John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday June 16, 2021

The long wait for inflation to return is over. The CPI (Consumer Price Index) surged in May, up 5% from a year ago. And that followed a 4.2% annual increase in April. The question is: will this price surge be temporary, fading away as the economy recovers from the price depressing pandemic? Federal Reserve chair Powell believes this will indeed be "transitory." The current surge definitely is being boosted by the depressed prices a year ago as the pandemic crushed demand. In addition, the current inflation numbers are being propped up by shortages in specific goods. New car prices, for example, are up sharply because of shortages of computer chips. This has spilled over, pushing up prices for used cars. Car rental companies sold off part of their fleets when the pandemic kept customers locked up at home. Now there are shortages of rental cars and the cost for renting is soaring.

These supply side problems can and most likely will be resolved as the recovery continues. Chip makers, for example, will improve production and then more new cars will become available. However, there is one aspect of the supply side that is worrisome over the longer run: that is the shortage of willing workers created by Congress' unemployment bonus program. Managers of hotels, restaurants, airlines and manufacturers complain that they can't get enough workers to get back to pre-pandemic service and production levels.

The Labor Department reported that there were 9.3 million job openings in April. President Biden and his fellow Democrats claim this is not due to their unemployment bonus program. But the facts say otherwise. Most teenagers do not qualify for unemployment benefits because of their short or nonexistent work histories. They are eager for work. About 40% of the newly employed workers in April were ages 16-19. Teenage unemployment is the lowest since 1953. That is solid evidence that the bonus program is keeping too many workers on the couch at home.

The unemployment bonus is set to expire this fall. Hopefully, Biden and company will let that happen so more Americans will return to work. Meanwhile, the labor shortage is driving up wages and contributing to current inflation.

Underlying the recovery from the pandemic are issues that will need attention soon. For example, only 22% of U.S. high-school seniors were proficient in science on the 2019 Nation’s Report Card. Foreign nationals on temporary visas make up half of engineering masters degrees awarded by U.S. universities. America’s education system needs to improve. Businesses that can’t find skilled workers will export jobs overseas.

Last Tuesday the Senate passed a bipartisan $200 billion industrial policy bill to counter China. But the bill ignores the question, where will U.S. businesses find qualified workers to operate the semiconductor plants and develop cutting edge technologies? What is needed is an employment-based immigration policy and improvement in America’s failing public K-12 schools. Unfortunately, neither is on Washington’s current agenda.

Kevin Warsh, a former member of the Federal Reserve Board, raises another issue that should be on the Biden agenda, namely how to fund his $6 trillion annual budget. About one third of that budget would be unfunded. So far, the Federal Reserve has been the primary buyer of U.S. Treasurys. Since the onset of the pandemic the Fed has bought 56% of the $4.5 trillion new Treasury securities. Most large foreign buyers, including

China, departed the Treasury auction market when the pandemic hit and haven't meaningfully returned. Mr. Warsh says: "Many foreign entities believe the Fed is monetizing the fiscal expansion and expect the new policy experiment to end badly."

Other central banks, including Canada's, and the central bank of Korea have announced meaningful steps toward normalization, with others expected to follow. Our Federal Reserve may not be ready yet to cut back on bond buying, but sooner or later that will happen, leaving the Biden gang at the mercy of the open market. History says the U.S. will find buyers for all the debt. But history does not say that the interest rate on the new debt will remain forever low. On the contrary, history says that governments deep in debt should expect to pay higher interest rates.

American consumers and American businesses continue to hoard cash. The personal savings rate was 14.9% in April, double what it was before the pandemic. Likewise, businesses are holding on to billions of dollars in cash, so much that banks are asking corporate clients to spend the cash on their businesses or move it elsewhere. Ordinarily banks welcome all the deposits they can get. But now companies are reluctant to borrow, leaving the banks holding cash that is depressing their profit margins. Total loans at American banks equaled 61% of all deposits as of May26, down from 75% in February 2020.

Banks are required to have capital equivalent to at least 3% of all assets. The Fed changed that calculation in 2020 but that expired in March. Banks have encouraged customers to put cash in money market accounts. They are subject to different regulations even if run by the same bank.

There was hope that as the recovery continued banks would see more loan demand, but that hasn't happened. Personal savings and corporate cash continue to climb. Between March and May 26 bank deposits rose by $411 billion to $17.09 trillion. While a bit slower than late last year, that is still nearly four times the average of the past 20 years.

Stock and bond markets did not plunge after the May inflation report. Investors, it seems, are focused on the recovery. They know that last year the economy and prices suffered a pandemic depression. And the markets say that investors understand that the recovery is a work in progress – we are not yet back to ordinary times.

And yes, the velocity of money in the U.S. is still down on the floor. Stocks continue to be our best investment.

I will have the next market review and update one week from today on June 23, 2021.

All the best,

John Dessauer