John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday May 5, 2021

News reports say that 100 million Americans have been vaccinated. Cases of severe side effects are few and questionable. Underlying medical conditions probably explain most of the severe side effects. For Marilynn and me the side effect was a sore arm for a couple of days. The economy is responding positively as consumers spend on goods and services. The latter is very important because services now account for about 60% of GDP. As I wrote a couple of weeks ago, we saw the opening firsthand during a visit to grandchildren in Boca Raton. We saw restaurants very busy and beaches crowded. Now the Commerce Department has confirmed that the recovery is robust and likely to get even better. During the first quarter of 2021 the U.S. GDP expanded at a 6.4% annual rate. Economists surveyed by IHS Markit are looking for the GDP to grow at an 8.3% annual rate this quarter. At this rate, the economy will soon be back at the level preceding the pandemic. However, absent the pandemic, the economy would have kept growing. The CBO (Congressional Budget Office) estimates the economy would have to be 3.6% higher than it is right now to reach the "just-right" level, so there is room for still more robust economic growth.

In ordinary times economic growth at this pace would be ringing the inflation alarm bells and the Federal Reserve would be tightening monetary policy. Not this time.

Last Wednesday Fed chair Jerome Powell said: "The economy is a long way from our goals, and is likely to take some time for substantial further progress to be achieved."

Part of the reason the Fed is still relaxed about inflation is the job market. As of March, there were 8.4 million fewer jobs than before the pandemic. And the Fed is more willing to test just how tight the job market can get, waiting for it to actually show signs it is starting to run hot rather than moving to slow things down before the fact.

In his post-meeting remarks last week, Mr. Powell was steadfast on the Fed's willingness to look through any inflation related to supply-chain problems that might emerge over the next several months. "We adapt," he said. "And we think of them as not calling for a change in monetary policy, since they're temporary and expected to resolve themselves."

There are signs that inflation may be heating up. In San Diego, the restaurant Cork and Craft has had so much trouble finding cooks that it raised wages by $4 an hour to $18 this year, says co-owner Matthew DeLoach. Workers are being lured by other industries, including construction, for higher wages. "Some of the people that had worked prior to the pandemic are not interested in coming back for anything less than $24". Mr. DeLoach added that his restaurant is considering raising prices to cover the additional labor costs.

The super low interest rates have made home buying much more affordable, with mortgage rates lower than they have ever been. According to the National Association of Realtors sales of previously owned homes reached a 14-year high last year. Demand for homes exceeds available supply. Home prices have been rising, adding another inflation worry point.

The Fed did acknowledge this potential inflation issue last week. They said they expect inflation in the short run to exceed their 2% annual average goal for this year. The Fed expects the rise in inflation to be temporary, falling back to 2% by the end of next year. The bottom line for investors is that interest rates are going to stay low for the foreseeable future.

President Biden, for his part, wants to keep spending trillions of dollars. How much of this would be real economic stimulus and how much support for left-wing proposals is unknown, but odds are that real stimulus would be a much smaller part of any of his spending plans.

To pay for all the new spending President Biden wants to raise the capital gains tax to 43.4%. The editors of *The Wall Street Journal* called this “The Dumbest Tax Increase.” Adding, “Biden’s capital-gains rate of 43.4% would reduce federal revenue.”

The current top rate is 23.8% which includes a 3.8% ObamaCare surcharge.

“The tax on capital gains directly affects investment decisions, the mobility and flow of risk capital from static to more dynamic situations, the ease or difficulty experienced by new ventures in obtaining capital, and thereby the strength and potential for growth of the economy.”

No, it wasn’t Ronald Reagan who said that. It was a leading Democrat President who provided that advice, namely John F. Kennedy. Joseph Biden should take John F. Kennedy’s advice. He was right when he said it and it is still true today.

“The last resort of progressives is that raising the capital-gains tax will increase revenue. They are wrong on that too. As former Federal Reserve Governor Larry Lindsey explains, a 43.4% federal tax rate will cost the government money. The Congressional Budget Office says the revenue-maximizing rate for capital gains is about 28%. Other economists say it’s lower, and many think the ideal rate is zero. No one outside the fever swamps thinks it is more than 40%, much less the 55% or more that would apply in high-tax states if the Biden proposal becomes law.

So why raise a tax that would reduce investment, reduce wage growth and reduce revenue for the government? Temporary economic insanity is one possible explanation.

Mr. Lindsey suggests another: punishment for its own sake. Without a rational basis for the tax increase, this sounds right. This is what happens when you turn your economic policy over to Bernie Sanders and Elizabeth Warren. Envy is in the political saddle, and Joe Biden is going along for the ride." (The editorial Board of *The Wall Street Journal*, 4/26/2021)

Remarkably the stock market has been doing well in the face of earnings, taxes, government spending, and inflation worries. The reasons are the strong underlying economic fundamentals, solid quarterly earnings, and an accommodative Federal Reserve.

Stocks remain the investment of choice.

I will have the next market review and update one week from today on Wednesday May 12, 2021.

All the best,

John Dessauer