John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday January 20, 2021

We now have President-elect Biden's "first installment" spending plan. The editors of the *Wall Street Journal* describe the plan this way: "He doubles Obama's 2009 plan even as the economy is poised to take off in 2021."

Remember the studies by the Federal Reserve and Census bureau that showed the results of eight years under Obama and Biden? They showed that the wealth gap widened and the number of Americans living in poverty increased during those eight years. Redistributing income, raising taxes, and increasing regulation did not work. In fact, the results were the opposite of what Obama and Biden intended. Instead of changing, Biden is doubling down. I am sure he hopes the results this time will be different. But studies by researchers at the St. Louis Federal Reserve bank detail the process that followed the Obama spending and taxing. They show how the money flowed and was used. The plans seemed to work for a short while. But after a year or so the rich got richer and the lower income people did not benefit very much. We can now expect a similar result from the Biden spending plan. A year or so from now the rich will be richer and the poor will still be poor. The question is, what will happen to the broader economy along the way? A debate about future inflation is already under way. Steve Forbes says there may be trouble ahead for the stock market. If inflation and interest rates rise, then Steve will most certainly be right. That combination has always been hard on stock prices. Interest rates have been rising. The benchmark 10-year treasury note closed at 1.097% last Friday, up from 0.515% on August 5. Inflation, however, remains subdued. The personal consumption expenditure price index, the Fed's favorite inflation measure, rose 1.4%

year-over-year in November. That means that interest rates are rising because of an increase in inflation expectations rather than an actual increase in inflation. Are those rising inflation expectations likely to be correct? Is Biden's two trillion-dollar spending plan about to push inflation back above the Fed's 2% target?

Sri Kumar, president of the Santa Monica, California-based Sri Kumar Global Strategies says, while pointing to the Biden administration's spending plans: "I think the tide is about to turn and the higher inflation provides a basis for the 10-year yield rising."

To his credit Kumar has gone against the Wall Street consensus over the past four years, predicting bond yields would fall while most said they would rise.

Not everyone on Wall Street agrees that the fiscal and monetary stimulus will change the low-inflation environment we have enjoyed these past twelve years.

David Rosenberg, chief strategist at Rosenberg Research, has this to say about inflation expectations: "The same people talking about inflation today were the same people talking about inflation 12 years ago. They were dead wrong then. They're dead wrong right now. The money being handed out to middle-class households will help pay for rent, utilities and food but won't do anything to accelerate wages or expand credit."

A surge in credit, called a credit bubble, is the usual predecessor to an outburst of inflation. Banks are swimming in deposits thanks to the high personal saving rate. But they also are keeping credit standards high. The pandemic lockdowns are a real threat to many businesses, especially small businesses. Bankers are already worried about potential loan losses. They are going to remain cautious because the long-term consequences from the pandemic are still unknown.

In Rosenberg's view the recent run-up in yields has been "one-part real interest rates and four parts inflation expectations," meaning the bond market is setting up for another buying opportunity.

If Rosenberg is right and inflation remains tame the stock market will not suffer from rising interest rates. Instead, stocks will likely benefit from low interest rates and a rising GDP growth rate.

What about Biden's talk about raising the corporate tax rate? A significant hike in taxes would dent corporate profits and be a restraint on stock prices. He has talked about raising the rate from the current 21% to 28%. Andy Laperriere at Cornerstone Macro thinks Democrats are worried about a backlash in the 2022 election and will be more restrained when it comes to taxes. He says they might raise the corporate rate from 21% to 25%, leaving it well below the 35% rate we had before the 2017 tax cuts. That move might satisfy the tax-hike Democrats while doing minimal damage to corporate profits and stock prices.

"This opens the possibility that at some point the U.S. will enter an environment in which worries about higher rates and taxes start seriously rattling financial markets. Before that happens, though, there could be an easing of Covid-19 concerns and a government-supported bounce in growth that makes investors even more ebullient." (Justin Lahart for the *Wall Street Journal*)

What happens in the U.S. will have an impact globally. China is currently driving the global economy, showing that the recovery from the pandemic can be robust.

Joe Kaeser, chief executive of the German giant engineering firm Siemens, has this to say about the U.S. "In the U.S. …they are holding all the cards and if they put the money to work in a wise way, there is going to be a very, very, strong second half of 2021 and especially 2022."

The Washington world bank is more cautious, cutting their global growth forecast to 4% from 4.2%. And they warned the growth rate could be as little as 1.6% if there are delays rolling out vaccines.

Christine Lagarde president of the ECB (European Central Bank) stuck with her global growth estimate of 3.9% for this year citing as positives the fact that Biden can count on U.S. Senate support for his economic program and that Britain and the European Union have averted a no-deal Brexit on December 31.

The bottom line is that vaccine production and distribution is essential for the U.S. and global economic recovery. The challenge is producing hundreds of millions of doses and getting them distributed around the world soon. Pfizer, Moderna, Johnson & Johnson and others are doing a remarkable job. Not only have they produced several vaccines in record time; they are ramping up production at an incredible rate. The world's major pharmaceutical companies are winners, and are being respected by politicians as never before.

As for the near-term outlook for stocks, a modest, 5% or so, correction seems overdue. At best, I expect stocks to mark time as we get more reports on fourth quarter 2020 earnings. But longer term, the bull market is intact. With interest rates low and likely to stay that way, stocks at current prices look attractive.

I will have the next market review and update one week from today on Wednesday January 27, 2021.

All the best,

John Dessauer