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Market Musings

Victoria Capital Management, Inc.

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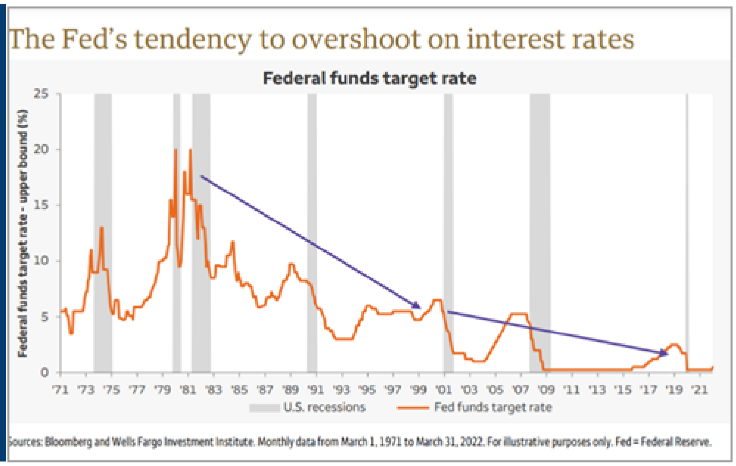
Financial history of the U.S. demonstrates that tight Fed policy (raising interest rates) leads to hard times. Note in the exhibit the fact that each economic recession since 1971 is preceded by a monetary policy that is characterized by Fed induced increases in interest rates. Unfortunately, current interest rates are relatively low in an historical context.



The Supply-Side Solution

The latest move by the Federal Reserve to continue a tight money policy (higher fed funds rate), as reflected by the recent announcement to keep interest rates rising until inflation is back to 2%, sent a chill through financial markets as the DJIA fell over 1,000 points on the day of Powell's speech! Back in 1979, Paul Volcker, the chairman of the Fed, sprung the tight money policy on financial markets to quell surging inflation. The big difference then was that fiscal policy offset tight money. President Reagan sponsored a massive tax rate reduction, so massive that Congress only let him phase in the tax rate cuts: 5% in 1981, 10% in 1982, and 10% in 1983. The phase-in slowed the recovery, nevertheless an economic boom characterized the balance of the 1980s as President Reagan pushed through a second tax rate cut plan to keep the economy on a growth track.

This time around, fiscal policy is non-responsive. The Administration is leaving the inflation fight up to the Fed alone. Moreover, fiscal policy today is focused on raising tax rates in addition to regulations. These policies reduce economic growth, quite the opposite of what the US economy needs. At a time when the world desires a dynamic United States, as reflected in a surging value of the U.S. dollar, current policies are not focused on the supply side that reflects efforts to increase output to meet surging demand.

Sometimes history repeats itself. When President Clinton raised taxes as his first economic priority in 1993 with a supportive Congress, the result was a dramatic change in the makeup of the Congress in 1994. The Republicans, under the banner of the "Contract with America" won a majority in both Congress and Senate, which led to a change in President Clinton's attitude about economic policy. He made major stimulative changes in tax policy that gave a boost to the economy like President Reagan's tax policy in the 1980s. Who knows what may happen because of the upcoming elections? We are hopeful that we get another shift toward policy makers encouraging economic growth through a reduction in regulations and lower tax rates to get the economy back on a growth track. History tells us this can happen.

"Compound interest is the eighth wonder of the world. He who understands it, earns it … he who doesn't … pays it. "

Albert Einstein

Market Commentary

August was shaping up as another good month for the stock market until the Federal Reserve said that they would continue to raise interest rates until they are "confident the job is done." As a result, domestic stocks fell across the board pulling all equity indices into the red for the month. European equities suffered on the back of Russia choking the supply of natural gas and oil coming into the winter months. Asian markets declined due to weaker economic growth in China because of continued Covid clampdowns. The upcoming People's National Congress beginning October 16th will involve pushing their policy of "common prosperity" forward which has investors concerned about changes in education and information technology initiatives. Bonds declined across the globe as higher interest rates spooked investors to take profits while the US dollar rallied to new highs and gold fell.

In June, total margin debt plunged by $69.5 billion, or 9.2%, to $683.4 billion, according to data from FINRA. The high reached in the first half of 2022 was $835.3 billion in February. The all-time high for margin debt was $935.9 billion in October 2021.

(source: BTN Research)