John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday February 17, 2021

The U.S. economy is in surprisingly good health. The pandemic has done a lot of damage, but - as can be seen in fourth quarter data - the U.S. economy is growing and is likely to keep growing this year. In sharp contrast, the U.K. economy contracted almost 10% last year, the worst performance in 300 years. Economists in London do expect a recovery this year, but still the Brits have suffered far worse than we have. Given the relative health of the U.S. economy there are serious questions about President Biden's $1.9 trillion additional spending plan. Some say it isn't needed at all, others say it is too much, and a few think we really need that much economic stimulus. Given the political balance in Washington, we will likely soon get another stimulus, whether we really need it or not.

Federal debt reached 100% of GDP, and that is *before* Biden's stimulus has become law. In addition to the ongoing debate about inflation there, are questions about the future consequences of unlimited borrowing. Does unrestrained federal spending have any economic costs? Can federal debt keep climbing to be larger than the entire U.S. economy without consequences? There are economists on both sides of these questions. Eventually we will find out who is right and who is wrong as the real-world consequences develop.

The bipartisan Congressional Budget Office (CBO) says federal spending rose to $6.55 trillion in fiscal 2020. That is a $2.1 trillion dollar increase in a single year. The big surprise was that federal revenue fell only 1.2% to $3.42 trillion because the economy held up better than expected. But the deficit still came in at a staggering $3.13 trillion or 14.9% of GDP.

The CBO says the federal deficit will rise again this fiscal year. They say the deficit will be $2.26 trillion or 10.3% of GDP this year.

Corporate profits, wages and government revenues are expected to far exceed earlier forecasts. The estimated net 10-year federal tax revenue loss from the pandemic is now just $49 billion - far less that the trillions of dollars predicted earlier. Tax reform and deregulation put the pre-pandemic economy on a sturdy foundation. The question going forward is: will the good economic news be able to continue under Bidenomics with its new taxes, new regulation, and assault on fossil fuels? During the Obama Presidency, the CBO cut its GDP projections by more than $2 trillion five times, as increased spending failed to ignite growth that was suppressed by regulation and tax increases. Biden supporters argue that this time the spending is so large that it will ignite growth even as taxes go up and regulations increase.

A crucial question is how long America can borrow as much as it wants from the world. The Biden spending plans assume there is no limit to what can be borrowed. Americans, at least while the economy is strong and growing, are able to finance 4%-5% of GDP in debt. That means the federal government is highly dependent on the willingness of strangers to buy our government’s debt. As long as the dollar remains the world’s reserve currency and a global safe haven, strangers will continue to buy U.S. government debt. So far all is well on world currency markets. But then the U.S. has never conducted a fiscal experiment like this one.

Fortunately, we have federal elections every two years. In 2022 every seat in the House of Representatives and 34 seats in the Senate will be up for election. The President's party has often lost control of the House in mid-term elections. If Republicans win control of the House in 2022, Biden's radical economic policies would be blocked. His actions so far seem to be hurting jobs, raising the cost of needed drugs, and threatening to increase the cost of energy, including electricity, gasoline, and home heating oil and gas. Cancelling the XL pipeline alone is said to cost over 11,000 jobs. And there is a recent story of a mother with a diabetic son. His insulin was costing her $60 a month. Now with the new Biden regulations, that cost has gone up to $300 a month and that is after a $200 credit from the drug company. In other words, the full cost of that insulin has gone from $60 a month to $500 a month. How many others are suffering similar punishing increases in medications? In my view this is not smart politics. Hurting voters' personal budgets will likely result in a reaction come November 2022, and improve the odds of a Republican takeover of the House of Representatives.

Meanwhile political unrest has been dominating the news. Fourth quarter corporate profits have not been getting much attention. Argus Research says: "That's too bad, because earnings reports have been coming in much better than expected. The average decline in fourth-quarter earnings from continuing operations is less than 5% on a year-over-year basis. Once we gather all data on 4Q20 earnings and first-quarter guidance, we will adjust our EPS estimates, including a final tally for 2020 and revised numbers for 2021 and 2022. Our adjustment bias is clearly upward, which would be positive for our stock-market valuation model."

Morgan Stanley forecasts EPS for the S&P 500 companies to be up 26.8% this year. Argus Research looks for stocks to be up 10%-12% this year.

There are a lot of risks, and lots for us to watch - the dollar, interest rates, inflation, federal debt auctions and Biden economic policies - but the best investment strategy still is patience and holding on to our stock positions.

I will have the next market review and update one week from today on Wednesday February 24, 2021.

All the best,

John Dessauer