Weekly Market Insights

November 4, 2019

A great marriage - smart monetary policy and strong labor market

Equity markets closed last week concluding their fourth straight week of gains. The Dow Industrials closed up 1.44%, the S&P 500 increased 1.47% and the NASDAQ rose 2.74%. If ever there was a week to inspire investors, it was this past one. Earnings came through without any damaging shocks, the labor report was better than expected and the Federal Reserve didn't disappoint.

The Fed and Monetary Policy

The Federal Reserve, as expected, lowered interest rates by 25 basis points (.25%), which is exactly what the market expected. They cautioned, however, that this may be the last move for a while. This is precisely what they should have done. The move was done as much, if not more, for the financial markets than the real economy. The reason we are so pleased with the Fed action is it satisfied investors while making everyone aware that this may be the end and not to expect continuing additions to the money supply. There is enough liquidity in the system. Monetary policy works in two ways. It lowers interest rates so businesses have a lower break-even bar, meaning more investment projects will be undertaken, and the expected chain of events will begin. More investment, leading to increased hiring, leading to greater consumer demand and the economy gets its boost. The other is what is commonly referred to as the trickle-down theory. Simply, as money flows into the economy, it increases the value of financial assets. The owners, feeling confident and wealthier, spend more and stimulate the economy. All positive. So why stop now? Two good reasons. First, interest rates are so low now that the investment break-even rate is low enough by far. If businesses cannot find worthwhile investments at this level, then the problem is not monetary policy. The problem with trickle-down theory is that, currently, financial asset prices are already very high and further stimulus will most likely just add to wealth inequality, rather than giving the economy an added boost. Therefore, we believe the Fed to have made a wise move.

The labor market and the real economy

Last week the Bureau of Labor Statistics (BLS) released its report for October. It would be hard for it to be more encouraging at this stage of the economy. Payroll employment rose by 128,000, which is much higher than economists expected. Not only was the number better than expected, but the past two months' numbers were revised upward. Labor compensation rose 0.7%, which is quite positive. Perhaps the most positive revelation from the BLS report was the increase in the labor participation rate, which means more people are entering into the work force.

All of these are very positive. Although not a perfect indicator, strong labor reports are an indication of future consumer spending, which leads us to continue in our belief that a recession is not in our forecast period 12-18 months.

The reasons we feel the increase in the labor participation rate is so important are more complex than just increased spending. As more and more people become employed, it helps alleviate the budget deficit. It is obvious that the more people

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that are employed, the more tax revenue will be collected, but it may not be so obvious that as the employed population expands, the cost of built-in economic stabilizers goes down. Fewer people are on welfare, food stamps and all the rest.

A larger work force also allows for greater production capabilities. The combination of more workers, higher wages, and greater consumption may lead to businesses starting the long awaited burst of investment and innovation.

Statistics - how to read

Last week, we produced a calendar of important economic statistics and Fed meeting dates. This week, we will write a few paragraphs on how to interpret economic statistics in general. There are three groups who care about these statistics: 1) policy makers and economists, 2) market professionals and 3) the interested public. Policy makers and economists are in the business of interpreting these numbers in an effort to adjust the levers of the economy for the best outcome. These include the Treasury, the Fed along with many others. Market professionals are in the business of trying to divine investing strategies from these numbers. The interested public, which includes both sophisticated and not so sophisticated investors, small business owners who don't have their own economic departments, and those citizens who are interested in what is happening around them, follow this data. Our main effort in this new addition is to help the latter group. We are not going to bombard readers with interesting groups of simultaneous equations or how to prove various theories, but how to read them, what they mean and how much faith a reader should have in them. Next week, we start with just what is statistical analysis. Just as our calendar, this will be on a separate page.

Again, let us know what you think.

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Please click here for the updated **Economic Release Calendar – November 2019**.