John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday July 28, 2021

It is a standard requirement for mutual funds and investment advisors. They must include the warning "that past performance does not guarantee future results." However, investors seldom take that warning seriously. Investment advisors often brag about past results in order to attract more paying clients. Mutual funds routinely report past results as if they did guarantee future results.

Why isn't past performance at least an indicator of a fund's or an advisor's ability to deliver great returns in the future? Because the stock market is a complex, dynamic system. Investing is so competitive that history can rarely repeat for long; if any past pattern reliably recurred, so many people would pounce on it that it would soon stop working.

Here is what Kevin Matras of Zack's thinks about today's market:

"There's no mistaking it. We are experiencing a market phenomenon the likes of which has never been seen. As the pandemic draws down, the unleashing of pent-up global demand and strong economic forces are primed to drive the markets to new highs and beyond. Yes, there may be bumps along the way, but they will bring even greater buying opportunities. By year's end, experts look for America to experience the highest GDP growth explosion in 37 years."

Today’s market is brand new, not following past performance. This unpredictable characteristic is not new or unique - it is typical of stock market behavior. No wonder past performance cannot guarantee future results.

When it comes to mutual funds there is a way of selecting the best for future results. Research of historic mutual fund performance shows that some people invest based on past performance, but funds with low fees have the highest future returns. John Bogel, founder of Vanguard was right. He worked hard to keep fees on Vanguard funds as low as possible.

I don’t know of any studies of investment advisors’ fees, but logic says that those fees are also very important. Advisors with lower fees most likely produce better future returns than advisors with higher fees.

Here is another market comment from Zacks that I think adds to the conclusion that the stock market is basically unpredictable: “It’s ironic that the two ‘concerns’ in the marketplace right now are inflation (too hot of an economy), and a potential slowing down due to a resurgence in the case counts (too slow of an economy). Leave it to the market to take such a schizophrenic position.”

The debate over inflation and the Biden Administration’s spending plans has intensified. Stephen Moore, an economist at Freedom Works who served as an economic adviser to former President Donald Trump is a sharp critic of the Biden budget spending plan. He says: “Government spending doesn’t stimulate the economy. It de-stimulates the economy and causes inflation. The one thing we learned from Milton Friedman is government spending doesn’t stimulate anything except government. We should be aggressively cutting government spending right now, not raising it. If these policies worked then Argentina, Mexico and Zimbabwe would be the richest countries in the world.”

On the other side is Mark Zandi, chief economist at Moody’s Analytics. He says worries that Biden’s $3.5 trillion spending plan will ignite “undesirably high inflation” are “overdone.” He added that there are three reasons inflation fears are misplaced.

First, there is still slack in the economy.

Secondly, the package would raise productivity growth and labor force growth, particularly among lower income workers due to child care, paid family leave and elder care benefits, leading to stronger underlying growth that will “take the edge off inflation.”

Finally, he said programs proposed as part of the package address inflation in the cost of living. For instance, increasing the supply of affordable housing- especially in parts of the country where supply is lacking. Housing costs are the largest component of inflation.

The core personal consumption expenditure (CPE), the Federal Reserve’s preferred inflation measure rose 3.4% annually in May, the fastest since April 1992. Fed chair Powell has repeatedly called the current price increases temporary. At this week’s meeting he is likely to point to the recent decline in lumber prices as support for his conclusion. Lumber prices are down 62% from their May high.

As we can see from the Zandi vs Moore debate, the inflation picture is still uncertain. There is one thing that concerns me. The enormous and growing federal deficit will put pressure on the Federal Reserve. Raising interest rates to combat inflation would increase the deficit by raising the cost of financing all that debt. The Fed is politically independent but very much involved in the economic consequences of financing massive political spending.

Speaking of politics, the editors of *The Wall Street Journal* recently wrote about "A Tale of Two Recoveries. Why is the jobless rate so much higher in Democratic-run states?"

A look at nine of the states with the lowest unemployment rates shows that all are governed by Republicans. In contrast the states with the highest unemployment rates are all run by Democrats. What is going on? The answer is: several things. High-tax Democratic states continued to lose population to lower-tax states during the pandemic. For example, the flight of high-earners and office workers has devastated New York City's restaurant industry.

Prolonged lockdowns in Democratic states have resulted in more permanent small business closures. At the same time, regulations and taxes are slowing business formation. According to Census Bureau data, Florida recorded twice as many new business applications per capita over the last year as New York.

Democratic-run states are also continuing the Democratic Congress's $300 unemployment bonus through Labor Day, while most Republican governors have ended theirs early.

It is pretty clear which economic policies work - reducing poverty, raising wages and creating jobs - and which lead to the opposite. It remains a mystery to me why so many voters keep electing politicians with the wrong agenda. Do voters like rising poverty? Why not choose politicians who propose policies that benefit them? Charter schools are another issue that bothers me. The evidence is solid that charter schools are the best choice for minorities. When there are charter schools the competition forces the public schools to improve. It is a win-win, especially for the children. Now our Democratic Congress wants to stop the rise of charter schools. I assume that is supposed to benefit the teachers' unions which are solid contributors to Democrat campaigns.

I find politics to be as unpredictable as the stock market. Never-the-less, my instincts say the Democrats will have a bad year come November 2022. If that happens, both the economy and the stock market would benefit.

I will have the next market review and update one week from today on August 4, 2021.

All the best,

John Dessauer