MV CAPITAL MANAGEMENT

Weekly Market Flash

The Markets Are The Guardrails

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Our weekly market commentary has never been the space for hashing out politics, and that will not change going forward. But every now and then, politics and the economy intersect in a meaningful enough way to merit top consideration among all the topics we might cover. So it is, in the days following what is likely to be recorded in the history books of the future as one of the most consequential elections in modern American history. What does the election mean for the economy, and what opportunities and risks might be ahead in the coming year?

Let's start by putting our own politico-economic cards on the table. We are, by and large, globalists, believing that our own domestic economy benefits greatly from the advantages of free trade and the intricate, globally-linked supply chains that optimize the factors of production, logistics, research & development, marketing and sales to deliver goods and services at the right time, at the right price, to the right customer in the right location. The Global Age – our expression for the economic era that ran more or less from the early 1980s to the mid-2010s – was by no means perfect. But it established the foundation for what remains today the strongest economy in the world, despite the major setbacks of the 2008 global financial crisis and the 2020 Covid-19 pandemic. An economy growing at steady clip of around three percent, with unemployment barely over four percent and inflation heading back down to two percent, home to the lion's share of the globe's most innovative enterprises, is an economy that deservedly remains the envy of the world.

This could change, radically, if some of the most extreme economic ideas heard on the campaign trail, about sky-high tariffs and an ultra-protectionist turn away from a multilateral trade system towards narrow, selective and restrictive bilateral arrangements, become actual policy. We have reason to believe that they won't, and that is where the "guardrails" of this article's title come into play. Markets – organic, decentralized and efficient in rendering an apolitical verdict in the form of a price – will let us know if the incoming administration's economic policies are working or not, mostly likely before they even happen. We have already seen a taste of this. Not in the unchained animal spirits of the stock market in the immediate aftermath of the election, but in the spike in bond yields, with the 10-year Treasury yield opening Wednesday morning nearly one percent higher than its level back in mid-September.

Structurally high tariffs and other protectionist measures, combined with a potentially draconian crackdown on immigration, in the absence of countervailing productivity-enhancing measures, would be a recipe for the return of that one thing on the minds of so many of the Americans casting ballots for Republicans this week – inflation. The bond market will warn us first, but eventually the stock market will follow suit. The good news? This incoming administration is going to take any warnings from the market seriously, because the market – financial markets in general and the stock market specifically – is how the former and future president himself measures his own performance more than by any other yardstick. If the market renders a negative judgment on a set of policies, those policies are likely to be withdrawn and replaced by ones more market-friendly.

Friedrich A. Hayek, an Austrian economist of the mid-twentieth century and one of the original founders of what became known as neoliberalism, said that price was the ultimate arbiter of democracy in a free society. An individual "votes," in a sense, by deciding to accept the price of one thing while rejecting that of another. When the micro behavior of individuals aggregates to the macro expression of markets, the result is a guardrail against potentially destructive policies.

Does this mean we can all sit back and coast along with a traditional allocation of equities and fixed income in 2025? Of course not – there are always plenty of ways things could go pear-shaped, and we need to be highly attentive to developments as they unfold when the new team takes over in January. For now, we believe the best approach is a "wait and see" position. That implies, among other things, that we will be even more deliberative as we assess our duration and credit risk positioning in the bond market. We hope that we are correct in our assessment of markets as the most effective guardrails in place as policymakers consider their economic agenda. If not, though, we will be ready to take action accordingly.

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