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"By the Way"

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Globalization has been a major part of the economic conversation for many years now, and is currently playing a significant role in which direction the world's economies will take in the near future. The four largest economic areas are engaged in a struggle that will likely determine a positive or negative growth scenario for themselves and the rest of the world. The U.S. and the Eurozone are showing signs of strength, while China and Japan are exhibiting weaker growth or stagnation. The question is, will the stronger countries positively impact the two weaker members, or be dragged down by the lack of strength, particularly in China. No economy operates in isolation, and as such, the interactions between the four should be followed carefully. The good news is that China and Japan are two of the most export sensitive developed economies, and thus would benefit greatly from cyclically stronger demand from Europe and the U.S. Given that fact, plus the continuing policies of all four central banks to be "all in" to forestall any significant weakness, we would come down on the positive side of the discussion. All the news will not be good, and volatility is likely to continue, but we see global growth continuing.

Most global stock markets have experienced historic volatility this summer, but with the exception of the Shanghai Index, not broken major support levels. Nor have they broken out to new highs either. (We, as usual, are focusing on the S&P 500 as a bellwether.) History would suggest that after such a period of high volatility within a trading range, when the breakout or breakdown occurs, the subsequent move will be substantial. Our inclination is that the resolution will be to the upside, but we are not "all in" on that opinion and have taken steps to protect capital until the matter is firmly resolved. One major concern is the recent "Dow Theory" sell signal, where both the Dow Industrials and Transports traded below important support levels. This is no doubt a "red flag" that we will monitor closely and watch for confirmation from other indicators, but as someone said, it is "Dow Theory", not "Dow Law". There are many confusing and frustrating crosscurrents to consider, and this market is not exhibiting a discernable trend as individual stocks have shown very mixed returns. Despite all of the above caveats, we remain longer term bullish until proven otherwise.

Painfully, we must continue to watch the ongoing dysfunction taking place within the U.S. Government. The chasm between Republicans and Democrats is only exceeded by the one within the Republican party itself. As proof, a motion is before the House to remove John Boehmer as Speaker, which was brought by a member of his own party. These issues can have a meaningful market impact, at least in the short term. In particular this fall, we again face the potential of a government shutdown if a budget compromise cannot be reached. Stay tuned.

The Fed leaves rates unchanged. The waiting is over for the time being. Reading the text of the statement, it appears the economy, while not robust, was the least of the members' concern. Inflation remains a worry, but "recent global economic and financial developments" and "developments abroad" were the major factors in the decision, as I read it. Three more months to wonder.

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