John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday March 1, 2023

It has been discouraging to watch the stock market struggle and decline day after day. There hasn't been a big plunge. The economy after all is performing quite well after a significant increase in interest rates. The problem is that the news on the economy and inflation has been mixed, if not absolutely confusing. Consider the following, first from Market Watch and a day later from the Wall Street Journal.

"The economy grew a touch slower at the end of 2022 than originally reported---at a 2.7% annual pace, revised government figures show, largely because consumers cut back on spending. The increase in gross domestic product, the official scorecard of the economy, was reduced from an initial 2.9% growth rate. Consumer spending, the main engine of the economy, grew at a 1.4% annual clip, rather than 2.1% as originally reported.

The slowdown in spending suggests the new year got off to a weak start. Economists say the U.S. will be hard pressed to match even the modest performance of the fourth quarter in the first three months of 2023. Early economic data indicate the U.S. is on track to expand at a far slower pace or even to contract."

That view of a slowing economy was published on February 23, 2023. And that was seen as positive for stocks because it showed that the Fed was winning its battle against inflation. The very next day the following appeared in the Wall Street Journal:

"Just when you thought inflation was conquered, the next government report pulls the economy back in. That's what the economists who thought the end of inflation was nigh must be thinking in frustration after Friday’s report on the personal-consumption expenditure price index.

This measure of inflation, a favorite of the Federal Reserve, accelerated in January at the fastest monthly pace since June. The PCE index is worth following because it offers a view of price changes from business sources and takes into account the substitution of goods and services in a way the consumer price index doesn’t.

PCE inflation rose 0.6% for the month, up from 0.2% in each of November and December. The PCE index over the last 12 months is up 5.4%, which was up slightly from December after several months of decline. Inflation in services drove much of the increase and is up 5.7% since January 2022.

The story here is that inflation is proving stickier than many expected. While PCE inflation is down from its peak at 7% last June, it isn’t continuing to fall toward the Fed’s target of 2%. The price signal in services shows what happens when inflation becomes embedded in the economy. No doubt our readers have noticed as they pay more every time they visit a doctor, hire a plumber, check into a hotel, or take the kids to Disney World.

The numbers reinforce the Fed’s view that it has more work to do to correct its great pandemic inflation mistake. Investors weren’t happy about the news on Friday as they priced in expectations of an additional 25 basis-point increase in fed funds this year, and they sold off equities and bid up bond yields figuring the Fed will have to keep rates higher for longer.

We can all hope this is merely a short-term inflation setback, like World War II’s Battle of the Bulge, in what will be a glorious victory in the larger campaign. But it’s worth noting that many of the same folks who claimed inflation was “transitory” in 2021 have been declaring premature inflation victory in recent months. Better to keep fighting until the enemy finally surrenders.”

Cailin Birch, global economist at The Economist Intelligent Unit says: “Although the U.S. economy is still growing, it is losing steam.”

That is good news because it shows that the Fed is being successful with its tighter monetary policy. Measures of the money supply are also showing a positive response to Fed policy. A slowing economy and shrinking money supply will bring inflation down. In my opinion it is just a question of time before inflation comes down enough to spark an upward move in the stock market. Meanwhile I expect the modest volatility in stocks to continue. No big moves until the inflation news is solid. And then the big move will most likely be to the upside.

I will have the next market review and update for you one week from today on Wednesday, March 8, 2023.

All the best,

John Dessauer