John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday March 10, 2021

Fourth quarter 2020 earnings season is winding down and the results are remarkable. With 482 out of the 500 companies in the S&P 500 index having reported, earnings are up 3.5% year-over-year on a 2.9% increase in revenues with 79.7% beating earnings-per-share (EPS) estimates. There was no pandemic in the final quarter of 2019. By March of 2020 stocks were plunging, the economy was headed for a deep recession. The consensus outlook back then was for a long period of economic suffering and corporate earnings decline. But here we are still suffering from the pandemic, but corporate revenues and earnings are up, and the economy is growing. Warren Buffet is right when he says always bet on America.

For this year analysts expect S&P 500 earnings to be up 28.1%, and yes, that is at least partially built in to current stock prices. Still analysts at Morgan Stanley and BNY Mellon see stocks gaining 10%-15% this year.

The report last Friday from the Labor Department supports the optimistic outlook. In February, the U.S. gained 379,000 jobs. There were jobs lost in the public sector, but the private sector gained and impressive 465,000 jobs. Plus, the Labor Department revised the January jobs increase upward by117,000. Clearly the U.S. labor market is on the road to recovery.

Most of the private sector job growth came from service industries as the pandemic lockdowns ease in most states. Leisure and hospitality created 355,000 new jobs. While this is definitely good news, you wouldn't know that if you were in

Washington DC. For Democrats pushing a $1.9 trillion stimulus package the good jobs news is awkward.

As the editors of *The Wall Street Journal* wrote: “Democrats are rushing into law a gigantic spending bill under the guise of Covid-19 relief. This would be the most ill-timed “stimulus” bill in history, except it’s really income redistribution and has very little that’s stimulating in it.”

This explains why President Biden responded to the great February jobs news with a plea based on what he calls a dire need. “Today’s jobs report shows that the American Rescue Plan is urgently needed.”

The truth is the opposite. The unemployment rate hit an 11-month low of 6.2% in February. February’s great jobs report raises serious question about what such a massive spending package will do to an economy that is clearly recovering nicely. The Atlanta Federal Reserve’s GDPNow estimate for the first quarter is for growth at an 8.3% rate. And most economists are predicting strong growth for the second and third quarters as well.

Adding another trillion dollars or more to our national debt unnecessarily is bad news for taxpayers now and for many years to come. But the risk of over stimulating the economy and creating inflation and higher interest rates is exaggerated. As the editors of *The Wall Street Journal* pointed out, there is very little stimulus in the bill. For example, there is $350 billion bailout for states and localities that are gaining tax revenue. The money will be used to cover existing debts that were the result of poor fiscal leadership in mostly Democrat controlled states and localities. In a twisted way that is good news when it comes to inflation and interest rates.

However, a fast-recovering economy will likely keep some pressure on interest rates. The S&P 500 stock index is trading at about 22 times earnings, close to its highest in 20 years. As Robert Shiller and others have pointed out this does not mean that stocks are overvalued, because very low interest rates make stocks relatively attractive. But it also makes stocks very sensitive to rising interest rates. We saw that a week or so ago, when the yield on a 10-year treasury rose to 1.5%, and stocks went down.

The Federal Reserve will keep doing its part to keep interest rates low, including a huge $120 billion a month in bond buying. Of course, the Fed could change policies if inflation actually became a challenge. Morgan Stanley sees inflation staying low this year and next. Their estimate for core PCE, the Fed's favorite inflation measure, is +2.2% this year and +2.1% in 2022. And that includes the impact from the $1.9 trillion massive spending plan. With inflation barely above 2% we need not worry about a significant rise in interest rates.

"Through it all, we expect the Federal Reserve to remain patient, lifting rates only gradually beginning in the third quarter of 2023." (Morgan Stanley)

Furthermore, before raising interest rates the Fed will have to first take its foot off the gas pedal.

"In our forecast, the COVID-19 cloud will have thinned by midyear and it will be apparent the recovery has been gaining sustainable steam. We continue to expect Chair Powell to convey a message at the June Federal Open Market Committee meeting that tapering the balance sheet could be on the horizon. We expect the official announcement to come at the December meeting that tapering will begin January 2022, at a monthly pace of $10 billion in Treasuries and $5 billion in mortgage-backed securities. On this schedule, the size of the balance sheet will grow to $8.7 trillion by year end 2021 and $9 trillion by year-end 2022." (Morgan Stanley)

In such a benign atmosphere we will still likely see upticks in interest rates caused by money shifting into bond funds and by bond traders taking short-term positions. That in turn will likely mean times when stocks temporarily go down.

Morgan Stanley sees all of this as normal at this stage of a new bull market, and says this supports their call for modest stock market gains this year with excellent longer-term gains still beneath the surface.

Stocks remain our best investment choice.

I will have the next market review and update one week from today on Wednesday March 17, 2021.

All the best,

John Dessauer