John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday July 17, 2019

The Economist has entered the discussion about the future for the U.S. economy. The front page of the July 13th issue banners this headline: Riding High, what could bring down America's economy? Inside, the editors provide an in-depth look at the U.S. economy and identify three risks that could trigger the next recession.

At the end of this month the U.S. economic expansion will have persisted for 121 months, the longest since records were first kept back in 1854. NBER, a research group, says that history suggests there will be a recession soon. But the data say otherwise. The stock market remains strong, up 19% this year. In June the U.S. economy created a surprising 224,000 new jobs. Unemployment is low and wages are rising but inflation remains very low.

The rate of growth has been slow but persistent. The average GDP growth during this expansion has been 2.3%, well below the 3.6% average during the last three expansions. The good news is that the economy is less volatile. A third of America's 20th century recessions were caused by industrial slumps or oil price spikes. Today manufacturing accounts for just 11% of GDP and energy per dollar of output is down 25% since 1999. Services now account for 70% of GDP and investment has shifted to intellectual property, which now accounts for more than 25% of the total. The total value of U.S. housing is currently 143% of GDP, well below the 2007 peak of 188%. And banks have plenty of capital.

"All this supports the idea that the familiar triggers for recession are still absent and that the moderately good times can roll on for years yet." (*The Economist)*

As far as risks are concerned *The Economist* points out that an interruption in the global supply chain, from trade tensions or other causes, could derail the U.S. economy. "Imagine if Apple was cut off from its factories in China." The second risk they see is a spike in interest rates. That would hurt because total private debt is high by historical standards at 250% of GDP. These two risks, while real, are unlikely given current economic conditions.

Here is the scary part from *The Economist*: "**A recession made in Washington?** The last danger is politics. As the economy has trodden a narrow path, the boundaries of economic policy have been blown wide apart, partly out of frustration at a decade of sluggish wages. President Donald Trump has tried to gin up growth, by cutting taxes and attacking the Fed. Most Democrats are keen to let rip on government spending. More extreme policies hover in the wings. On the left, modern monetary theory (a kind of money printing) and massive state intervention are popular. One of Mr. Trump's new nominees to the Fed board supports a gold standard. The greatest threat to America's long and placid expansion is that a new era of wild policy may be just beginning."

The U.S. national debt is now $22.4 trillion, an all-time record. Worse, the annual federal government deficits are approaching $1 trillion. Politicians in both parties know the deficits and debt are a huge problem. But during the first set of Democratic primary debates on June 26-27 in Miami, none of the 20 candidates offered ideas to control the debt or deficits. Four hours of debate passed, and the word "deficit" was never mentioned. The government's debt was mentioned only once.

Last year the House of Representatives and Senate formed a special bipartisan panel to examine ways to improve how budgets are written. It failed to make any recommendations, but its operating budget added about $500,000 to the national debt.

The cause of the deficits is well known. Spending is growing at a 7% rate while tax collections are growing at a 3% rate. Democrats want to increase taxes, especially on the rich. Republicans argue that is unrealistic. And neither party wants to dig into the spending issue because that involves the most politically sensitive issues, namely Social Security and Medicare.

Forecasting politics is very difficult. But given the growing voice of the left wing of the Democratic Party, it seems likely that their massive spending proposals will force the debt and deficit issues to the political surface. Taxing the rich will, at best, be exposed as insufficient to pay for the programs, leaving spending cuts as the remaining option. Failing that, the debt and deficit issues will linger until they become critical and politicians are forced by market and economic forces to bring down the deficits. It can be done. The federal budget was in balance under President Clinton in 1998 and for the following three years.

Fortunately, the economy is strong and growing. Federal Reserve Bank of New York President John Williams recently had this to say: “While the current picture is complex, the economy is in a good place.” He expects growth this year to be +2.25%.

Stocks have been strong. Investors are expecting an interest rate cut at the Fed’s next meeting July 30 and 31. The betting is that by year end interest rates will be down by 0.5% or a bit more.

As far as the stock market is concerned, here is the latest analysis from Kevin Matras, Executive Vice President Zacks Investment Research: “In the meantime, the markets are poised to keep the gains coming. We had a great first half. Actually, a record first half. And I'm expecting the second half to be just as good, if not better.”

Our best strategy is to stay invested in stocks.

I will have the next market review and update for you one week from today on Wednesday, July 24, 2019.

All the best,

John Dessauer

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