John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday June 24, 2020

It is almost unbelievable that in 2020, after all the progress in technology and medicine, the global economy has been all but shut down by a virus from China. Even worse is that there is no quick fix, no laboratory capable of figuring out how to defeat this virus. Thankfully, there is progress in solving the virus-vaccine puzzle. It is possible that we will have a vaccine by the end of this year or early in 2021. But once a vaccine is available it will take time to make enough vaccine and inoculate hundreds of millions of people. Meanwhile we are stuck, doing our best to limit the number of infections and deaths from the virus. Southwestern Florida, where we live, is a virus hotspot. And temperatures here have been in the high 80s for several weeks. This indicates that hopes the virus will calm down in the summer months are just wishful thinking. The bottom line is that we are going to live with the virus threat for at least several more months. For us that means staying home, venturing out only for essentials. Like so many others we are taking advantage of on-line shopping and home delivery. Technology, especially the internet, has "saved" the economy from a much worse fate.

Data pouring in are showing the economy is doing much better than economists expected. For example, data from the New York Federal Reserve Bank showed manufacturing down to a reading of -0.2 in June from May. That is a one-month surge. The May reading was minus 48.5. And June is also far better than the minus 29.8 economists expected. Yes, that is a measure of the level of U.S. manufacturing activity. For manufacturing to be rebounding from the early pandemic plunge is definitely encouraging. And it is consistent with readings on consumer activity.

In April retail sales dropped a record 14.7%, seasonally adjusted. That plunge was followed by very gloomy forecasts by leading economists. There was talk of a continuing economic plunge, led by consumers staying home. The gloomsters were wrong. Apparently, they missed April data showing an increase of 18.5% in fixed residential investment. At the height of the stay-at-home rules in April, sales of new homes rose 1% from March. Economists had expected a decline of 22%. That news should have signaled the gloomy economists that they might be wrong. Instead they ramped up their pessimistic outlook, going so far as to call for a 20% decline in the overall economy. Then came the news of 2.5 million new non-farm jobs in May. And that has been followed by a string of other data contradicting the gloomy forecasts.

Retails sales in May soared, up a record 17.7%. That was the best monthly increase in records dating back to 1992. While the May surge is very good news, total retail sales were still lagging. The May total of $486 billion in retails sales was still below February’s pre-pandemic $527 billion. What the May data indicate is that the worst of the virus recession is likely behind us and that the economy has the potential of a strong rebound once the virus is defeated. The details in the May data confirm this conclusion. Sales at clothing stores rose 188% from a depressed April. Furniture sales were up 89.7% from April. And online sales continued to rise.

The Federal Reserve deserves much of the credit for the underlying strength in the U.S. economy. The Fed has purchased most of the new debt created to provide the cash stimulus for consumers and business. In addition, the Fed saved the day back in March when financial markets suddenly froze. More recently the Fed has launched a corporate bond buying program, targeting a broad market approach rather than buying specific individual corporate bonds from potentially troubled companies. This move coming on top of the Fed's support of the market for treasury bonds, and supplying cash for the CARES act shows the Fed has unlimited resources to prevent a financial market sell-off and to maintain needed liquidity in the economy.

However, the massive financial support comes with a warning from Fed chairman Powell. In his semi-annual testimony before Congress in June he warned that the U.S. budget deficit, which is expected to reach $3.7 trillion this year is on an "unsustainable path." The previous record federal deficit was $1.41 trillion in 2009.

"The United States federal budget has been on an unsustainable path for years now", said Powell on the first day of his two-day testimony. "And that means the debt is growing faster than the economy, so debt-to-GDP is rising. That is, by definition, unsustainable."

In February, before the virus gained a foothold in the U.S., Powell told Congress that it would be a good time to start trimming the budget deficit. But during his latest testimony he suggested lawmakers should not prioritize reducing the deficit, saying the unprecedented amount of spending has been necessary to protect the U.S. economy from the coronavirus pandemic and related shutdown.

"The time to work on that hard is when the economy is strong, unemployment is low, there's growth. That's when you want to work on it. Those concerns are always going to be there, but I wouldn't prioritize them at a time like this, when spending is giving us a better economy moving forward, which will really help service the debt."

My concern is that some of our leading politicians do not seem to understand how the economy works. Raising taxes, for example, could deny the economy needed investment and could retard growth. President Trump did not roll back the Clinton-Obama taxes on investment income and limiting deductions for client lunches. He did roll back corporate taxes and as a result investment increased, not as much as he wanted, but a solid increase that did boost pre-pandemic growth. Hopefully growth will still be a high priority after the November elections.

I will have the next market review and update one week from today on Wednesday July 1, 2020.

All the best,

John Dessauer