John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday June 23, 2021

The Federal Reserve board met again last week. As expected, they left interest rates unchanged. But stocks fell anyway. Investors were spooked by a Fed projection that showed an interest rate hike to 0.6% from 0% by the end of 2023, a little sooner than expected. On the plus side that projection implies no change in interest rates for the rest of this year, no change in interest rates next year and no change in rates for much of 2023. That is still a very accommodative position.

The other important aspect of Fed policy is the monthly bond buying. While there has been no announcement of a change in the bond buying, the Fed board members are now at least talking about tapering. That raises the possibility of a change later this year, or an announcement of a tapering in 2022. Meanwhile the Fed will keep buying $80 billion a month in Treasuries and $40 billion a month in mortgage-backed securities.

As far as economic growth is concerned the Fed raised the growth outlook from 6.5% to 7.0% for this year. And they see growth at 3.3% next year and 2.4% in 2023.

Inflation is higher right now than expected but the Fed still sees it as transitory. The Fed has a lot of company. A Bank of America Global Fund Manager survey showed that 72% of respondents believe that inflation will be transitory, and that it's largely due to the supply chain disruptions brought about by the pandemic. They also believe inflation will fall once the disruptions are resolved.

The main takeaways from the Fed meeting are that the economy is booming, that inflation will be transitory and that interest rates will stay near zero for this year, next, and well into 2023.

Yes, retail sales declined 1.3% in May compared with April, but the economy is still booming. Retail sales for April were revised significantly higher and March sales were also bumped up. And even after the decline, May sales were 28% better than in May 2020. Keep in mind that with pandemic restrictions fading, consumers are spending more on services, which account for the bulk of economic output but aren't captured in the retail sales report except for restaurants and bars. Sales at restaurants and bars rose 1.8% in May, and are now above the pre-pandemic levels.

I find it interesting that there is little to no talk about a coming recession. Normally there would be a group of pessimists warning that the recovery is reaching its limits. I suspect the pessimists are having a hard time with the Fed still so accommodative. After all, except for the pandemic plunge, there has never been a recession when the Fed Funds rate was under 4%. We are a long way from seeing the Fed Funds rate climb above 4%, which means there will be fundamental support for stocks for at least the next two years.

The United States is clearly well ahead of the rest of the world. Emerging economies, especially India, are still suffering from the virus. The OECD (Organization for Economic Cooperation and Development) sees the global economy growing 5.8% this year and 4.4% in 2022. But the growth is concentrated in first world countries and even then, quite mixed. For example, the OECD sees the economies of France and the UK being 4% lower in 2025 than they were in 2020. The U.S. is the only major economy where expectations for 2025 are higher than they were in January 2020.

In its most recent report, the OECD expressed concern that a big chunk of the lost global output may be caused by a permanent reduction in the capacity to produce goods and services especially in poor countries. They have had difficulty getting people vaccinated and they have less capacity for fiscal stimulus because borrowing can endanger their currencies.

There is no talk of overheating or inflation in India or in other countries still suffering from the pandemic. With so much pandemic-caused economic damage around the world, it is hard to believe that the U.S. is headed for an unwanted burst of inflation. The global outlook supports the Fed’s expectation that the current U.S. inflation will be transitory. After all there is a global marketplace and lots of competition. Prices are likely to remain low in much of the world for some time to come.

President Biden recently agreed to rejoin the Paris Agreement on climate change. He did so on his own without the approval of Congress or American voters. President Biden and his fellow climate alarmists have a big problem. Every time voters are presented with something close to the actual costs of achieving draconian CO2 emission targets, they say no. The latest case is Switzerland, where 51.6% of the voters rejected a government scheme to meet the anti-carbon goals of the Paris Agreement on climate change.

“At least the Swiss were honest enough to tell voters that they would have to pay for their climate indulgences with the likes of a surcharge on car fuel costs and a tax on airline tickets. Perhaps most Swiss thought this cost was exorbitant, or useless, since the country contributes only 0.1% to global CO2 emissions. The Swiss could go net-zero on CO2 and it wouldn’t matter a whit to the climate.

This explains why America’s climate left assiduously avoids putting carbon taxes on the ballot. Mr. Biden won’t even endorse indexing the federal gas tax for inflation.

Instead, the Administration is planning to use regulatory and judicial coercion. Voters understand they will pay for the climate obsessions of elites." (*The Wall Street Journal 6/16*)

Thank goodness for countries like Switzerland and Ireland. They face rough and tough competition from larger economies. Their successes with fiscal policies, especially taxes, are a glaring example of what works and what doesn't. Of course, the high tax group, including Biden, don't like the competition. But stubborn players like Ireland and Switzerland will fight long and hard to preserve their winning policies.

I will have the next market review and update one week from today on June 30, 2021.

All the best,

John Dessauer