John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday June 12, 2019

President Trump's tough stand with Mexico has resulted in major changes south of our border. Mexico's President Obrador has agreed to take measures to stop the flood of immigrants. That will include toughening Mexico's southern border and detaining immigrants before they reach the U.S. border. In return, President Trump has cancelled plans for new tariffs on goods imported from Mexico. This deal with Mexico coming on top of the new trade deal with Canada and Mexico is very good news for all three countries. Canada, Mexico and the United States will enjoy economic benefits from the more open and free trade agreement.

The deal with Mexico on immigrants is likely to impress the Chinese. It shows that President Trump really means what he says and is willing to take risks to improve trade between the United States and others. It also strengthens his position, because it settles an important trade and immigration relationship. Investors will like the news about Mexico. And that deal raises hopes that a deal with China will be made soon.

There is a financial storm brewing in Europe. The EU has a rule that government debt should not exceed 60% of GDP. But several members have debts that are well above the limit. Greece is the worst offender and is still vulnerable. Italy's government debt has been growing too fast and now is so far above the 60% limit that the EU has threatened Italy with economic punishment unless something is done to reduce government deficits. Recently the EU sent warning letters to France and Belgium, both of which have allowed

their government debt levels to soar. Neither is in the Italy or Greece debt mess yet. But both will get there in a few years unless they take steps to reduce annual deficits.

With all the posturing going on in anticipation of our national elections next year I am surprised that our government debt and annual deficits have not been given much attention. The United States will also be at risk if our national debt continues to grow rapidly.

Conditions on world financial markets are changing. Twenty years ago, then Federal Reserve Chair Bernanke described the world's savings glut. Emerging economies especially China had very high savings rates. The savings flooded local banks and filtered up to central banks, which in turn bought government bonds in Europe and the United States. Those bonds were regarded as "safe" and at the time provided a respectable interest income. The global savings glut provided so much cash that governments had no trouble finding buyers for their increasing debt sales. Most have become complacent and assume they will always be able to roll over existing debt and borrow more if they want.

The situation is not yet critical. But the conditions that developed the savings glut have changed. For example, the Chinese have become consumers, spending more and saving less. While it is difficult to get accurate figures, it is highly likely that the global savings glut has stopped growing. This means that there is an unknown but very limited amount of time before the total amount of government debt in Europe and the United States exceeds the available savings. When that happens, it will become impossible to roll over all the existing government debts. The riskiest, including Greece and Italy will suffer first and most. A rolling global recession could develop.

We can thank the EU for sounding the alarm. At least the long-term danger in Europe is creeping into the headlines. The solution, of course is to reduce the annual deficits. Left leaning politicians think that can be done by raising taxes, especially on the "rich." However, that approach has seldom worked. Raising tax rates risks slowing the economy, making the deficits worse. The best answer is to adopt policies that encourage economic growth. When an economy grows faster than the underlying spending, deficits shrink because tax revenue grows along with the economy. Some European countries Italy and France, for example, have had difficulty adopting pro-growth reforms and policies. Whether you like Donald Trump or not he has changed U.S. policies to a more pro-growth footing. The rate of growth has picked up to more than 3%. However, looking to this quarter economists are predicting a slowing to 2% or less. Morgan Stanley thinks the rate of growth in this quarter will slow down to 0.6% annual rate. Part of the slowdown is due to President Trump's trade policies. And part is the slowing in capital spending by business. The capital spending slowdown is not a surprise because last year there was an outsized burst in capital spending. It is normal for capital spending to slow after a significant burst. This year will likely be a return to normal when it comes to capital spending, slower growth than last year, but still growing. For all of 2019 Morgan Stanley is currently predicting U.S. growth at a 2.4% annual rate.

Settling with Mexico and Canada will help lift the growth rate. But to get growth heading back towards the 3% level, President Trump needs to settle the trade tensions with China.

Stocks have been volatile, but have not succumbed to pessimists' expectations. The latest reason is a potential interest rate cut by the Federal Reserve. If inflation stays low as expected and if the economy slows as much as Morgan Stanley expects, the Federal Reserve very likely would cut interest rates to make sure the economy keeps growing. While I always like to see stocks go up, I am not impressed by the interest rate cut euphoria. I much prefer economic growth over interest rate cuts. Especially since interest rates are still so low.

There is no way of knowing when a China deal will be made. What we do know is that there are growing pressures on both sides to make a deal soon. Just as the Mexican deal came as something of a surprise, I expect the China deal will emerge when least expected. Meanwhile holding stocks remains the best strategy.

I will have the next market review and update for you one week from today on Wednesday, June 19, 2019.

All the best,

John Dessauer