John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday March 3, 2021

Two economists have spotlighted a major difference between the huge monetary stimulus after the 2008-2009 financial crisis and the Covid-19 massive stimulus. John Greenwood is chief economist at Invesco in London. Steve Hanke is a professor of applied economics at Johns Hopkins University. Together they published and article titled: "The Money Boom Is Already Here." Here are the highlights:

"After that crisis, (2008-2009), the Fed began quantitative easing, which massively expanded its balance sheet. At the same time, commercial banks were busy shrinking their loan books and writing off losses from mortgage debt and securities, which meant the Fed's injections did little more than offset the contraction of commercial bank balance sheets. As a result, money growth from 2010-2019, as measured by the Fed's broadest money measure, M2, averaged only 5.8% a year.

While money on the Fed's books grew rapidly, money in the hands of the public grew slowly. Spending and inflation were restrained, and the postcrisis recovery was anemic with inflation persistently below the Fed's target."

That explains why quantitative easing did not result in an outbreak of unwanted inflation. The two economists go on to take a close look at what is happening today.

"Fast-forward to February 2020. Since then, the quantity of money in the U.S. economy, measured by M2, has increased by an astonishing $4 trillion. That's a one-year increase of 26%--the largest annual percentage increase since 1943."

Looking back at the 2008-2009 financial crisis Greenwood and Hanke add what happened in China.

“In contrast, China’s money-supply growth exploded in 2009 and 2010, averaging 23% a year. China achieved a strong recovery as a result, but also a jump in inflation, which moved from minus 1.8% in July 2009 to 6.5% by July 2011.”

A continuing surge in US M2 is already set for this year. “The M2 money supply will grow by nearly 12% this year. That’s twice as fast as its average growth rate from 2000 to 2019.”

That for me is, the clearest case for rising inflation. As Greenwood and Hanke wrote: “Money Matters.”

The yield on a ten-year Treasury has tripled since last August rising to 1.53%. Falling bond prices and rising bond yields have often preceded a rise in inflation. In addition, the GDP fourth quarter growth rate has been revised to up 4.1% from an earlier report of 4%. Federal Reserve chair Jerome Powell recently said that the U.S. economy could grow in the range of 6% this year. That is in line with forecasts by private sector economists. So, we have an economy that is recovering nicely, M2 growing at a rapid pace and bond yields rising. No wonder some economists are sounding the inflation alarm. They worry that rising inflation will force interest rates higher and become a restraint on further economic growth.

However, Federal Reserve officials are countering that idea. For example, Kansas City Federal Reserve president Esther George, speaking at a virtual event last week said: “Much of this increase (in bond yields) likely reflects growing optimism in the strength of the recovery and could be viewed as an encouraging sign of increasing growth expectations.”

Atlanta Fed President Raphael Bostic, speaking in a separate online event organized by the Greater Naples Chamber, said bond yields remained comparatively low and that the central bank did not need to do anything at this time to address the uptick. Bostic added: “Right now I am not worried about that. We will keep an eye out…I am not expecting that we will need to respond at this point in terms of our policy.”

Consumer spending, which accounts for more than two-thirds of U.S. economic activity, jumped 2.4% in January. That was the biggest gain since last June and ended two-straight monthly declines. Personal income shot up 10%, the largest increase since last April, after rising 0.6% in December. Durable goods orders excluding transportation rose 1.1% month over month in January. That was better than the 0.7% increase economists expected. And at the end of last month initial jobless claims fell to 730,000 from a downwardly revised 841,000 the prior week. This data confirms that the economy is recovering. And as more vaccine becomes available and the economy reopens faster the rate of growth is likely to rise, making Fed chair Powell’s 6% 2021 outlook look good.

Stocks went down as yields on 10-year treasuries rose. However, I think Kevin Matras at Zacks investment research has it right: “I would chalk this up to typical profit taking after a spectacular run-up. It should be known that stocks usually pull back about -5% roughly 3-4 times per year. And stocks usually pull back -10% on average about once a year. So, we’ve all lived through these types of things time and time again.”

Jonathan Golub, strategist at Credit Suisse recently upwardly revised his S&P price target for the second time in two months. His new target is 4,300, meaning a further gain this year of 10%-11%.

Golub explains: “Accelerating GDP should result in higher revenues (every 1% in GDP is a 2.5-3% change in sales), and an even greater gain in EPS given operating leverage.”

Golub now expects aggregate S&P 500 earnings per share to grow to $185 this year and $210 per share in 2022. That is up from $175 and $200 he expected earlier. Companies are off to a good start this year thanks to fourth-quarter EPS topping estimates by 17% and unexpectedly growing on a year-over-year basis.

“With the economy reopening, stimulus abundant, and Fed policy uber-accommodative, it is no surprise that 2021 GDP is expected to run hotter than at any time in the past 35 years.” Golub added.

Of course, it is possible that inflation will return at higher than wanted levels. And the Fed would then have to change direction. Interest rates could rise high enough to bring stocks down. But the rate of growth of M2 is likely to quiet down and return to normal levels. And that would ease upward pressure on inflation. Plus, it will likely be a long time before loan demand rises and pressures bank deposits. Consumers have not been spending all the stimulus money. The household savings rate jumped to 20.5% in January, up from 13.4% in December. The core PCE (personal consumption expenditure), the Fed’s favorite inflation measure, increased only 1.5% in the 12 months ending in January.

For me the inflation worries, while understandable, are quite premature.

I will have the next market review and update one week from today on Wednesday March 10, 2021.

All the best,

John Dessauer