John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday August 3, 2022

The U.S. economy contracted by 0.9% in the second quarter. That is the second back-to-back quarterly decline. Technically that means the economy is in a recession. But it is hardly a recession. The second quarter decline was much less than the 1.6% decline in the first quarter. Fed chair Powell says we really are not in a recession. Treasury secretary Yellen says the same thing. However, there are economists who say we are in a recession and that the decline is going to get worse. Wikipedia has suspended editing for the word recession. The confusion and political blame game is so bad that Wikipedia has been overwhelmed by searches for what the word recession means.

The pessimistic economists could be right. There are plenty of signs that growth is slowing. A survey of small businesses dropped to its most negative level in 48 years. Unemployment is low but weekly unemployment claims have risen by 85,000 since mid-March. Retail sales have softened as consumers recoil from higher prices for food and gas. Businesses generally are becoming more cautious.

In any case this situation is very different from past recessions. Normally the Fed raises interest rates to slow down an overheated economy. This time the fed is raising interest rates as the economy slows.

The political blame game is in full force. Senator Elizabeth Warren is already threatening the Fed, saying that if there is a recession it is all the Fed's fault. She claims the inflation is the product of supply chain issues and the Ukraine war. But if that were

true inflation would not have risen to 7.9% before the war began. She wants to absolve the Biden Administration and the Democrat agenda of spending and easy money policies of having any role in the inflation debacle. But she has no answer for inflation now other than to hope it goes away on its own.

"Considering the mess we're in, an economic paradigm shift is in order. The Democratic economic strategy of vast government spending and easy money has failed. A better agenda would let the Fed target stable prices while policy makers on Capitol Hill and the White House target incentives for growth to counter the tighter money that will be required to reduce inflation.

What would this mean at the current moment? Take all tax increases and more government entitlements off the table. Put a moratorium on new regulations and declare an end to the White House war on fossil fuels. Reduce tariffs and cut trade deals with Britain, Japan and others in the Asia-Pacific that want the U.S. as a trading alternative to China.

Then make permanent the tax cuts in the 2017 reform that expire as early as 2025. Democrats won't do any of this now, but if they lose in November the GOP will have a chance to press a growth strategy. If the economy is in recession, or if there's stagflation, Democrats may have to listen.

Mr. Powell is right that the Fed's overriding duty now is restoring stable prices. The politicians can help by letting the central bank get on with it while doing their job of

restoring pro-growth tax and regulatory policy." (The editors of *The Wall Street Journal, 7/26)*

With wholesale inflation running wild, at 11% in the last reading, economists have every reason to wonder how high interest rates will have to go to knock down inflation. With the last 0.75% rate hike the Fed Funds rate is now 2.5%, up sharply from a year ago, but still way lower than the inflation rate.

There is hope that we won't need dramatically higher interest rates even with our reluctant politicians. The housing market has cooled off in several major markets. The combination of high prices and rising mortgage rates has made homes unaffordable for many potential buyers. Housing is a major component of inflation. It is possible that inflation will come down even with a still strong labor market. After all, inflation has remained very low for years with a strong labor market and booming economy.

As far as the stock market is concerned, we are now in the midst of quarterly earnings reports. With 60 out of the 500 companies in the S&P 500 reporting, overall earnings are down 11% from the second quarter of 2021. And that is far better than many analysts expected. Revenues were up 6.6% and the majority of companies beat expectations. There are still a lot of quarterly reports to go, but so far so good.

The S&P 500 closed July on a positive note, up 9.1%, the best month since 2020. Investors see the slowing economy as a positive when it comes to interest rates. A slower economy could mean the Fed will be able to go slower raising interest rates. The positive July may also mean that stocks have discounted a bigger economic setback than now

seems likely. It is too soon to expect a full recovery, but the July rebound looks as if we have seen the bottom for this cycle.

I will have the next market review and update for you one week from today on Wednesday August 10, 2022

All the best,

John Dessauer

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