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Five 'swords of Damocles' hang over markets

Weekly Market Compass: Several critical deadlines are fast approaching

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In Greek mythology, the "sword of Damocles" is a powerful morality tale. King Dionysius is a leader who grows weary of a young sycophant, Damocles, who is constantly extolling the benefits of being king. To teach Damocles a lesson about the pressure and insecurity that comes with leadership, Dionysius allows him to sit on the throne for a day – but over the throne, the king has suspended a large sword, hung by a single hair. Damocles quickly learned what it feels like to be a leader who exists in imminent danger and jeopardy.

I feel as though there are several different swords of Damocles hanging over markets right now, including some imminent deadlines:

1. **US government shutdown: Deadline Feb. 15.** While members of Congress from both sides of the aisle have been negotiating for a number of days, they have not yet reached an agreement that would avoid a fast-approaching shutdown. And now talks have stalled. I believe markets would take another government shutdown far more seriously this time, given that many of the implications are better understood. For example, significant economic data was not released during the last government shutdown, resulting in delays of important information. The Bureau of Economic Analysis will not release its estimate of fourth-quarter gross domestic product (GDP) until Feb. 28 (originally scheduled for Jan. 30). And data on personal income and consumption for December and January will not be released until March 1. At a time when the global economy has been slowing down and it's critical to assess how much it is impacting the US economy, this is a particularly bad time to be "flying blind" from an economic data standpoint. In addition, another shutdown could undermine market confidence in a major way, as it begs the question of whether the executive and legislative branches of government could work together when they must tackle the debt ceiling later in the year – not to mention how they could work together in the face of a real crisis where the stakes are far higher. Finally, in my opinion, another government shutdown would be likely to prompt a credit downgrade.
2. **US-China tariff increase: Deadline March 1.** US stocks, including the S&P 500 Index, sold off last week on reports that US President Donald Trump would not be meeting with Chinese President Xi Jinping before the March 1 deadline,[1] increasing the odds that a deal will not be made before tariffs are set to increase. I am still optimistic that Trump could extend the deadline – news of American farmers being hurt by the trade wars, with foreclosures on the rise for them, cannot be going unnoticed by the administration as Trump prepares for a re-election run in 2020. This incentivizes the administration to not only seek a compromise but to extend the tariff deadline in the meantime. Having said that, it may be more likely that the administration moves forward in raising the tariffs on March 1 as a show of strength – not only to China but also to the European Union, which is next up on the administration's radar in terms of trade. I think it would be a mistake to allow the tariffs to increase on March 1 – especially since I expect more downside volatility for stocks as we close in on that deadline.
3. **Brexit: Deadline March 29.** While further in the future than the other two dates listed above, the Brexit deadline, when the UK is scheduled to exit the European Union, is getting far too close for comfort. European Commission President Jean-Claude Juncker met with UK Prime Minister Theresa May for talks on Feb. 7, but it appears no real progress has been made, and so it seems increasingly likely that May will have to push out the date of the vote in the UK House of Commons on her revised Brexit deal (that vote was scheduled for Feb. 14). Meanwhile, the longer that time passes without

economic policy certainty, the greater the potential for damage to the UK economy. Some recent examples include Nissan's announcement that it will alter its plans to build an SUV in the UK, moving production elsewhere.[2] However, most notable is the surprise contraction in UK GDP growth for December, which was released Feb. 11 (and which shouldn't really have been much of a surprise given how little visibility there is right now on what March 30 will look like for the UK).

4. **Earnings: Ongoing.** There's no deadline for this issue, but a formidable sword dangling over stocks is earnings – and the downward guidance of these earnings, which has already been placing downward pressure on stocks. While fourth-quarter earnings season is coming to a close, I will be very eager to hear from companies about their expectations for the first quarter.

5. **New ECB president: Coming Nov. 1.** Finally, there is one additional sword that I worry about, but I don't expect it to weigh on European markets for some time – and that is the prospect of a new European Central Bank (ECB) president on Nov. 1. I have mentioned this in previous blogs because I believe it carries serious implications, especially now that noted monetary hawk and Bundesbank President Jens Weidmann looks more likely to replace Mario Draghi. We will want to follow this closely.

Conclusion

It didn't take long for Damocles to absorb the lesson taught by King Dionysius. After a short time living under the dangling sword, Damocles begged to be released from the throne. I remain optimistic that global leaders will work hard to resolve these ongoing issues, and markets will be released from the overhanging fear. The question is, how much volatility and uncertainty will we encounter in the process?

Source

[1]CNN Business, "Stocks plunge on worries about US-China trade talks," Feb. 7, 2019

[2]The Guardian, "Nissan warns of Brexit concerns as U-turn at Sunderland confirmed," Feb. 3, 2019

Reuters, as of Feb. 1, 2019