John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday May 19, 2021

Last Tuesday the Bureau of Labor Statistics released the results of its JOLTS survey. It showed a record 8.1 million job openings in March. That roughly equals the number that payroll employment is down from pre-pandemic levels last February. Overall job openings in March increased by about 600,000 while new hires ticked up only 200,000. This is strong evidence that the $300 a week additional unemployment benefit is discouraging people from returning to work. The Biden administration keeps saying that there is no "measurable" evidence that the $300 federal unemployment bonus is discouraging unemployed people from seeking work. Well, now there is solid "measurable" evidence of just that. Governor Gianforte of Montana did not need the survey to know that the bonus was hurting rather than helping. He said Montana would forgo the $300 a week bonus before the Bureau of Labor Statistics' survey was released. And now the governors of Arkansas, Mississippi, and South Carolina have done the same. Businesses in these states will be grateful to have workers come back, and so will their customers.

One of my daughters was visiting last week. We went out to dinner at three different restaurants. All three suffered from a shortage of workers. It is very clear, outside of the White House, that rewarding people for not working is hurting the recovery. I won't be surprised if more governors forego the $300 a week bonus.

Federal Reserve Chair Powell's wish has come true. Inflation is back. The Labor Department reported that its consumer-price index rose 4.2% in April from a year ago. That is the highest level since the summer of 2008. And producer prices rose 6.2% in

April over a year earlier. That was up from 4.2% in March. The Federal Reserve expects that this burst of inflation will be transitory. And there is data supporting that point of view. About one third of the rise in consumer prices was due to a 10% jump in used car prices. The average price for a used car is now $25,000 - the highest on record. A shortage of semiconductor chips has slowed the production of new cars and stimulated demand for used cars. Of course, the solution to that source of inflation is to make more chips. And that is what is already happening. In coming months, the supply of new cars will increase and soften the demand for used cars.

In addition, we are looking at prices that are up from the year ago sharp drop as demand collapsed from the pandemic lockdowns. Economists surveyed in March by *The Wall Street Journal* expect this year's inflation rise to prove to be temporary. They on average see inflation measured by the CPI rising to 3% in June, which would be the highest rate since 2012, before falling back to 2.6% in December.

When inflation rose in past years the Federal Reserve responded by raising interest rates and tightening monetary policy. That is not happening this time and the Fed is on record saying that interest rates will remain low until the economy has fully recovered. That will take time, probably until 2023 at the earliest.

As Jon Sindreu, writing for *The Wall Street Journal* says: "To cool the used-car economy by raising interest rates and inflicting pain elsewhere would make little sense. Instead, the Biden administration seeks to fix the chip shortage by investing $50 billion in onshore semiconductor production capacity. The plans will take time and are still underfunded, but they help understand that the best way to fight chip inflation is to make more chips."

Jon added: “The prices of most products haven’t changed much. CPI gyrations are mostly down to a few items particularly affected by lockdowns and travel restrictions, such as airfares and restaurant prices, as well as commodities. Excluding food and energy, U.S. inflation in April was just 3%.”

A week or so ago the stock market was jolted by remarks about interest rates from Janet Yellen, Treasury Secretary. She said, “It may be that interest rates will have to rise somewhat to make sure our economy doesn’t overheat.” She was concerned that the many economists talking about a coming “boom” for the economy, with GDP growth above 10%, might be right. And that sustained growth at such a high rate would leave the Fed with only one option, raising interest rates.

Federal Reserve Governor Lael Brainard has a different view of the recovery. She has urged the Fed to be patient and not take its foot off the gas too soon, saying that a strong economy was not a sure thing.

“The outlook is bright, but risks remain, and we are far from our goals.” She threw some cold water on the “boom” forecast, saying that the weaker-than-expected April jobs report was a reminder that “the path of reopening and recovery is likely to be uneven and difficult to predict.”

“Basing monetary policy on outcomes rather than the outlook will serve us well”, she added.

“The boost to spending from pent up demand this year as the economy reopens is unlikely to be repeated next year. A persistent material increase in inflation would require not just that wages and prices increase for a period after reopening, but also a broad expectation that they will continue to increase at a persistently higher pace.”

She also pointed out that past experience suggests that businesses will try to compete against rivals by keeping prices low by compressing margins and relying on automation to reduce costs.

There is one alarm being sounded and largely ignored by the media: U.S. Treasury securities have long been the number one asset for foreign investors looking to hedge against risk in their portfolios. It was a shock when during last year's stock market meltdown foreign investors were aggressive sellers of U.S. Treasurys. Even now after stocks have recovered and the economy is recovering nicely foreign investors remain net sellers of U.S. Treasurys. Given the huge deficits now being run up in Washington, we will need all the support we can find to provide the necessary credit to keep the Treasury market solid and liquid. The Fed is well aware of this situation, but sees it as the result of technicalities rather than doubts about the soundness of current policies.

The Fed always watches the Treasury market and is sensitive to foreign demand. If foreign investors keep selling, the Fed will respond, but raising interest rates will be the last resort.

I will have the next market review and update one week from today on Wednesday May 26, 2021.

All the best,

John Dessauer

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