John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday June 5, 2019

Marilynn and I are in Scotland where Brexit politics is a very hot topic. In local newspapers I have seen headlines claiming that Jeremy Corbyn's labour party is dead. Jeremy Corbyn is the far-left leader of the Labour party who once was thought to be in the running to replace Theresa May as Prime Minister. Apparently, he has fallen behind. One reason is that his party did not take steps to deal with charges of sexual harassment by a high-ranking member of the Labour Party. Of course, it could also be that British voters are not buying his anti-capitalism nonsense. I suspect the latter is the more dominant cause of Corbyn's decline.

At home President Trump has once again used tariffs as a trade weapon and rattled investors. This time he is targeting Mexico and the flood of immigrants trying to cross into the United States. Mexico certainly can do more to help stop the flood. For example, Mexico can, as it has done at times in the past, close its southern border. That would stop the immigrants from further south in countries such as Guatemala from crossing into Mexico. Early indications are that Trump's tough approach is beginning to work. Mexico's president Obrador is responding by looking at ways to stop the flood. If he implements tough measures the tariffs will not go into effect.

The Commerce Department has published its revised calculations for the first quarter. Now we are told the economy grew at a 3.1% annual rate. That is a very modest decline from the first calculation of 3.2% growth. The bottom line is that the U.S.

economy is in very good shape and has absorbed the current tariff impact without much suffering.

The surprise in current economic data is an unexpected downward revision in inflation. Economists expected core PCE inflation to come in at a 1/6% rate in the first quarter. Instead the initial report said the first quarter inflation rate was 1.3%. More recently that has been revised down to a 1.0% rate.

Sung Won Sohn, an economist at Loyola Marymount University in Los Angeles, talking about inflation said:"The low inflation readings are likely to be persistent. With both inflation and economic growth going in the wrong direction, the Fed is likely to cut rates later this year."

It seems as if it was just yesterday that stocks went down because of fear that the Fed would keep raising interest rates and trigger a recession. The pessimistic pundits were wrong about that expectation. I guess they are in shock with reports that the opposite might happen. The clear lesson is that the Fed, unlike the pessimists, is focused on the data and is ready to respond to any threats to economic growth. The main threat to growth is coming from the White House. President Trump wants to push China into a truly free trade agreement which he believes would be a major benefit to China's economy as well as to the U.S. He wants also to stop the flood of illegal immigrants trying to cross from Mexico into the United States. In both cases he has decided that tariffs are his most potent weapon. Mexico's President Obrador is struggling to root out longstanding corruption and stimulate job-creating economic growth. The tariff proposal is a real threat to his regime. He is responding, making a real effort to stop the immigrant flood from Mexico. President Trump may be right - tariff threats may work where other approaches have failed.

He is also using tariffs to pressure Chinese officials into making major changes to their trade practices. China has been using capitalist methods to drive economic growth for the past three decades. I remember visiting remote villages in China in the 1990s. Beijing ordered provincial leaders to allow villagers to vote on who should be their leader. Democracy prevails at the lowest levels in China, but not at the higher levels. There, Communism still prevails. Communism and Capitalism might seem theoretically incompatible. However, China has shown that they are in fact quite compatible. In some ways they work better together than Democracy and Capitalism. Under Communism, political leaders can make decisions without worrying about voting booth political fallout. For at least two decades, demonstrated economic success was required for advancement in the Communist party. The leadership in Beijing used to be called the gang from Shanghai, because Shanghai was the most successful economic region in China. While there has been a shift in recent years, economic success is still the highest political priority.

China’s economy has grown rapidly and is now several times larger than it was twenty years ago. The larger size makes it more difficult to keep up the rate of growth. It is called the law of large numbers and China is definitely suffering that problem. The economy is not threatened by recession. It is threatened by the need to create more good jobs to replace the remaining State Owned Enterprises.

The trade negotiations between China and the U.S. have stalled. Chinese officials are afraid to take the bold steps President Trump is demanding. The Chinese have been talking with the Japanese. For decades Japan deliberately kept its currency deeply undervalued versus the U.S. dollar. The Plaza Accord ended that practice. It forced a major upward revaluation of the Japanese yen. That was followed by two decades of Japanese economic stagnation. Beijing is fearful that a broad trade agreement with the U.S. would have the same effect on the Chinese economy and currency. In reality that is unlikely because the yuan has not been kept at a deep discount to the U.S. dollar. China's trade behavior in recent decades has been far different from Japan's in the 1950s, '60s, and '70s.

Hopefully, the Chinese will be able to work through their fears and reach an understanding with the United States soon.

I will have the next market review and update for you one week from today on Wednesday, June 12, 2019.

All the best,

John Dessauer