John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday January 13, 2021

The Republicans lost both Senate races in Georgia. We now will have a united government controlled by Democrats for at least the next two years. In 2022 every member of the House of Representatives will come up for election. History tells us that quite often the President's party suffers losses in the mid-term election. So, it is possible - even likely - that the Republicans will gain control of the House of Representatives in 2022. Of course, the Democrats will do their best to prevent that and keep control of the House of Representatives. And that political situation is a major reason the stock market has done so well after the Georgia Senate results were known. The Democrats know that they need to show they can boost the economy and keep the job creation process alive and well. Legislation that would slow economic growth and hurt the stock market - such as a major tax increase or an all-out assault on the fossil-fuel industry - are less likely to succeed at least until after the 2022 election and the economy is back at a solid and sustainable rate of growth. While the Senate looks more secure for the Democrats, there will be 14 Democrat Senators up for election in 2022. Just like the Democrats in the House of Representatives they also will want a strong economy to help them in 2022.

In addition to doing no long-term harm, Democrats are likely to push forward with another stimulus spending plan and aid to cash-strapped local governments in order to keep the economy growing while we wait for the vaccine rollout to become effective.

No wonder stocks have held their high ground and interest rates have ticked up. However, not everyone is optimistic about the near-term outlook for the stock market. Byron Wien is now 87 and still highly respected among Wall Street leaders. He was a senior strategist for Morgan Stanley for decades. He now is vice-chairman of Blackstone Group Inc.'s private wealth solutions business. Byron sees the economy growing at 6% this year, pushing the 10-year Treasury yield to 2%. And he believes rising interest rates will be a short-term negative for the stock market. He predicts the S&P 500 stock index will fall 20% in the coming months and then recover to a new all time high of 4,500. The S&P 500 stock index finished 2020 at 3,756.07. If Wien is right, the index will first fall to 3,004.86 and then soar 50% to 4,500.

The problem with his forecast of a 20% decline is that the economy currently is quite strong. And likely to gain strength as the Democrats' spending plans come on line. S&P 500 earnings are forecast by the consensus to rise 23% this year. The combination of strong earnings and an economic stimulus is favorable for stocks. Next week we will start getting fourth quarter 2020 results. The major banks will come first, and others will soon follow. Those results will show the damage from the pandemic. But a rough fourth quarter 2020 is already widely anticipated by investors and not likely to be fuel for a major stock market decline.

In December U.S. manufacturing activity rose to its highest level in nearly 2-1/2 years. The Institute for Supply Management (ISM) reported last week that its index of national factory activity rebounded to a reading of 60.7 last month. That was the highest level since August 2018 and followed 57.5 in November. Millions of Americans have been working and taking classes from home. That has driven up demand for electronics, home improvement products and other goods like exercise equipment. Still the ISM index is 3.8% lower than it was before the pandemic.

Not only do we have the ISM data; we also have data on the GDP showing that the economy has rebounded far better than once believed possible. The U.S. economy fell at a 31.4% rate in the second quarter. At that point, the pessimists were out in strength confidently predicting that the worst was yet to come. They were wrong. In the third quarter the economy rebounded at a 33.4% rate and is expected to have grown at about a 5% rate in the final quarter.

In November U.S. wages and salaries were higher than in November 2019, and the personal savings rate was a whopping 12.9%, twice as high as before the pandemic. As I wrote last week, there is more than enough cash on the sidelines to fuel an increase in GDP growth in coming months.

The vaccine roll-out has begun. While the process is regulated by the federal government, there are wide differences from state to state. Here in Naples, we have to go on-line and register for an appointment. The problem is that there is not enough vaccine available, so the few appointments are filled in minutes after becoming available. However, as more vaccine becomes available this will get straightened out and more and more will be vaccinated. By summer experts expect we will be able to travel, visit theaters and go out to restaurants again.

As the saying goes, stocks go up and down. A normal correction, after reaching all time highs, is to be expected but not feared. By a normal correction I mean a pull-back of 5%-10%. A 20% decline would be far more than a normal correction and I believe would require a double dip recession. The political outcome giving Democrats control of the Senate makes that more unlikely. Sorry Byron, but I must disagree with your 20% stock market decline. However, there is one way that you could be correct: if the stock market soars to an unsustainable high after the new stimulus bill is enacted, then a 20% fall could develop. But with money flowing into cash and bonds and with bond yields rising I doubt investors will become euphoric and drive stocks significantly higher. More likely is that stocks will hold their ground as investors watch earnings reports and determine if the consensus of a 23% rise this year is possible. Meanwhile our best strategy is to be patient and maintain our stock holdings.

I will have the next market review and update one week from today on Wednesday January 20, 2021.

All the best,

John Dessauer

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