John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday July 6, 2022

In the July first issue of *The Economist* magazine there is an editorial titled, "Power Struggle, how to fix the world's energy emergency without wrecking the climate."

"One priority is finding a way to ramp up fossil fuel projects, especially relatively clean natural gas that has an artificially truncated lifespan of 15-20 years so as to align them with the goal of dramatically cutting emissions by 2050."

Unfortunately, the Biden administration does not understand the reality. It will be many years before we have alternatives to fossil fuels for heating, producing fertilizer and transportation. Instead of encouraging U.S. production of natural gas, the Democrats have done the opposite. There is a town in California where the Democrat leadership wants to ban the use of natural gas. And there is Elizabeth Warren who has cut off pipelines that bring natural gas to Massachusetts.

The Permian Basin in Texas and New Mexico is currently the most productive, and cost-effective, oil shale reserve in the U.S. It accounts for 43% of U.S. oil production. President Biden and his staff keep saying they are doing everything they can to produce more oil and gas in the U.S. That is a bold face lie. They are making rule after rule to throttle oil and gas production. The latest is a threat from the EPA that could throttle oil and gas production in the Permian Basin.

Drilling for oil produces volatile organic compounds (VOC) that create ozone when mixed with nitrogen oxides (e.g. from vehicles) and sunshine. The EPA has started using solar powered air sampling systems to remotely measure emissions in the Permian Basin. If the EPA deems ozone emissions too high, Texas and New Mexico would have to limit drilling. The EPA does not have the legal authority to ban fracking. So, it is now trying to do so through this ozone back door.

President Biden formally nominated Joe Goffman to the EPA. Mr. Goffman is dedicated to cutting oil and gas production any way he can. “His specialty is teaching an old law to do new tricks. “How many more tricks does he have up his sleeve to keep gas prices high.”

“If Mr. Biden didn’t want to stop U.S. oil and gas production, he wouldn’t appoint regulators whose main purpose in life is to just that. And as Texas Governor Abbott noted, the president has the power to stop them.” (*The Wall Street Journal, 7/1*)

Sadly, the Biden Administration is adopting policies and regulations that are likely to make things worse for the climate and consumers. Would anyone have believed that our President would first drive energy prices up and then head to Saudi Arabia to beg them to increase oil production. The President owes us an answer to the question, why is drilling for oil in the U.S. bad for the climate and drilling for oil in Saudi Arabia is not?

In any case energy prices are likely to stay high. And that may help bring overall inflation down. Economists are focused on the Fed and interest rates. Some well-known economists, including Larry Summers, former Treasury secretary, say that there will be a recession. They come to that conclusion because they see the Fed having to keep raising interest rates until demand falls off enough to create a recession.

However, they are not taking into account that rising prices also kill off demand. Prices at some point become too high for consumers who then stop buying. And high gas prices make that more likely. Consumers have no choice but to pay higher prices for gas and other energy sources. That leaves them with less discretionary income for everything else.

Analysts expect a wave of retail discounts in the weeks just ahead. Retailers including Target and Walmart have swollen inventories. That by itself is an indicator that consumer inflations pressure has come down quite a lot. This is already showing up in consumer price indexes. The Fed’s preferred inflation gauge, the index of consumer prices, rose 0.6% in May putting it 6.3% above its year-earlier level. Core prices which exclude food and energy in an effort to measure underlying inflation trends, rose 0.3% in may putting it 4.7% higher than a year-earlier. Both measures were below economists’ forecasts. For core prices that is the lowest level since last October.

The possibility that inflation is already cooling off won’t stop the Fed from raising interest rate 0.75% once or twice more. But it will raise doubts about the inevitably of a recession. And that will be a major positive for stocks.

Nikolaos Panigirtzoglou, market strategist for J.P. Morgan says the simplest way to extract probabilities from price moves is to compare price falls with the average peak-to-trough of past recessions. Since the S&P 500 is down a bit over 20% and the average fall in the last 11 recessions was 26%, that suggests an almost 80% chance of recession is priced.

It also means that if there is a recession stocks are not going down much more. The worst is over for investors. On the other hand, if inflation starts coming down and the Fed signals an end for rising interest rates, stocks are likely to rebound and make all the patient long-term investors very happy.

I will have the next market review and update for you one week from today on Wednesday July 13, 2022

All the best,

John Dessauer