John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday April 28, 2021

President Biden announced his tax hike plans and the stock market went down. But the next day stocks recovered. That came as a surprise to many investors because the president wants to double capital gains taxes on the wealthy. That would be the highest tax on capital gains since 1920.

There were two reasons stocks came bounding back so quickly. First, there are doubts such a high tax would pass the Senate. The Senate is 50-50 with the Vice President able to break any tie vote situations. But if just one Democrat says no, there would not be a tie and the measure would fail. Second is that there is historical data indicating that raising the capital gains tax has only a short-term impact on stocks. In the six months before the 2013 capital gains tax hike investors pulled $38 billion out of U.S. equity funds and ETFs. (According to an analysis of Morningstar data by Mathew Miskin, co-chief investment strategist at John Hancock Investment Management.) In the six months after the tax hike those funds enjoyed a $58 billion dollar inflow. And over the whole 12 months the S&P 500 index rose 18%.

Six months after the 1987 capital gains tax hike the S&P 500 was significantly higher. There have been times when the stock market reacted negatively following capital gains tax hikes. That was the case after capital gains tax hikes in 1969 and 1976. But in both cases, there was a combination of tax hikes and a soft economy. This time the economy is recovering at a rapid rate. Optimists like Jamie Dimon CEO of JP Morgan Chase believe the strong recovery will carry through 2022 and possibly also through

2023. If that proves to be the case, then stocks will likely continue their upward climb even if the proposed tax hike passes both the House and the Senate.

In addition, there are doubts about how much new tax revenue would follow a tax hike that applies only to taxpayers reporting a million dollars or more in income. And sensing resistance, the President has indicated that he is ready to negotiate the size of his tax hike. The last thing the President and fellow Democrats want is a softening economy ahead of next year's mid-term elections.

In my view Ryan Detrick, chief market strategist at LPL Financial, is right when he says: "the stock market has probably priced it in." After all, Biden has been talking about raising taxes for a long time. The only thing new is that he has now uttered specific numbers. And, as he admits, they are subject to negotiation.

Major nonfinancial corporations are sitting on a mountain of cash. In the U.S., Japan, and the euro area the total amount of cash is $10 trillion. That is about double what it was a decade ago. In the case of Japan, the corporate cash is 60% of GDP. In the euro area the cash amounts to 30% GDP and here in the U.S. it is 10% of GDP.

The cash build up goes back a long way but was given a boost as corporations took precautions due to the pandemic. Holding cash can be a positive, but holding too much cash indicates a lack of investment opportunities. A cash buildup like Japan's effectively means that companies have looked at the investment options available and found them wanting. Japan's cash buildup began in the 1990s and over the last decades the cash mountain has weighed down returns on equities for shareholders because the cash assets yield little to nothing.

Activists and analysts look at the cash and wonder why it has not been productively invested or returned to investors through dividends and stock buy backs. The pressure gets results. Corporate governance in Japan has become markedly more shareholder friendly in recent years. The euro area is not yet at the Japanese level but is quite high and trending higher. In contrast the U.S. looks far more shareholder friendly and with the economy recovering rapidly, odds are that U.S. corporations will find investment opportunities for the cash. And a significant increase in investment would further boost economic growth, and support Jamie Dimon's optimism.

Jamie Dimon is not the only optimist. Here is the latest from Kevin Matras of Zacks Investment Management.

"There's no mistaking it. We are experiencing a market phenomenon the likes of which has never been seen. Right through the pandemic, the unleashing of pent-up global demand and strong economic forces are primed to drive the markets to new highs and beyond.

Yes, there may be bumps along the way, but they will bring even greater buying opportunities. Experts look for 2021 to experience the highest growth explosion in 36 years.

Very soon we're about to see unprecedented economic demand meet an unprecedented amount of stimulus money."

We are in the middle of quarterly earnings season and so far, the results are excellent. According to FactSet, as of last Friday, companies in the S&P 500 that have reported, have beaten expectations by a combined 30%. That compares with a five-year average of 7%.

There is more good earnings news to come. Companies in the consumer-discretionary sector are forecast to report earnings up 96% from a year ago.

The stock market has had a long run without much in the way of pullbacks. Kevin Matras talks of potential bumps in coming months. I agree and expect a pullback of 5% or so. But we may have to wait until after quarterly earnings season to see that happen.

I will have the next market review and update one week from today on Wednesday May 5, 2021.

All the best,

John Dessauer

© April 2021