John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday April 21, 2021

There is good news and interesting news. The good news is that same store retail sales were up 13.2% in March versus March a year ago. That is a significant improvement over the 10.6% year-over-year gain reported in February. This is more solid evidence that the economy is recovering nicely from the pandemic recession of a year ago. The rollout of vaccines is gaining momentum. And that has opened up all sorts of businesses including restaurants.

Marilynn and I received our second Moderna shots on April first. Two weeks later on tax-day the 15th we drove across Florida to Boca Raton so Marilynn could connect with daughters and granddaughters. We stayed at the Boca Raton Beach Club and it was packed. Everyone wore masks inside and did their best to maintain social distancing. There were lots of families with small children. Going out to restaurants for dinner proved to be a challenge because they reached full capacity quickly. This long weekend trip showed me that this part of Florida is very close to being as busy as it was before the pandemic. Our son-in-law is a captain for a party boat business. He says he has been very busy. The corporate business is still down but they have benefited from local business such as weddings and family celebrations.

So much for the good news. The interesting news is about inflation. Last week the Labor Department reported that overall consumer prices were up 0.6% in March versus February. That is the largest monthly rise in prices in over eight years. That news sparked fresh worries that the combination of trillion-dollar stimulus packages and very easy monetary policy might be igniting a round of high inflation. I say this news is interesting because nearly half of that overall increase was a 9.1% jump in gasoline prices. And gasoline prices were up 6.4% in February. The rise in gasoline prices is due to a combination of higher oil prices and supply disruptions due to Covid. Delivering gasoline has been difficult with drivers isolated, sick, or just plain afraid to travel very far. The rollout of vaccines will likely resolve the transportation issues and allow gasoline prices to settle back down.

The so-called core Consumer Prices index, the one favored by economists looking for the underlying inflation trend, rose only 0.3% in March after a February rise of 0.1%. Year-over-year the core CPI was up a modest 1.6% in March.

A report showing a surge in Producer Prices in March confirms that supply side bottle-necks are affecting more than just gasoline prices. And that report also pointed out the problems with worker absenteeism due to Covid. This supply side disruption has left manufacturers grappling with acute shortages of basic materials, rising commodities prices and difficulties transporting finished goods.

In the short run, as we see with rising gasoline prices, there is upward pressure on prices due to Covid. Companies might want to raise consumer prices to cover the current price pressures. But that will be difficult because employment is still 8.4 million jobs below the pre-pandemic peak in February 2020. And while consumers are spending, they are also saving and keeping debts under control.

Inflation expectations, as expressed by the bond market, have also cooled. In early April the benchmark 10-year U.S. Treasury yield was up to 1.71%, from 0.91% a month earlier. That yield briefly broke above 2%. That was a signal that inflation expectations were on the rise. However, the 2% yield did not last very long. The 10-year Treasury yield is now back down to1.66%. So, the bond market is not all that excited about future inflation.

In my view the Federal Reserve has it right. They are keeping interest rates very low and continuing to buy bonds at a rate of $120 billion a month. They would not do that if the underlying inflation trend was threatening. The Fed sees the current headline inflation as transitory, receding later this year as supply sides restraints ease. What will the underlying inflation trend be after a full recovery? Clearly, no one knows. If inflation does become a problem, you can be sure the Federal Reserve will respond as it has in the past. So there is a possibility that interest rates will be rising sooner than 2023.

President Biden wants to raise taxes on corporations and individuals. However, there is push back from Republicans and moderate Democrats. The President says raising taxes will not dampen economic growth. History says he is wrong. Democrats facing the 2022 election do not want the recovery stalled or stocks declining. The tax increase when it comes will likely be less than what the President is now planning. In fact, he has said that he is willing to negotiate on the actual rate hikes.

Never-the-less a century worth of data say raising taxes hurts stocks. Data dating back to 1910 show that when corporate and individual taxes were raised, the average return on the U.S. S&P 500 benchmark index in the years of the combined tax hikes is 2.4%. Once those increases are implemented, however, the average return drops to minus 0.9% for the year following. That compares with a long-run annual average of plus 7.7%.

The reason stocks suffer from tax hikes is that the additional taxes reduce overall profits and also reduce consumer demand.

So we can expect a significant change in stock market returns a year after the tax hikes are enacted. But history is comforting in that stocks have not plunged after taxes were raised. In addition, once the economy adjusted to the new tax rates, economic growth and stock prices improved. It may be more difficult to get double digit returns on stocks after the Biden tax hikes, but at least we can expect single digit returns.

About 40% of revenues for companies in the S&P 500 index are taxed overseas. And globally the trend is for lower corporate tax rates. That will help blunt the impact of the Biden corporate tax hike.

I will have the next market review and update one week from today on Wednesday April 28, 2021.

All the best,

John Dessauer