John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday May 11, 2022

It has been a very rough start to 2022. The S&P 500 Index is down more than 10%. And the volatility has been wild. Stocks soared after the Fed meeting last week and then gave it all back the following two days. Morningstar's analysts think the stock market is oversold, and 12% below fair value. I agree. The major indices were down last Friday, but there were a lot of individual stocks that finished up for the day. That is an indication that the panicky selling is winding down.

The selling is due to worries that the Fed will have to be aggressive to bring inflation back down. And that could mean interest rates high enough to cause a recession. The concern is understandable: in the 1970s the Fed had to raise interest rates to double-digit levels to bring inflation down and that did cause a nasty recession. President Reagan did his part in the inflation battle. He changed the government's course by returning to a stable-dollar policy and added supply-side tax cuts that encouraged the production of more goods and services. With those changes the recession rapidly ended and was followed by an economic and stock market boom.

So far, the Biden Administration has not changed course. They are still talking about a major tax increase that would make the inflation rate worse. But with inflation at a 40-year high, the inflation story of the 1970s is being discussed. And the political polls for the President and many Democrats show their approval rating is down and sinking. The last thing they want to see is an economy sliding into recession as November elections approach. Karl Rove is already saying that the Democrats are facing a red

tsunami come November. The combination of sinking approval ratings and articles about the 1970s is making Biden and other Democrats cautious about their spending and tax plans.

"Those who suffered the most were middle-class workers hit by rising prices, especially for energy, surging way ahead of wage increases. Between 1972 and 1981---under Presidents Nixon, Gerald Ford and Jimmy Carter—hourly earnings for workers went from $4 to almost $7, a roughly 70% gain. But after accounting for inflation, workers were getting poorer because the purchasing power of wages *fell* by roughly 12%. Is it any wonder that Ford and Mr. Carter were voted out of office? That's exactly what workers are facing today with wages up 5.6% over the past year but consumer prices up 8.5%. Then as now, the White House and the Fed said the inflation would be temporary and blamed it on global factors beyond their control. We don't think it is too late for a sharp policy reversal to prevent a recession and market contraction." (Arthur Laffer and Stephen Moore writing for *The Wall Street Journal* on May 1)

The reality at the moment is that the economy looks strong and likely to show growth in the next few quarters. Last Wednesday Fed Chair Powell said the economy looks "solid" for the rest of this year and that there's "nothing about it that says we're close or vulnerable to a recession. The bond market agrees. The yield on the ten-year Treasury rose to 3.13% last week. It hasn't been over 3% since 2018. The two-year Treasury was 2.71%. The two-ten indicator is not pointing to a recession.

In April the economy added another 428,000 new non-farm jobs. The U.S. economy has been adding 400,000 jobs a month all this year. Total employment is still

1.2 million jobs below the pre-pandemic level, but at April's rate it won't be long before the economy is back to pre-pandemic job levels. The unemployment rate ticked down in April to 3.6%, and wages kept rising. The labor market is absolutely not signaling a recession. On the contrary - it is signaling continued strength.

Fed Chair Powell said that he doesn't see signs of "a wage-price spiral" and added that there are signs that inflation in the Fed's favorite price index has peaked. If that is right and inflation starts falling, then a soft landing will become achievable.

"It has certainly been a rough start to the year with the S&P 500 in correction territory - down over 10% year to date. While markets will likely remain choppy, history tells us that even after a rocky start, stocks often end the year higher. We continue to believe that it is prudent to avoid becoming too defensive in your investment portfolio as the environment can look much different in six to nine months, whether it's due to inflation easing, the Fed successfully achieving a soft landing or an end to the Russia-Ukraine conflict. We recommend that clients adhere to their carefully constructed investment plans, remain diversified and stay invested." (BNY Mellon, 5/6)

I agree. After the stock market crash in the 1980s there was one investment advisor who openly bragged that he had sold stocks before the crash and bought Treasury notes instead. I was humbled because I did not sell before the crash. I held on and followed the path that BNY Mellon now recommends. A year later the pessimist still held Treasury notes. He and his clients totally missed out on the economic and stock market boom that followed the crash.

I remember the 1970s. Peter Lynch is a legendary investor. He managed the Magellan fund for Fidelity. Under his management that fund averaged 29.2% a year from 1977 to 1990 - an amazing record, in fact the best fund record in the world. But in the mid-1970s the Magellan fund suffered a one year drop of 40%. Soaring interest rates took a big, but temporary, toll on the stock market. Imagine selling that fund just before the big 40% drop. Would you have bought it back in time to enjoy the huge gains that came a few years later? My guess is that anyone who sold before the crash stayed out and missed the big gains that came later. It is very difficult to go from pessimist to optimist, especially after your pessimism proved correct.

I will have the next market review and update for you one week from today on Wednesday May 18, 2022

All the best,

John Dessauer

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