John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday June 29, 2022

The stock market is looking much better. Stocks were up last week. But concerns about a recession are still on investors' minds. The Fed is clearly doing what it can to depress inflation. But as I explained last week the Fed can only cool inflation by killing off enough demand to bring supply and demand back in balance. Congress and the President have the ability and power to stimulate the supply side. Instead, the Democrats are fully engaged in a blame game.

Jerome Powell, the Fed chair, testified before the senate and here is how Elizabeth Warren reacted to his testimony: "Will gas prices go down as a result of your interest rate increase? Will the Fed's interest rate increase bring food prices down for families? You know what's worse than high inflation and low unemployment? It's high inflation and a recession with millions of people out of work. And I hope you'll reconsider that before you drive this economy off a cliff."

Translation: she will do her best to blame the Fed if there is a recession. Never mind that she personally helped block pipelines that brought natural gas to Massachusetts, causing a huge increase in home heating costs. And the more expensive natural gas comes on Russian ships to Boston harbor. She also supports the Biden Administration's supply side policies that started the burst of inflation in the first place.

Ms. Warren opposed a second term for Mr. Powell, so her animosity is not surprising. After igniting inflation and refusing to change policies, a cynic might ask if

President Biden renominated Mr. Powell precisely to be the fall guy. You can be sure that Biden will join Ms. Warren in blaming the Fed if there is a recession. After all, he keeps trying to put the blame on Putin and the war for the inflation that his policies caused.

When you understand that the burden to depress inflation rests solely on the Fed, a recession seems likely. Killing off demand to fight inflation has often resulted in a recession. But not everyone agrees. Argus Research for example, sees GDP growth of 2.2% this year and 2.8% in 2023. As far as stocks are concerned Argus researchers, like Jeremy Siegel, think we most likely have seen the bottom. How soon and how robust the recovery will be, depends on how soon there is confidence the Fed is making solid progress bringing inflation down.

The Fed is not getting help from the President or other Democrats, but it is getting help from ordinary Americans. That help is in the form of a huge cash hoard. At the end of the first quarter U.S. households held $17.9 trillion in cash and cash equivalents. That is much higher than the $13.7 trillion held at the end of the first quarter in 2020. Indeed, before the pandemic, U.S. households never experienced anything like the increase they have experienced over the past two years. Rising interest rates encourage saving. Households are likely to keep the cash because finally they will earn some income on that cash.

The cash hoard is well distributed across a variety of wealth, income and demographic strata. Yes, people in the top 10% by wealth held 32% more cash in the first quarter from two years ago. But people in the bottom half held 45% more cash than two years ago.

"All that cash doesn't mean that people will spend willy-nilly, especially if worries about the economy continue to mount. And when it comes to the durable goods such as washing machines and couches that people loaded up on the past two years, a lot of consumer appetite has probably been sated. But the sort of belt-tightening that typically comes with a recession might not happen, which would blunt the depth of any downturn—or prevent a downturn from coming at all." (*The Wall Street Journal*, 6/23)

The combination of a household cash hoard and a Fed raising interest rates could mean a soft landing, lower inflation, and no recession. Argus researchers could be right. If so, you can be sure that President Biden will quickly switch from the blame game to trying to take credit for continuing GDP growth. The problem is that inflation and recession fears may last beyond the November elections. It will take time for the Fed's efforts to show real progress.

As far as the near-term outlook for stocks is concerned, I think we should expect more volatility. Fund managers are selling. The buying we have seen recently has been from individuals. I think stocks will stabilize after the fund managers stop selling. Given the "a recession is inevitable", attitude among fund managers it may be a few more months before there is enough progress on inflation for attitudes to become less pessimistic. However, I have seen markets like this before. Fund managers can shift from selling to buying at any time. When the shift begins it will quickly gain momentum as managers fear being left behind. Money flows quickly away from poorly performing funds.

Our best strategy is to hold on and be patient. The eventual recovery will prove to be very rewarding.

I will have the next market review and update for you one week from today on Wednesday July 6, 2022

All the best,

John Dessauer