Weekly Market Insights

September 28, 2020

Equities slide, Slow but continued economic growth, Debt issues and Mounting political concerns

Equity Markets
Equity markets closed with a fourth straight week of modest losses. There were a number of catalysts for the decline. First, the market has been on a positive run and investors became concerned about overvaluation, second, the expected new spending bill has not occurred, third, some investors are anxious about the coming election and the most important of all is the continued advance of the pandemic.

Although investors seldom like to see the market retreat, they should be comforted that with the damage done to the global economy, the S&P is only 2.6% below its pre-pandemic peak.

The economy
Bulls and bears alike agree that economies, whether in expansion or recession, tend to move in fits and starts. Economic indicators can temporarily slow during expansions and temporarily speed up during recessions. The disappointment that some indicators are slowing lately is compounded by the uncertainty of the pandemic. The temptation is to be Chicken Little and think “the sky is falling” rather than Alfred E. Neuman and think, ”What, me worry?”

There remains substantial evidence that the U.S. economy continues to expand. The Purchasing Managers’ Index (PMI) for the U.S. registered 54.4 for September; anything above 50 shows the economy expanding. Both the service and manufacturing sectors showed solid growth in September.

Another positive, as reported in last Monday’s Wall Street Journal, is the rapid recovery of global trade. In fact, the recovery of trade is much stronger than the recovery from the 2008 recession.

So, it appears that in our earlier attempt at humor, Mr. Neuman may have the right of it.

Of course, there are legitimate concerns.

A mountain of debt
Commentators have been pointing out the rapid buildup of debt since the recession began. Of course, the growth of government debt will always accelerate as a country sinks into a recession. This is what fiscal policy is all about. We should expect both fiscal and monetary stimulus to accelerate when a country sinks into a recession. But even so, the growth of debt has been exceptional.

A reader sent us an article written by Stephen Roach.[1] Mr. Roach argues that there is a more than 50% chance that the United States will experience a double dip recession within a year or two and more ominously, that the U.S. dollar will fall severely. He argues, the cause will be the extraordinary debt burden and the growing current account deficit. Mr. Roach is certainly correct that the balance of payments balance[2] and the current account balance[3] have fallen, but this has happened before and is not shocking given the depth of the recession.

Another point brought out was the decline of the national savings rate. In order to make sense of this number it is important to understand its construction: the national savings rate is the sum of savings of individuals, businesses and government. It has recorded a record decline. It is important to look at each factor independently. The personal savings rate, although down a bit recently, remains the highest it has been in at least fifty years. Household debt service as a percent of disposable income is the lowest in the past fifty years, and total savings deposits at all depository institutions are at record highs. The reason for the high debt level is government debt which is explainable. All countries will accrue large debt burdens when they are in a recession; the deeper the recession the larger the debt burden. But government debt accrued during a recession is different than corporate or personal debt. The first obvious difference, at least for countries like the United States, is that they can issue more debt, but there are other more important differences.

As the country comes out of the recession, tax collections rise rapidly. So the income stream goes up. Happily, the expenditures go down. The automatic stabilizers[4] such as unemployment insurance and welfare payments start to fall. The combination decreases a country's debt burden often at an increasing rate.

Mr. Roach's arguments are certainly not without merit but we believe they overstate the case significantly.

Politics

Investors are trying to sort out the investment implications of the coming election. Right now there is considerable confusion, and perhaps the debates will help.

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[1] Stephen Samuel Roach is an American economist and serves as senior fellow at Yale University's Jackson Institute for Global Affairs and a senior lecturer at Yale School of Management. He was formerly chairman of Morgan Stanley Asia and chief economist at Morgan Stanley, the New York-based investment bank.

[2] The balance of payments of a country is the difference between all money flowing into the country in a particular period of time and the outflow of money to the rest of the world.

[3] In economics, a country's current account records the value of exports and imports of both goods and services. It is one of the three components of its balance of payments, the others being the capital account and the financial account.

[4] In macroeconomics, automatic stabilizers are features of the structure of modern government budgets, particularly income taxes and welfare spending, that act to dampen fluctuations in real GDP.
Wikipedia

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