John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday August 19, 2020

The S&P 500 election indicator I have written about has been picked up by TD Securities, a Canadian firm that provides a wide range of financial services. They came up with the same data, namely that when the S&P 500 stock index rises between August and October the President is reelected. They also point out that no incumbent president has been reelected in the midst of a recession. Recent polls show Biden leading Trump by 8 percentage points. However, that is well below the lead the polls showed for Hillary Clinton three months before she lost the election.

COVID-19 pummeled the economy. The U.S. GDP fell 32.9% in the second quarter. If that happened in more ordinary times that would certainly be a huge negative for a Trump second term. But these are not ordinary times. The consequences from COVID-19 have been like an invasion by a foreign army. I see December 7, 1941 and the Japanese attack on Pearl Harbor as an historical similarity. After that surprise attack the Dow Jones Industrial average plunged, down more than 25%. The numbers are different, but the Dow also plunged after the COVIOD-19 attack. In 1942 the Dow was up, almost 30%. And as we can see the Dow is behaving in a similar way today. In 1942 the economy grew, up 26% over 1941. There are pessimists today who argue that the worst is yet to come from the virus. But others see a 20% jump in this quarter and 20% overall growth as possible for the second half of 2020. The data so far are supportive of the optimists' view.

Last week the number of Americans filing for unemployment insurance benefits dropped to 963,000, below one million for the first time in 20 weeks. Employers added

1.8 million jobs in July. The unemployment rate is down to 10.2%. But there are still ten million more Americans out of work than there were in February. These labor market data show that like 1942, post Pearl Harbor, the economy is bouncing back.

Retail sales data confirm the rebound. Retail sales were up in July for the third straight month and are now at the highest level since the government started tracking the series in 1992. This supports the optimists' view that consumer spending would rebound this quarter after a record collapse in the second quarter.

Looking forward there is concern that consumer spending might slow unless there is another virus relief package from Congress. What is missing in the pessimists' view is the personal savings rate. American consumers have been piling up cash. The personal savings rate was up to 23.2% in May. The rate in 2019 was 7.5%. People are scared. This virus is highly infectious and has taken too many lives. But consumer confidence can come roaring back. We have seen that after past recessions. What is needed today is news that there is an effective vaccine or at least an effective treatment.

So, as Morgan Stanley says, this certainly is the worst recession ever seen and will likely also be the shortest. The economy may not keep roaring ahead in 2021. The rate of improvement may slow down because the virus has done so much damage and it will take time to fully recover and achieve a healthy, sustainable rate of growth.

The bottom line is that this virus-induced recession will not block a Trump reelection. Which leaves the stock market as the best election indicator. The S&P 500 is up so far in August, but with the index near its all-time record high there are doubts about the index being able to stay strong through the end of October. The problem for the worriers is the internal S&P 500 Index data. The Index has been driven by a small percent of the companies in the Index. Half of the stocks in the Index are still down 20% from their respective highs. Only 25% are within 5% of their highs. This means the Index can go higher even if today's leaders do not. A recovery by the laggards would push the Index higher without creating a stock market bubble.

The balance sheets of central banks around the world are collectively growing at a year-over-year rate of 33%. In other words, the global economy is awash in liquidity and there are no signs of that slowing down. At home the U.S. money supply, as measured by M2, is growing year-over-year at a 23% pace. There is a saying when it comes to stocks: "Don't fight the Fed." When the Fed is pumping in liquidity, stocks are not likely to go down. Of course, there can be short term ups and downs, but the underlying trend is not likely to be down as long as the Fed is accommodative. Not only is our Fed being accommodative, central banks around the world are also providing unprecedented liquidity. This supports stock markets around the world.

Can the S&P 500 stay above the August 1 closing level? The data say yes, that is possible, and it can be done without today's leaders galloping to further heights. The unique economic attack by the virus likewise is not necessarily a negative for a Trump reelection. The economy has already bounced back and can keep improving, albeit at a slower pace.

Wall Street analysts are looking closely at Biden's proposed policies and at Trump's record. Based on what is known so far, a Trump victory would be more favorable for both the economy and the stock market. The great unknown is what would happen if Democratic gains tip the Senate away from Republicans. A policy shift toward extreme socialist ideology would be a negative for both stocks and the economy.

There is a lot at stake in the coming election but there is no way of knowing the outcome until the votes are counted. Our best strategy is to keep watching the data on earnings and the economy.

I will have the next market review and update one week from today on Wednesday August 26, 2020.

All the best,

John Dessauer