John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday January 22, 2020

There is a serious and growing long-term risk for the U.S. economy and financial markets. But so far, it is not getting much attention from the Presidential hopefuls. That risk is the huge and rising national debt. During the Obama years the U.S. national debt doubled from roughly $10 trillion to $20 trillion. And it is still growing at roughly $1 trillion a year. The problem is not a shortage of tax revenue. It is that spending is growing faster than tax collections. Critics like to blame the Trump tax cuts, claiming that they are shrinking tax revenue. That is not the case at all. Thanks to the strong economy and robust labor market federal government tax collections have been and still are growing. Tax receipts rose 4% last fiscal year and are up another 4.6% in the first three months of this fiscal year. The shocker for the Trump tax cut critics is that corporate income tax receipts are also growing, up an astounding 23% in the first three months of this fiscal year.

The problem is that spending is growing faster than tax collections. In the first three months of this fiscal year federal government spending grew at a 6.7% rate. The three biggest spending categories are social security, national defense and Medicare. There isn't much that Washington politicians can do about these spending obligations. There is another item that could become a big problem, namely interest on the national debt. With interest rates at near record lows, the cost of financing the national debt and deficits is contained. However, if inflation and interest rates rise, the cost of financing the national debt could become overwhelming. Commonsense says that all of our Washington politicians should be focusing on discretionary spending and worrying about

the annual deficit. Instead, several leading presidential hopefuls are proposing more huge spending programs such as Medicare for all. History is very clear: big spending programs always cost more than expected, and the additional taxes produce less revenue than planned. The last thing our economy needs is an even larger annual deficit. The conclusion is that there is a lot at stake in the November elections. Financial markets will react to the election results. For now, and until November, investors will have to live with the political uncertainty. This is likely to mean more short-term volatility, especially in the stock market. The best strategy is to ignore the short-term volatility and stay focused on the long-term. There will be opportunities to make portfolio adjustments once the election results are known.

And President Trump's challengers have an uphill battle. The party out of power has to make a case for change. As the editorial board of *The Wall Street Journal* says: "But the challenge for Democrats pitching carnage will be persuading Americans that they shouldn't believe the economy they see with their own eyes.

The U.S. economy has been expanding for a decade, the jobless rate is 3.5%, and incomes are now rising faster for low-income workers than for their bosses. That includes a 5.9% annual increase for the bottom tenth of workers during the Trump Presidency, more than double the rate in President Obama's second term. The bottom half of households have seen their net worth increase 47% since the 2016 election, according to a report by the White House Council of Economic Advisers."

Recent data point to continued economic growth and tightening in the labor market. U.S. retail sales increased for a third straight month in December. The number of Americans filing claims for unemployment benefits dropped for a fifth straight week last

week. A third report last week from the Philadelphia Federal Reserve Bank showed factory activity in the mid-Atlantic region accelerated in January. Growth estimates for the fourth quarter are as high as 2.5%. The economy expanded at a 2.1% rate in the third quarter.

With the labor market so tight and wages rising, you would expect inflation to be rising. And the Consumer Price Index or CPI did rise at the fastest pace in eight years during 2019. However, even with that rise U.S. inflation remains very low. For all of 2019 the CPI rose 2.3%, the highest since a 3% rise in 2011. But most of the price increases last year were concentrated in just a few areas and other measures suggest that U.S. inflation is rising less than 2% a year.

The Federal Reserve is more worried that inflation may slip even lower than it is currently, than it is about a sustained increase in prices.

Low inflation will keep the Federal Reserve from raising interest ratee this year. Low interest rates should help the economy to continue growing for a record 11th straight year. The economic reality is making it hard for Americans to believe the rhetoric from the Democrat challengers. Joe Biden's remarks are typical of what was heard at the last Democrats' debate.

Joe Biden: "Where I come from, the neighbors I come from, they're in real trouble, working-class people and middle-class people. When the middle class does well, the working class has a way up and the wealthy do well. But what's happening now? They're being clobbered. They're being killed." He added that "the wealthy are the only ones doing well, period."

Hardly, Joe - remember, households in the bottom half have seen their net worth climb 47% since 2016. Trying to make voters believe that things are much worse than they really are is not likely to work. There is hope that the left lurch by too many Democrats will not work.

I will have the next market review and update one week from today on Wednesday January 29, 2020.

All the best,

John Dessauer

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