John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday February 22, 2023

The China spy balloon story has focused attention at every level on our dependence on China for so many goods, from solar panels to pharmaceuticals. The President and other Washington politicians call for change, meaning bringing corporate operations back to the United States. The President has provided funding to increase the manufacturing capacity for microchips. But he and his supporters are still attacking U.S. businesses with taxes and regulations. For example, President Biden wants to raise the tax on stock buybacks from 1% to 4%. One economist said that even the Chinese are not stupid enough to do that. If the President and his supporters really wanted to bring manufacturing back to the United States they would reform taxes and reduce regulations to make the United States more attractive than China for businesses. Instead they have been doing the opposite for a long time.

At one time there were several pharmaceutical companies with operations in Puerto Rico. They were there because of favorable tax rules and a source of water that was good for their operations. Under pressure from Democrats President Clinton signed a law that eliminated that tax benefit after ten years. And, sure enough when the tax benefit was eliminated the pharmaceutical companies had moved their operations out of Puerto Rico to China.

At one time China's main attraction was lower cost labor. Over the last twenty years China has developed manufacturing ability that is competitive with the USA. During that time the U.S. has increased regulations and taxes making it difficult for U.S. businesses to stay competitive. The result has been a dramatic rise in manufacturing in

China and a corresponding decline in the U.S. Our politicians are right when they say that this situation needs to change. But talk will not bring manufacturing back. We need a major change in policy to make the U.S. more attractive to manufacturers. There has been a change in the leadership in the House of Representatives. Hopefully, that will help to at least stop the attacks on U.S. businesses.

Recent data indicates that the attacks on U.S. businesses through higher taxes and more regulations is affecting investor behavior. In the past six weeks investors have pulled $31 billion from U.S. equity mutual funds. A substantial amount of that, $12 billion, has gone into international equity funds. Investors want to hold equity funds for future gains but worry that U.S. equities might be damaged by Washington’s anti-business policies. That should be a wake-up call for the President and his supporters.

The rest of the outflow from U.S. equity funds went into taxable and municipal bond funds. While the rate of inflation has come down investors are still worried that it might take still higher interest rates and perhaps a recession to get inflation down to the Fed’s 2% target.

The Fed has already raised its benchmark interest rate by 4.5% since last March. That is the fastest pace since the early 1980s. The price of goods has cooled, but the labor market remains stringer than expected. The economy added 517,000 new jobs last month and the unemployment rate decreased to 3.4%.

“The reports shocked forecasters because previous releases had suggested that climbing interest rates were beginning to curb hiring, said Marc Giannoni, chief U.S. economist at Barclays. The latest figures suggest that the Fed policy “has gained less traction against labor demand than we expected,” he said.

At the last meeting of the FOMC two policy makers voted for a 0.5% rise in interest rates. The majority, as we know, went for a smaller, 0.25% rate increase. Now the strength in the labor market has economists worrying that the 0.25% increase was too small and that it will take longer and higher interest rates to bring labor demand and inflation down.

Inflation did come down in January, to a 6.4% annual rate from a year earlier. That is down from 6.5% in December. But the January rate is still too high. Fed officials pointed to the January inflation news as evidence for their view that the U.S. faces a longer fight to subdue price pressures than many investors have anticipated.

Some economists argue that it takes longer than this for the rate increases already made to have their full effect.

"The latest data illustrates that inflation is still declining only gradually. We still expect that downward trend to accelerate soon, as easing goods shortages feed through and housing inflation starts to turn down." Said Andrew Hunter, senior U.S. economist at Capital Economics.

Andrew Hunter is not alone, other economists also expect the decline in inflation to accelerate in coming months. In my opinion that make sense because the Covid supply side pressures are now fading fast. We just completed a two-week cruise on the Regent Splendor. The ship has a capacity of 735 guests. There were 703 on this cruise, about 90% of capacity. Other cruise lines are seeing similar increases in demand. This is more evidence that the U.S. and global economies are returning to normal. Yes, there is more work to be done to bring inflation down, but more and more it looks like that can be done without severe damage to the U.S. and global economies.

I will have the next market review and update for you one week from today on Wednesday, March 1, 2023.

All the best,

John Dessauer