John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday June 30, 2021

The rising stock market with the NASDAQ reaching new highs gets most of the attention. But real estate has been soaring too. A three-bedroom house in Bend, Oregon recently sold for $1.25 million, a 44% increase from a year ago and yielding a price per square foot higher than Queens, New York and most of Washington DC. Overall house prices are up 13% year over year in the United States. Homes sell in 17 days, a record low. And the typical sale is 1.7% more than the asking price, a record high. The inventory of homes for sale is so low that there are more real estate agents in the United States than listings. When Redfin, a real estate firm, conducted its annual survey of 2,000 home buyers, 63% said they bid for a home they had not seen in person.

Clearly, we are witnessing a real estate boom. The last real estate boom ended in a deep and painful recession. Is history going to repeat itself? While anything is possible, this boom's underlying credit fundamentals are much different and on more solid ground.

Between 2004 and 2007 just 25% of mortgages were for people with "very good" credit scores (above 760). In 2019 60% of mortgages were for people with credit scores above 760. And during the pandemic banks kept tightening lending standards. During the first quarter of this year 73% of mortgages went to people with credit scores above 760. On the riskier side, sub-prime borrowers accounted for 12%-13% of mortgages between 2004 and 2007. In the first quarter of this year, that was down to 1.4% sub-prime borrowers.

Bankers learned hard lessons from the last real estate boom. They are not ready to repeat past mistakes. Credit standards are much higher, and borrowers are in much better

financial condition. This boom will run its course. The number of homes for sale will increase. Prices will stabilize. And the economy will continue to grow.

The rate of economic growth in the first quarter of this year has been confirmed at 6.4%. Better yet, second quarter growth is expected to be 9.7%. The Fed, for its part, has increased their estimate for all of 2021 to 7%, which would be the best year in 37 years. The details support this optimistic outlook. For example, durable goods orders came in better-than-expected last month. And weekly claims for unemployment fell by 7,000 to 411,000. The economic recovery remains strong.

There is another boom developing. I am not talking about stock prices. I am talking about corporate profits. The broad measure of U.S. corporate profits, which includes private companies, recently showed a 28.1% year over year gain. Public companies will start reporting second quarter results in a couple of weeks. For the S&P 500, analysts are now expecting second quarter profits to be 64% better than in the second quarter of 2020. In April these same analysts thought second quarter profits would be up 54%. These numbers are exceptional because they are compared with the worst period during last year's pandemic crisis. But the current earnings expectation puts the results 8% above the second quarter of 2019. So, there is real growth in corporate profits. Analysts do not get everything right. During normal times they tend to be a little too optimistic. During this pandemic the opposite has been the case. At the beginning of the year analysts thought S&P profits would be up 16% in the first quarter. They were not just a little too pessimistic, they were way off the mark. First quarter profits for the S&P 500 were up 58% in the opening quarter of this year. Will their 64% second quarter

forecast also be too low? We will find out in a couple of weeks. Even if they get it right this time it will be an outstanding quarter.

Last week Federal Reserve officials suggested that interest rates might start going up in late 2023, sooner than expected. That rattled investors and stocks took a temporary dip. At the same time those Federal Officials said they are talking about when to "taper" the monthly bond buying program. Pessimists have focused on the idea that the Fed might start cutting back on monthly bond buying. They argue that tapering will change the supply and demand balance in the bond markets and cause interest rates to rise. Interest rates rising due to market forces would be bad news for investors. Bond prices would come down. Stocks would at least stall if not come down. The real estate market would also suffer as the cost of owning a home rose.

Fortunately, history tells us that the pessimists are once again wrong. As Jon Sindreu, writing for the *Wall Street Journal* said: "Investors rely too much on 'supply and demand' explanations of quantitative easing, which is why they have again been wrong-footed."

In 2013 the Fed's previous taper announcement drove markets into a tantrum and led to a sell-off in long-term debt. But a few months later the trends went the opposite way, causing pain and suffering for pessimistic bond traders. A similar thing happened when the European Central Bank tapered its bond buying in 2018. Bond traders betting on rising rates were initially vindicated, only to be very wrong a few months later.

The bottom line is that there is a world of difference between tapering a buying program and actual selling of bonds. It is hard to push interest rates up while a central

bank is still buying. Our Fed will keep buying for this year and next. The end of quantitative easing and reversal of Fed policy is still a long way off.

I will have the next market review and update one week from today on July 07, 2021.

All the best,

John Dessauer

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