weak economic releases in the United States. The biggest gainers in the short run will be holders of financial assets. This is obvious. There is a chance that the economy may grow a bit faster, but the U.S. economy is already growing at what many believe to be above capacity. Inflation may move toward the hoped for 2%.

A number of dangers loom for the Fed and the economy if the Fed starts to ease. First, they will be accused of bowing to the political will. It is well known that the Administration has been pushing the Fed to ease. We have written that a tariff war does not pose a very great danger to the United States and the most likely outcome will be some kind of trade agreement between Xi and Trump. If the easing makes the U.S. economy grow faster, it may help the European economies if the U.S. imports more. On the flip side, the dollar will weaken, making all imports less attractive. As far as the weak U.S. economic releases are concerned, the economy remains in good shape. The weak numbers are quite recent and may be reversed. The weak labor numbers have already been reversed. If the Fed does lower interest rates, they put themselves in a difficult position when the next, more severe slowdown occurs. They will lack the monetary ammunition to fight the next battle. Last, there are alternative tools at the disposal of the Federal Reserve. There are trillions of dollars in non-required reserves being held at the Federal Reserve. They have the option of lowering the interest rate paid to the commercial banks, encouraging banks to remove these deposits and lend them at higher rates, thus stimulating the economy.

Another reason for a cut in interest rates is an “insurance cut.” An insurance cut is not prompted by data suggesting a rate cut, but is a preemptive move by the Fed to keep the economy on an even keel.

The Federal Reserve is in a difficult position but it was created in a fashion to allow it to be independent, and it should remain that way.

**Europe and China.** We have written quite a bit recently about the difficulties facing Europe: Brexit and a single currency for a group of countries with different economies and fiscal policies. Readers can go to our web page and see them.

China is another interesting story. There are any number of reasons China may be facing a slowdown, however, it is important to remember China is coming from a very high rate of economic growth. Here are some possible reasons. The tariff war is causing more difficulties than anyone thought. A good thought, but it can’t be the only reason because the slowdown started well before the tariff war. President Xi has precipitated an economic slowdown because he has abandoned the free market policies started by Deng Xiaoping. This is what happens to a low income country when it moves into middle income status. Comparative wage rates begin to narrow, taking some of the wage advantages away. Advancing technology replaces labor, having the same effect, and other less advanced countries begin to take business away. Most likely all have some truth, the importance being in reverse order than we have written.

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