John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday May 6, 2020

We are now getting solid numbers on the toll the Covid-19 is taking on the U.S. economy. The numbers are not pretty, but neither are they signs of a full-blown disaster. For example, the popular media headlines focus on the number of jobs being lost. What they omit is that as of February there were 152 million Americans still working and collecting their paychecks.

The official count is that the U.S. GDP shrank at an annual rate of 4.8% in the first quarter. We are now well into the second quarter and economists are struggling to calculate how much more damage will be done this quarter. Most think the second quarter will be worse than the first. There is a wide range of opinions with many expecting a second quarter contraction at a 20%-30% annual rate.

"Nearly everything in the private economy contracted (in the first quarter). Personal spending subtracted 5.3 percentage points from GDP, with most of that coming from the shutdown in restaurants, retail, non-Covid-19 health care, and the rest of the service economy. Spending on goods held up better, subtracting 0.27 points, but expect a much bigger decline this quarter. Private investment took away nearly a percentage point from growth. Overall, the economy shrank by $234 billion to a little under $19 trillion. The second quarter could see GDP fall below $18 trillion." (The editorial Board of *The Wall Street Journal*, 4/30/2020)

Every recession brings economic pain to many businesses and individuals. And this one is clearly worse than anything since the great depression. But let's keep things in perspective. In 2010, ten years ago, the U.S. economy was pulling out of a deep recession caused by a financial crisis. U.S. GDP in 2010 was almost $15 trillion. Before the Covid-19 crisis the U.S. GDP was $22 trillion. The point is that the U.S. economy was growing nicely and had expanded significantly since the last deep recession. This means the U.S. economy is much stronger than it was in 2008 and therefore better able to survive the hit from Covid-19.

Of course, what we need is effective treatment for those who become infected and a vaccine for everyone. Innovation at pharmaceutical companies is in full swing with competitors working together on both fronts. The FDA, for its part, is ready to fast-track treatments and vaccines. We are much better prepared to deal with Covid-19 than we were to deal with the pandemic of 1918.

"In a March 27 article for Liberty Street Economics, a blog published by the Federal Reserve Bank of New York, authors Sergio Correia, Stephen Luck and Emil Verner examined the responses of different cities to the 1918 pandemic. The conclusion is striking: Cities that implemented stronger social distancing measures ultimately saw higher levels of industrial production. Fighting the pandemic and protecting the economy were one and the same. To wit, in 1918, the Dow Jones Industrial Average rose 10%." (Morgan Stanley's *On the Markets* May 2020)

Taiwan is a small country with 24 million people, but it also is a big thorn in mainland China's ambitions. Beijing regards Taiwan as a rogue Chinese province and encourages others, including WHO, to treat it as such. The U.S. media have not paid much attention to Taiwan, but they should. Taiwan, being close to China geographically and with open borders, is a prime Covid-19 target. However, as of the end of last month Taiwan had 429 confirmed cases and only six deaths. A week ago, Taiwan announced zero new cases and officials said they believe the local epidemic could be over by June. This is in sharp contrast to the disaster in Mainland China. The difference is that Taiwan handled the virus outbreak, quickly, transparently and in a competent manner.

The virus emerged in China late last year. On New Year's Eve, public health officials in Wuhan China told WHO about a pneumonia virus but doubted it could spread easily. On the same day, Taiwanese officials say they asked WHO for more information about the virus risk and human-to-human transmission. WHO officials confirmed receipt of the request from Taiwan but didn't respond. WHO has long bowed to Beijing's wishes when it comes to Taiwan.

The poor treatment by WHO did not stop officials in Taiwan. They sprang into action immediately, imposing health inspections on flights from Wuhan. Meantime, Chinese and WHO officials played down the threat from the virus. By late January China had no choice but to admit that the virus seemed more contagious than originally reported, and acknowledged that the virus could spread between humans. By then Taiwan had taken competent action, starting drills and implementing quarantines to contain the threat from Covid-19.

President Trump and the U.S. Congress should make better treatment of Taiwan by WHO a condition of continued financial support.

Here at home the Congress has appropriated an astonishing $2.9 trillion in a mere six weeks to counter Covid-19. Democrats and some Republicans want trillions more. A better strategy would be to take a break, wait and see how the reopening goes and then decide where more money is needed, if it still is. Washington politicians should be worrying about the federal debt and deficits. The CBO (Congressional Budget Office) says the federal deficit is now expected to quadruple to $3.7 trillion or a stunning 17.9% of GDP. Not since World War II has debt as a share of the economy risen so fast. In 1946 federal debt held by the public was 106.1% of GDP. The current CBO calculation is that the national debt will reach 101% of GDP by the end of September and still be rising.

Treasury Secretary Steven Mnuchin likes to say the debt is no problem because interest rates are so low. That is correct for now. But he is overlooking the fact that so much U.S. borrowing is making an outsize claim on the world's limited capital. And the global slowdown means a decline in new capital formation. There are limits to what the U.S. and other governments can borrow. Hitting the limit would surely mean higher interest rates and an unwanted increase in the cost of financing all the debt. The U.S. and other countries need both a medical answer to the virus and methods for reopening their economies. Thanks to private innovation, a medical answer is likely to be available soon. The politics of borrowing is more uncertain. Hopefully, President Trump will be firm and not be drawn into another round of borrowing for non-virus-related priorities.

I will have the next market review and update one week from today on Wednesday May 13, 2020.

All the best,

John Dessauer