John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday May 18, 2022

I always enjoy listening to the BNY Mellon market updates. The latest was very interesting. For example, there is scary talk about the Fed having to raise interest rates a lot higher to bring inflation down. History suggests that interest rates will have to get higher than the inflation rate. BNY's fixed income analyst made a point of saying that while interest rates are still low by historical measures, the change from 0 to 3% is huge, a tripling of the cost of credit. He says, look at the Delta, the rate of change. The Delta was less than a tripling in the 1970s. They think the Delta is more significant than the actual level of interest rates and that Fed policies will bring inflation down to 3.75%-4.25% by year end.

Loretta Mester, President of the Federal Reserve Bank of Cleveland agrees. She says the Fed will raise interest rates by half a percentage point at each of the next two meetings. That will lift interest rates to a level that is no longer stimulating for the economy and also not restrictive. In other words, she is hopeful that by late this year inflation will have come down enough for a soft landing.

As for the economy, BNY Mellon sees U.S. GDP growth to be 3%-3.5% this year with only a 30% chance of a recession in 2023.

As for the stock market, the BNY Mellon forecast is for a modest rise by year end, with the S&P 500 index finishing at 4,300 - 4,700.

It has been disturbing to see stocks go down, but there also has been other contrary market signals. For example, the dollar is up 8.6% and gold is up only 2%. In the past, high inflation was negative for the dollar and very positive for gold. Investors see the dollar as a safe haven during these uncertain pandemic times. And, for some reason, investors are not rushing into gold to protect their portfolios from inflation. Why not? The only logical explanation is that they do not see inflation as a long-term problem. They expect inflation to come down in coming months.

The CPI inflation rate did tick down in April, a sign that inflation may be peaking and will come down as BNY Mellon expects.

Unfortunately, the Biden Administration still does not remember how inflation was defeated in the 1970s and 1980s. Inflation after all is too much money chasing too few goods and services or a situation where supply is unable to keep up with demand. Biden has thrown trillions of dollars into the economy. That is done and cannot be undone. What can be done is to reduce taxes and unnecessary regulation to provide an incentive for businesses to increase the production of goods and services. That would increase supply and reduce inflation pressures. Understanding supply and demand is not difficult. It remains a mystery why President Biden and fellow Democrats do not do the obvious to bring inflation down. The polls show the President's approval ratings to be down and falling. He has been a career politician. You would expect him to do whatever he can to improve those ratings. The economy, inflation in particular, is the number one issue among voters of both parties. If he does not change course, he will likely lose control of both the House and the Senate.

The Senate in an 80-19 vote has confirmed Fed Chair Powell for a second term. His term expired in February and he has been working in a temporary capacity ever since. Finally, the Senate has gotten around to doing basic business. In my opinion Powell has done a good job dealing with all the challenges from the pandemic to not-so-transitory inflation. I am sure he will do his best to orchestrate a soft landing for the economy.

There is a disturbing side to all of the pandemic spending here and abroad. All that money was so tempting that it spawned criminal enterprise. For example, a Texas man filed loan applications for 15 made up firms and pocketed $24.8 million in government support.

The IMF (International Monetary Fund) estimates that since January 2020 governments have doled out $15.5 trillion in non-health-care spending and loans in response to the Covid-19 pandemic.

The rush to support households and businesses led to poor procurement, messy programs and inadequate oversight. In the United States at least 4.5% of funding under the CARES Act, the largest pandemic stimulus bill, went to cheats. Applying that rate globally indicates that nearly $700 billion ended up in the wrong hands. This is alarming because it could take years to uncover the full extent of the fraud. In any case it is clear that the U.S. and other governments have demonstrated their incompetence in handing out large sums. What a huge waste of taxpayer funds.

Three Dozen Senate Republicans have demanded more transparency on how the funds were spent. And the President has appointed a chief prosecutor to take down criminals who defrauded the system for their own profit. The Texas man who took $24.8 million has been caught and pled guilty to money laundering. While this after the fact catch-up is good, it looks like too little too late. It is unlikely that the U.S. or other governments will recover a significant amount of what has been stolen. And we are stuck with the inflation and its consequences caused by the excessive spending.

What to do in the face of all the risks and uncertainties? That was one of the questions during the BNY Mellon presentation. Their chief of equities, a brilliant woman, had this to say: “It is very hard to get back in after you have gotten out.” That squares with my view. It is no fun to watch the volatility in the stock market. But corporate profits are still growing and dividends are secure.

I will have the next market review and update for you one week from today on Wednesday May 25, 2022

All the best,

John Dessauer

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