John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday June 26, 2019

It is disturbing: the now huge U.S. national debt and trillion-dollar annual deficits are all but ignored by politicians from both parties, the media and even the stopped-clock pessimistic pundits. The national public debt outstanding has reached $22.02 trillion or 105.3% of GDP. Interest rates are very low, but never-the-less, interest payments on our national debt were $523 billion last year. Worse is that the annual deficit is expected to reach $1 trillion this fiscal year, up from $779 billion last year.

The national debt almost doubled during the Obama years. Candidate Trump scolded Obama on the debt increase and called for urgent action saying: "We're going to bring it down big league and quickly." He has failed on that promise. The debt and deficits have increased during the Trump years.

Federal tax revenue collections have grown over the last decade and are running at record high levels. The prime cause of the rising deficits is spending that has grown faster than the tax collections. Analysts also blame the Trump tax cuts, but that is saying that tax revenues would have grown faster without the tax cuts.

Critics, such as Maya MacGuineas, president of the Committee for a Responsible Federal Budget, focus on the threat from rising interest costs saying: "No one wants to be spending more on interest payments than on kids or defense, but that's the path we are on at the moment."

Interest costs will increase as the deficits push up the debt. If interest rates are pushed up by inflation or other reasons, then the interest payments would escalate. Maya MacGuineas is right to sound the alarm over the debt and deficits. But there is yet another, larger reason to worry about the rising national debt: the United States is not alone. Many other countries are suffering deficits and rising government debts. Fifteen years ago, there was a global savings glut. That provided the cash to finance all the rising national debts. The glut was so large that it also held interest rates down. Governments could not only easily find buyers for the government securities - they did so at attractive interest rates. Interest rates have remained low because inflation has remained lower than expected. However, the savings glut is disappearing. China is a prime example. China's economy has grown, individual incomes have risen, and Chinese consumers are spending more and saving less. At some point the rising government deficits will exceed the readily available savings, making it far more difficult to find buyers for all the new government securities.

The U.S. dollar is still the world's reserve currency and U.S. government securities are regarded as the safest. When the competition among governments to sell their securities intensifies, the U.S. will be in a strong position. But interest rates likely would rise, at least modestly. Governments like Italy and France would be among the first to suffer from a diminished global savings glut. What would they do if they couldn't sell enough securities to pay their bills? The answer in their cases would be that they would be forced to make unpleasant spending cuts. Other governments not tied to the euro might print more money. But history is clear that taking that approach leads to destructive inflation. So, while the United States might be able to keep selling securities, we are not an isolated economy. The suffering by other countries would negatively impact the global economy and reduce economic opportunities for all including the United States. Even then there would be limits to how much debt the U.S. could finance. Eventually the United States would have trouble selling securities and be forced to make spending cuts.

President Trump's allies say that economic growth and spending cuts combined will shift the balance so revenues will grow faster than spending. That is a good idea and has worked in the past, but with a much smaller national debt and modest annual deficits. The Committee for a Responsible Federal Budget calculates that it would take "unprecedented" 4.8% annual growth over the next ten years to balance the budget through higher economic growth alone. That is highly unlikely.

Democrats are proposing massive spending increases with programs called 'Medicare for all', a 'Green New Deal,' and 'Student Loan Forgiveness.' Each of these programs are estimated to cost trillions of dollars and would swell the annual deficits. Left-leaning economists argue that since the U.S. controls its own currency, the federal government has unlimited borrowing capacity. What they mean is that we can simply print more money to pay our bills. However, history is clear that approach has very real limits and horrible economic consequences if pushed too far. We suffered double digit inflation in the 1970s. That was bad enough. Printing money to finance ever growing deficits could push inflation much higher, with devastating consequences. Hopefully, these massive spending programs will be rejected by the voters.

The U.S. federal budget is a very important issue. If not addressed soon it will eventually mean higher interest rates, slower growth and diminished opportunities for all. Fortunately, the U.S. and global economies are still growing. Argus Research says the U.S. economy will likely grow 2.7% this year and 1.7%-2.0% in 2020.

Earnings for the S&P 500 companies grew 2% in the opening quarter. That was outstanding because earnings grew 14% in the final quarter of 2018, making a tough comparison for the opening quarter. The Argus earnings model indicates 6% earnings growth this year and 8% in 2020. Dividend increases will likely follow the earnings growth path. Stocks remain our best investment choice.

I will have the next market review and update for you one week from today on Wednesday, July 3, 2019.

All the best,

John Dessauer