John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday August 12, 2020

Newspaper journalists and many TV reporters put a negative spin on every new report on the economy. I assume this attitude is political. It certainly is not fact based. We really have had some good news. Businesses and consumers are adapting, finding ways to meet the COVID-19 challenge. The media fear is that good economic news will help Trump get reelected. So, they dig deep and look for anything that can be given a negative spin. In this dismal environment it was a pleasant surprise to read Joseph LaVorgna's outlook in Yahoo Finance. Joseph is a long-time, highly respected Wall Street economist. He is now serving as a special advisor to President Trump. In a Yahoo Finance interview by Emily McCormick, LaVorgna said: "We're looking at GDP this quarter of 20%. GDP growth of 20% in the second half of 2020 is doable." Wow! While not enough to get all the way back to pre-COVID-19 levels, that would be great news.

The economy plunged 32.9%, the worst quarter on record, in the second quarter. In light of that and the ongoing challenges from COVID-19, LaVorgna's outlook may seem aggressive. In response, he points to the July jobs report as a reason to be optimistic. Payrolls came in better than Wall Street estimates, as did the unemployment rate.

Non-farm payrolls were up 1.783 million, better than the 1.48 million expected.

The July unemployment rate was 10.2%, better than the 10.6% expected.

Average hourly earnings, month over month, were up 0.2%, far better than the 0.5% decline that was expected.

Average hourly earnings, year over year were up 4.8%, versus +4.2% expected.

Beth Ann Bovino, S&P Global Chief economist, agrees. Looking at the July jobs report she said: “I’ll take this report over anything. It’s a positive number.”

The report on U.S. manufacturing in July lends support to the optimists. In July U.S. manufacturing activity accelerated to its highest level in nearly a year and a half. The Institute for Supply Management (ISM) said last week that its index of national factory activity rose to a reading of 54.2 in July, up from 52.6 in June. That was the strongest since March 2019 and marked two straight months of expansion. A reading above 50 indicates growth in manufacturing, which accounts for 11% of the U.S. economy.

The ISM’s forward-looking new orders sub-index increased to a reading of 61.5 in July, the highest since September 2018. The survey’s measure of order backlogs at factories rebounded as did orders for exports.

There are pessimists who disagree. One is Neel Kashkari, president of the Federal Reserve bank of Minneapolis. He sees the continuing spread of the virus as a major threat to the economy. He wants a radical solution, namely a six-week total shutdown of the economy. Otherwise, he argues, the rest of 2020 could be much worse than what America has experienced so far.

Missing from Kashkari’s gloomy outlook is the fast-developing work on a vaccine. Some vaccines are in human trials and the results so far are promising. A vaccine later this year is possible. Or it may be early next year before we have a vaccine that works. But odds on a vaccine are high. And once a vaccine is available the economic outlook will rapidly change for the better.

Looking state by state we see that states that have been slow to open their economy are lagging behind those that have allowed a partial reopening. This real time experience suggest that Kashkari's call for a total lockdown could do more damage than he expects. While there is no doubt the virus remains the critical challenge to the future of the U.S. and global economies, businesses and consumers have in many ways adapted to the new environment.

"With 50% of the U.S. workforce now working from home, US employers have effectively been forced into a radical experimental shift in the location of their workers en masse." (Morgan Stanley, August issue of *On The Markets*) This experiment is working and the number of employees working from home is likely to be greater in the future than before the pandemic.

Working from home has benefits. First, it is based on technology, the internet and connecting devices from computers to smart phones and tablets. The suppliers of all that technology are enjoying rising sales and profits. And that trend is likely to persist long after there is an effective vaccine. Second, work from home offers job opportunities to the disabled and others who are not able to commute to a central office. Morgan Stanley thinks work from home will expand the workforce and improve productivity.

The shift from central office to home has already increased e-commerce. Consumers are shopping online and enjoying home delivery. Even healthcare has adapted with telehealth, virtual meetings between doctors and patients.

Once there is a vaccine the economy is likely to bounce back, raising inflation concerns. Rising inflation would mean rising interest rates and a threat to governments and others who are deeper in debt because of the virus. Morgan Stanley says: "Longerterm, we expect inflation to reemerge more forcefully than in the three previous cycles. We expect Consumer Price Index (CPI) inflation to run right at 2.0% by 2021 and through 2025."

Whew, that would be a far cry from the high, 10%+, inflation rates of the 1970s. While any rise in interest rates will increase debt servicing costs, a 2% inflation rate would not mean devastating interest costs for indebted governments.

There will always be pessimists warning us about possible worst-case scenarios. Looking back, history tells us that they are usually wrong or far off the mark when right. For example, we did not plunge into a depression during the 2008-2009 financial crisis. And we did not suffer sky high inflation after the financial crisis. Odds are we will have a vaccine in time to prevent a worst case COVID-19 economy.

I will have the next market review and update one week from today on Wednesday August 19, 2020.

All the best,

John Dessauer