John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday May 12, 2021

Ouch! The April jobs number was a shock. Economists expected nearly one million new jobs in April. The reality was 266,000 new jobs in April. As if that is not enough of a big disappointment, the Labor Department revised the February and March new jobs numbers down 48,000 and 78,000, respectively. And instead of declining to 5.8%, the unemployment rate ticked up to 6.1%. Economists and politicians are now scrambling to explain the April jobs disappointment. The editors of *The Wall Street Journal* have this to say: "An economy doesn't live by demand alone…..The Keynesians who run U.S. policy, at the Treasury and Federal Reserve, have been using their usual demand-side playbook. Bathe the country in government cash, keep interest rates at zero, and the resulting rise in consumer demand will drive everything.

They've underestimated the supply-chain constraints that have been screaming across the economy for months—from too few workers to the computer chip shortage and soaring lumber and freight prices. The economy can't produce enough goods and services fast enough to meet soaring demand from the easing pandemic and government policies that have shoveled cash to consumers and rewarded Americans for not working."

The April jobs data prove that it was a big mistake to extend the $300 weekly jobless bonus. Most lower-income workers can make more staying home than going back to work. Half of the new entrants to the labor market in April were teenagers, most of whom don't qualify for jobless benefits because of their short or nonexistent employment records.

The Labor Department also reported that its latest survey showed there were 7.4 million job openings in February. While filling all would not quite get the labor market back to pre-pandemic levels, (we are 8.2 million jobs short of that goal), there are plenty of jobs available, but not enough willing workers.

The good news is that employers have begun paying more to keep and attract new workers. Average hourly earnings increased at an 8.4% annual rate and even more for lower income jobs like retail (+16.8%) and leisure and hospitality (+19.2%). This introduces the risk that these wage increases will become embedded in expectations and lead to a more general rise in inflation.

The editors of *The Wall Street Journal* conclude: "The policy lesson is to ease government constraints on supply. That means repealing the federal bonus not to work. And it should mean withdrawing the Biden tax increases that are a frontal attack on investment and supply. There is no need for more Keynesian stimulus, which has become part of the problem."

There is another reason President Biden should abandon his tax increase plan. The United States is a competitor in the global economy. Raising taxes would make American business less competitive.

The current U.S. top capital gains tax rate is 23.8%, 20% plus the Obama 3.8% surcharge. President Biden wants to raise that rate to 43.4%. Add in the local taxes in states like New York and California and the total capital gains tax rises to more than 50%.

Our most significant global competitor is China. Beijing wants China to replace the United States as the leading global economy. To accomplish that goal the politically

communist government has adopted capitalist economic policies. President Biden has acknowledged this competitive threat, referring to China's goal as "deadly earnest."

The top capital-gains tax rate for Chinese investors is 20%. Chinese citizens are allowed - even encouraged - to buy and own stocks in Chinese companies. The Chinese model, a political dictatorship, a market economy, and low taxes for investors, continues to generate rapid economic gains. President Biden and his administration should make keeping the United States capital and risk taking friendly and stop the verbal and tax attack on investment and capital gains.

The Congressional Budget Office has warned President Biden that raising capital gains tax rates would **reduce tax revenue by $124 billion over ten years.** A think tank favored by Democrats has issued a similar warning, but saying that the tax revenue decline would be $33 billion. The bottom line is that even economists who support Democrats agree that raising capital gains tax rates would reduce government tax revenue.

Why then would any government want to reduce tax revenue by punishing investors? Lower capital-gains tax rates reward patient capital needed to create and build business.

Hopefully, President Biden will get the message and back off on taxes - especially capital gains taxes.

Meanwhile quarterly earnings season is delivering better results than expected. Before the actual results started coming in, analysts predicted that first quarter 2021 earnings for companies in the S&P 500 index would show 21% year-over-year growth.

As of April 30, 60% of S&P 500 companies had reported earnings. The results were 45% higher than the first quarter of 2020, and 87% of companies beat expectations.

Put the robust economic recovery together with growth in earnings and you have fundamental support for stocks. Of course, the good news was anticipated by investors and is now priced into the market. What I think is needed now is the usual profit taking that produces a “correction.” My guess is that we will see a 5% pull back in stocks in the near future. Having said that, do not try to time the market. Hang on to some cash in case a buying opportunity arrives. Otherwise, relax and continue holding quality stocks.

I will have the next market review and update one week from today on Wednesday May 19, 2021.

All the best,

John Dessauer

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