John Dessauer Investments, Inc.

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

The U.S. economy is recovering faster than expected. Economists now estimate that the economy could grow this year by as much as 7%, fueled by the massive fiscal stimulus and rollout of vaccines that are expected to get the pandemic under control. That would be the fastest rate of growth since 1984. It would also be an incredible turn-around after last year's 3.5% contraction, which was the worst in 74 years. No wonder economists and market analysts worry about the potential for much higher inflation.

As I wrote last week there are serious questions about the size of the $1.9 trillion stimulus package. Here is how the editorial board of *The Wall Street Journal* reacted to the $1.9 trillion stimulus: "Only a small part of what Democrats passed is for pandemic relief. It's mainly a way station on their high-speed train to a cradle-to-grave welfare-entitlement state. Most of the $1.9 trillion will flow to government unions or supposedly temporary income transfers that Democrats intend to make permanent later this year."

I am a fan of *The Wall Street Journal* and especially the articles written by the editorial board. So I was surprised when Treasury Secretary Janet Yellen forcefully defended the $1.9 trillion Biden spending plan. I found her to be a solid, positive financial leader when she served as chair of the Federal Reserve. In an interview with *The New York Times,* she said: "We need to make sure that those most affected aren't permanently scarred by this crisis."

In response to the concerns that President Biden's $1.9 trillion stimulus plan is too large and would potentially waste money on those who don't need help, Yellen said that some Americans who are suffering can be hard to reach. "The truth is there are pockets of pain that go beyond what can be reached with those highly targeted ways. The plan's direct payments of $1,400 could find the pockets of misery that we know exist out there."

Yellen reiterated the Biden administration's argument that there is more risk in doing too little than in doing too much. She also said: "A key job for a Treasury Secretary is to make sure the country is on a sound fiscal course. If you don't spend what is necessary to get the economy back on track, that has a fiscal cost as well."

When asked about the huge federal deficit and rising national debt, she said that low interest rates are reducing the cost of additional federal spending. "I think we have more fiscal space than we used to because of the interest rate environment, and I think we should use it."

Janet Yellen is clearly focused on the damage done by the pandemic. Others, including the editors of *The Wall Street Journal,* are focused on the current rate of recovery. And there is a lot of partisan politics involved. That seems to be the case whenever the government is spending a lot of money. In this case the obvious political handout is to states that worried about tax shortfalls. Like the stock market there were early steep declines in state tax collections. And also like the stock market the forecasts were that the declines would get worse. But the state tax forecasters were just as wrong as the stock market forecasters. Combined state tax revenues almost fully recovered last year. By the end of 2020 state tax revenues were down just 0.4% from 2019 pre-pandemic levels. With the economy recovering, vaccines rolling out and businesses reopening, state tax revenues are expected to fully recover and grow again. Never-the-less states will be getting fiscal help from the stimulus package whether they need it or not.

All of this brings us back to the core question, will all the stimulus result in an unwanted rise in inflation? If that were to happen then interest rates would rise and significantly increase the cost of all the federal borrowing.

The Labor Department said last week that consumer prices rose 0.4% in February from January. That is a little scary because if that rate continues the annual rise would be about 5%. And that would be enough inflation to force the Federal Reserve to change course. But fortunately, the February rise was mainly due to an increase in gasoline prices. The so-called core rate, which the Federal Reserve watches, was a timid +0.1%. And after the February one month jump the year over year overall increase was just 1.7% with the core rate at 1.3%. From here on, watching inflation will get more difficult because we will be seeing inflation rates based on earlier pandemic-induced price declines. The true underlying inflation pressure won’t be known until we get a full recovery and unemployment is back to pre-pandemic levels. With 2 million still out of work that will take some time.

The really good news is the rising rollout of vaccines. States are reducing the eligibility age. Johnson and Johnson’s vaccine has been approved. Now there are three vaccines rolling out for adults. It won’t be long before every adult who wants to be vaccinated will have been able to do so. And a vaccine for children under 16 will also soon be available. In addition to the vaccines, it is also possible that we will have a pill or series of pills like the Tamiflu that will knock back the Covid virus. If that happens the pandemic will clearly be over. Then the economic outlook will depend on federal government and Federal Reserve policies. I expect that a year from now the discussion will be all about the Biden administration’s tax and regulatory changes.

When asked about taxes Janet Yellen said Biden is interested in raising taxes on corporations and maybe on capital gains, but a wealth tax is probably off the table, in part because it would be hard to implement. “A wealth tax has been discussed but is not something President Biden favors.”

Thank goodness. The last thing the economy needs is a radical change in taxation. Far better to simplify the existing tax code.

As far as the outlook for the stock market, Argus Research has published a March update and says: “We look for stocks to rise 10%-12% in 2021, in line with norms over the past 40 years.” That would be a very attractive result.

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

All the best,

John Dessauer