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“By The Way”

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No change. Having just reread my January letter, I am forced to admit I have nothing new to say about equity markets. The S&P 500 in particular, continues to have the ability to accept negative news, the latest being the coronavirus scare, and still move higher in the face of such news. I don't wish to make light of the human tragedy and economic cost of the virus, but the market is taking the view that, while serious, the impact will be temporary. I was unhappy to recently learn that Yogi Berra never actually said “It's never over 'til it's over”. Nevertheless, there is no better description of the current position of the stock market. As long as central bankers are prepared to act to offset any economic or geopolitical events that might be detrimental to markets, and as a consequence of those policies investors remain on the greed side of the trade as opposed to the fear side, it is hard to see reasons for a significant decline in stocks. Fear has become a two-edged sword, not just the fear of losing money but also FOMO, the fear of missing out. Having said that, as readers know I have many concerns as to why markets should be lower, they are just not relevant in the face of the current euphoria.

Given my lack of new and useful insights on the current market, I am going to use the opportunity to reflect on what I believe are important geopolitical issues that might impact not just the financial world but other aspects of life.

The coming US election while important in the short term, could also be a referendum on the direction the country will take. In what seemed unlikely only six months ago, Bernie Sanders has risen to become the favorite to win the Democratic nomination for President. There is still time before the convention for things to change but his momentum and impressive fund raising recently puts him in a strong position. Last September after his heart issues the media (and myself) had written him off, but that seemed to galvanize his supporters and here we are today. Sanders has defended loudly at times, the principals of democratic socialism, which can sound benign but at its core espouses an end to capitalism. That has found appeal among younger voters and would suggest a new and different long-term path for the country if Sanders is elected. Most people find this an inconceivable notion but even a beginning of a swing could be important. Markets are actually thrilled Sanders will be the candidate, believing he has no chance against Trump but its not long ago no one thought Trump had a chance in 2016. The sitting President does look very strong at this point with his strongest approval rating ever, a growing economy and a Gallup poll indicating 74% of Americans are expecting to be better off financially a year from now. On a personal note, I would vote for Amy Klobuchar – she is left of center but at least hasn't called for the death of capitalism yet.

Another indicator of social change is the rapid growth of investment in ESG Funds. There have been “green” funds and “sustainability” funds but ESG represents a much broader definition of what is to be expected from public companies and would have significant impact on how corporations will be ranked for investment. No longer is simple growth in earnings and the rights of shareholders the be all and end all. The rights of workers and society are to be equally important. In short, companies will be evaluated on these principals:

Environmental – the usual like climate change and pollution

Social – community relations, diversity, philanthropy

Governance – board accountability, executive compensation, ethics, compliance

The message is becoming mainstream and the effect on markets could be meaningful, reflecting what is important both to investors and society at large.

The world is changing rapidly and as a consequence, it is becoming difficult for us to even understand where we are economically and what policies are appropriate in this environment. Many old rules seem to have become obsolete, for example aggressive growth in money supply and low unemployment haven't caused a significant increase in inflation. That is but one example of the difficulty for investors and even the Fed to assess the future. It sometimes seems the old tools aren't useful in the modern world and old methods of measuring the economy aren't helpful. GDP and CPI were created in a vastly different era that has made them less indicative of the real world, yet are still the mechanisms used to shape policy and strategy. One has to feel for FED Chairman Powell navigating with what might well be an out-of-date map. In addition even if he felt it appropriate to slow the current expansive monetary policy, he would run the very real risk of a repeat of the market decline of the 2018 4th, quarter and of course the wrath of President Trump.

The US economy continues to plod along. China is feeling the negative effects of the coronavirus and Europe catches a cold whenever China sneezes. S&P earnings weakened significantly in 2019, now estimated to report a 4% growth rate versus a 14% estimate one year ago. All the central bankers of the major developed economies continue to promise liquidity as necessary and I will continue to take that as the overriding reason to expect continue strong markets.

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