John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday August 21, 2019

Marilynn and I are in Vancouver British Columbia at the Fairmont Waterfront hotel, across the street from Canada Place the cruise ship terminal. Saturday there were two ships here, the Royal Princess, 3,600 passengers and the Holland America line's Nieuw Amsterdam, 2,100 passengers. Imagine 5,700 passengers a day landing in the port of Seattle Washington during the Alaska cruising season. That would be an economic boom for Seattle and the state of Washington. But, because of a law called the Jones Act, passed during the Alaska gold mine rush, Vancouver, Canada is the prime beneficiary of the booming Alaska cruise business.

The Jones Act is part of a Maritime law passed in the United States in 1920. It is clearly protectionist. It says that cabotage, meaning people or goods, can only be carried between U.S. ports by ships built, owned and operated by U.S. citizens or permanent residents. The Jones Act should have been repealed decades ago. The port of Seattle is not the only U.S. victim of the Jones Act. Hawaii, Alaska and Puerto Rico pay inflated prices for goods shipped from U.S. ports because the number of ships that can qualify under the Jones Act is very small compared with the global supply of ships.

A few years ago, we ran into the Jones Act when we were on a cruise that stopped in Key West. Marilynn's oldest son lives in Key West. We carried Christmas presents for him on the cruise ship. When we tried to go ashore with the packages, we were stopped by a uniformed U.S. customs official who made it very clear that we could not bring the Christmas presents ashore in Key West. Talk about unintended consequences. I doubt the Jones Act was ever meant to restrict family to family Christmas present deliveries. Yet we are still spending taxpayer dollars to enforce the Jones Act in Key West and other U.S. ports.

President Trump likes to claim that the U.S. is not protectionist, but he is not entirely correct. The Jones Act is a clear example of U.S. protectionist legislation. Our trading partners complain of other laws and regulations that act in a protectionist manner. It is way past the time when President Trump and the Congress should have cleaned out old, outdated protectionist laws like the Jones Act.

On August 14 Fox News carried this headline: “Recession indicator with perfect track record flashing red.” Shortly thereafter the Dow Jones Industrial Average fell 800 points in a single day. Yield curve hysteria was the cause. The Fox News headline is at best misleading. For example, after the yield curve inverted it sometimes took two years before the recession developed. In other words, if the inverted yield correctly forecasts the next recession, it might not happen until the late summer of 2021. We have national elections next year. Our Federal Reserve is already cutting interest rates to blunt the slower rate of growth. Lots of powerful economic forces can change between now and 2021. In addition, the inverted yield curve has been no help at all in predicting the length or severity of the following recessions.

Francis Gannon, Co-Chief investment officer and managing director of the Royce Funds has this to say about the yield curve hysteria: “I think investors have been over-focused about a recession coming and the headlines have confused people. What is happening is a slowdown in the rate of growth—the most normal thing in the world. We are not going into anything like a recession. So, I think investors are overreacting to that.

Second, inflation coming down or not going up dramatically is in general, a very positive thing. So, we're having a very good combination really for stocks overall."

Kevin Matras, Executive Vice President at Zacks Investment Research agrees:

"The U.S. – China trade tensions remain. There was a bit of de-escalation on Tuesday after the White House announced a 3 ½ - month delay to more than half of the $300 billion in additional tariffs until December 15th. But that good cheer was short-lived since those tariffs weren't removed, just delayed.

But quite frankly, none of the additional tariffs may ever go on. September 1st is when the remaining tariffs are supposed to go into effect. But those too could be postponed like they were ahead of the June trade talks and G20 meeting.

But none of this is new news.

The only thing that was 'new' was the latest yield curve inversion of the 10-year Treasury vs. the 2-year Treasury.

But the hysteria surrounding this has defied logic.

Article after article became more and more breathless with warnings of an impending recession – maybe 2 years down road or more.

Really?

Nevermind that the 30-year is still well above the 10-year. Nevermind that the economy often expands after an inversion. And nevermind that the stock market typically goes up afterwards on average of 16%.

If anything, an inversion is one of the best buy signals ever!

The quickest way to stop the insanity of this yield curve obsession is for the Fed to cut rates. That will push short-term yields down further, where they belong, and correct the inversion."

Thank you, Kevin Matras - that is the clearest analysis of the current situation that I have seen.

The protests in Hong Kong have not stopped, they have gathered strength. The relatively new Hong Kong airport had to shut down, cancelling all flights twice.

Xi Jinping, China's president is reported to have been enraged by the high-level reception given in recent weeks to leading members of Hong Kong's pro-democracy camp during visits to Washington. While that is probably hardening Beijing's stance in the trade talks, I think it is very important for the United States to support the peaceful pro-democracy protestors. No one knows how the protests will end. If China uses military force the consequences for Beijing would be severe. As *The Economist's* editors say: "Hong Kong is hugely important to the main-land. Cross-border lending booked in Hong Kong, much of it to Chinese companies, has more than doubled in the past two decades, and the number of multinational firms whose regional headquarters are in Hong Kong has risen by two thirds."

Putting the protests down with military action would jeopardize China's stability and prosperity. Beijing has a Hong Kong problem and the world is watching to see how it is finally resolved.

I will have the next market review and update for you one week from today on Wednesday, August 28, 2019.

All the best,

John Dessauer

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