John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday January 8, 2020

Be wary of the ever-popular long-term predictions of coming Armageddon. History makes it very clear that such scary forecasts are almost always wrong. Twenty years ago, there were several predictions that by now the world would be very warm and millions would be suffering from heat, no fuel, and malnutrition. One prediction was that the earth's temperature would be up six degrees in 2020. It is up, but only one degree or less. The forecast that rocked financial markets and had many investors running for cover was that by 2020 the world would have run out of oil. At one point, fear of oil shortages sent oil prices soaring to $200 a barrel. As we know, thanks to innovation, the opposite is the case. The world is awash with oil. And the United States is producing as much or more than OPEC's leader, Saudi Arabia.

On October 21, 2016, Politico published a now infamous article that began: "Wall Street is set up for a major crash if Donald Trump shocks the world on Election Day and wins the White House." How many investors sold stocks after reading that article?

The lesson is that Warren Buffet is right. He says don't bet against the United States to succeed. Americans make mistakes, voters sometimes hand power to misguided politicians, and the public sometimes succumbs to financial manias that turn into panics and market crashes. But left to work, trade and invest without too much political interference Americans unleash their energies in productive fashion. Stocks fluctuate, but over time they go up – often in years you least expect it.

Paul Volcker, former Federal Reserve Chairman recently passed away at age 92. He is credited as the man who defeated inflation. The 1970s were a time of destructive

inflation caused by rising oil prices and an accommodative Federal Reserve. Fed board members and ranking politicians were afraid that unemployment would rise if the Fed attacked inflation by raising interest rates and curtailing money supply growth. They were wrong. Too much money fed the inflation fires. Interest rates followed, rising to double digits. Then Paul Volcker came along, reversed Fed policy and crushed inflation. There was a price to pay for the inflation victory. Reining in the money supply pushed the economy into a recession. That allowed the Fed to bring interest rates down and the economy eventually recovered. The broadly accepted lesson from the 1970s and Volcker's bold actions is that flooding the economy with money always leads to unwanted, runaway inflation.

That is why Fed Chair Bernanke's response to the 2008-2009 'Great Recession' was met with near universal condemnation. Under his guidance, the Fed, between 2008 and 2015, expanded its balance sheet from $900 billion to $4.5 trillion and effectively brought interest rates to zero. As the economy started to recover and grow, a new consensus formed about what was going to happen next. The crowd, including well respected economists, stock market pundits and bond traders, was sure the U.S. was heading for runaway inflation. After all, the Fed had eliminated the cost of borrowing and injected trillions of dollars of fresh liquidity. If that didn't lead to a credit bubble and runaway inflation, what would? By now the Fed funds rate was supposed to be well above 4%. Instead it is in a range from 1.5%-1.75%.

Zacks Investment Research asks: "**So, What Happened? Why Did Inflation Never Really Take Hold?**"

Economists are struggling to answer those questions. The Federal Reserve is also struggling, trying to figure out how they can boost the rate of inflation up to their 2% target. Zacks says, while we are not yet at a point where we can look back and understand exactly why inflation stayed so low, there are a few working theories.

"First, the return of the savers. In the wake of a financial crisis—particularly one that profoundly affected nearly every American—we tend to see households, businesses, and banks de-risk and take steps to improve balance sheets. Regulation forced banks to make changes, and households followed suit and paid down debt in the ensuing years. These actions generally mean less borrowing, investing and risk-taking, which keeps a lid on growth, inflation and interest rates.

A second possible cause for weak inflation is technology, which has actually been a deflationary force since the 1990s.

There are myriad ways to think about how technology has reduced the cost of goods and the cost of doing business. Think about household goods and retail. The massive shift to buying goods via e-commerce versus a trip to a brick-and-mortar store may increase the cost of physical delivery, but it reduces or eliminates the cost of real estate, utilities, requires fewer workers, lowers inventory carrying costs, and uses data to target consumers with precision ads. In all, technology has driven efficiency, which has kept a lid on costs and prices.

Finally, a third possible explanation for subdued inflation over the last ten years is spare capacity in the U.S. economy. The 'Great Recession' led to such a dramatic decline in output, job losses and wealth destruction that it created a substantial amount of spare

capacity in the economy that we are only now starting to reach. It would make sense, then, that price pressures would remain tepid so long as that spare capacity existed.

Bottom Line for Investors

Even with weaker-than-expected inflation – or perhaps because of it- the U.S. economy has managed to deliver its longest economic expansion on record, with unemployment at a 50-year low and the stock market at all time highs. In other words, this head-scratching bout of low inflation has not resulted in any material adverse impact for investors, businesses, or consumers."

Mary Daly, President of the Federal Reserve Bank of San Francisco, says the Fed may need a new policy framework to lift inflation back up to the Fed's 2% goal.

"We don't have a really good understanding of why it's been so difficult to get inflation back up. But with global growth slowing and the populations of most advanced economies aging, this new 'fighting inflation from below' is going to be with us, I would argue, for a longer period of time than just a few years."

In other words, this expansion can continue for longer than now expected. The usual causes of recessions, such as high inflation and rising interest rates, are still missing. Stocks, while looking fairly valued at the moment, still hold the potential for more gains this year.

I will have the next market review and update one week from today on Wednesday January 15, 2020.

All the best,

John Dessauer

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