John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday August 26, 2020

The United States has been spending trillions of dollars in an effort to keep the economy from total collapse. European countries have been doing the same. And more trillions are being spent by Japan and other countries.

What is not showing up in media headlines is how much is being spent to develop a vaccine against COVID-19. The editors of *The Economist* in the August 8 issue had this to say: "The world is not spending anywhere near enough on a coronavirus vaccine." They calculate that a mere $10 billion or so has been devoted to vaccine development. The problem is that spending billions on vaccines that may not work is seen as an extravagance. The editors of *The Economist* say the world needs to look at such spending as an insurance policy. There are several vaccines that are now in large scale clinical trials. The media keep reporting that several vaccines are showing promise. What they don't say is that some will fail, perhaps as many as 20%. And those that make it to final approval may not be suitable for the elderly or may not provide full protection. Far better *The Economist's* editors say is to have many more vaccines in development than to end up with too few, or vaccines that do not provide full protection. They also say that raising vaccine spending from $10 to $200 billion is a wise investment. If that brings an end to the virus just one week earlier than otherwise, the boost to the global economy would be tremendous. However, the idea of deliberately overproducing something does not sit well with politicians. They will spend trillions of dollars to appease voters but miss the point that we should be throwing a lot more money at vaccine development.

The current state of the U.S. economy shows us that spending trillions to prop up consumers and businesses has its limitations. Yes, we have had a strong rebound from the devastating second quarter. And third quarter growth is likely to be in the 20% range. But there are signs that the economy is flattening out.

The Labor Department reported that the number of people filing new unemployment claims rose by 135,000 to 1.1 million last week. Economists expected a continuing decline in new claims. And claims for unemployment benefits remain higher than at any other time on record.

The Commerce Department reported last week that retail sales rose by 1.2% in July from June. That was less than the 2.3% economists expected. But retail sales in June were revised up from +7.5% to +8.4%. The broader message is that after plunging in March and April and rebounding in May and June, consumer spending hasn’t been doing much of anything lately. JP Morgan Chase credit and debit-card data confirm that since June consumer spending has been basically flat.

In ordinary times the private sector provides the tax revenue that supports government. Covid-19 has turned that on its head. Now governments are borrowing to keep the private sector afloat. Obviously, this is not sustainable. There are limits to how much governments can borrow. And borrowing heavily raises the risk of rising debt service when interest rates rise. There is only one practical way to reverse the current situation and get back to normal with a strong and growing private sector. That is to have an effective vaccine. The bottom line is that the editors of *The Economist* are right. The world should be committing far more money and resources into the development, production and distribution of an effective vaccine. Otherwise we can only hope that the scientists at the pharmaceutical companies will get a breakthrough soon enough to save the day.

Goldman Sachs says the S&P 500 will rise 7% more this year. Unless the stock market hits an air-pocket in October that will likely mean a higher close in October than in August, signaling a win for Trump reelection. The Goldman Sachs reasoning is similar to mine. Goldman analysts point out that more than 25% of the stock market's rebound from the March plunge has been driven by 5 stocks: Apple, Microsoft, Amazon, Alphabet and Facebook. These five leaders could stay where they are and the Index could rise as the many laggards improve.

Corporate profits took a big second quarter hit, down 35.4% on a revenue decline of 11.3%. Goldman analysts think that will change and we will see corporate profits bounce back soon. The details from the second quarter support Goldman's earnings optimism. In the second quarter, bad as it was, 80% of reporting companies beat consensus earnings-per-share estimates and 63% beat revenue estimates. Goldman has raised its year-end S&P 500 Index target from 3,000 to 3,600, 6% better than last week's close. The Wall Street consensus for S&P 500 earnings in 2021 is $165 a share. Goldman thinks that is too light and instead is looking for $170 in 2021 per-share earnings.

Goldman also believes investors will pay a higher multiple for stocks. Before the pandemic, the S&P 500 traded at 17 times expected 2021 earnings. Now the multiple is about 20 and Goldman believes by the end of this year the multiple will be 21 times 2021 expected earnings.

Goldman expects that there will be at least one approved COVID-19 vaccine by the end of this year, with widespread distribution by mid-2021. As far as risk from the

November election is concerned, Goldman is more relaxed than some others. Their analysts see the stock market as already pricing in a Democrat victory and higher corporate taxes. But they also see policy changes in fiscal spending and trade that would make up for the lost profits.

I am more worried about the election than the Goldman analysts. A move toward the Green New Deal could be a problem. California has had anti-fossil fuel policies for a while. The result is that now during a heat wave, the air conditioners and lights in parts of California go out when the sun goes down. There used to be natural gas electric plants that provided back-up for solar. But several have been shut down because they could not compete with heavily government subsidized solar. There is a lot more to the story of California and its misguided green policies. For example, California imports some electricity from neighboring states who use coal, oil and natural gas fired electric generating plants. That is not exactly going green. My fear is that the left might impose economically damaging green policies if they have the chance. Every time I look out the window, I see trees, plants and flowers using photosynthesis, converting carbon dioxide into oxygen. What we need is a technological breakthrough that can do the same on a large scale. Better to stay rich and be able to finance that research than to hurt the economy and accomplish nothing.

I will have the next market review and update one week from today on Wednesday September 2, 2020.

All the best,

John Dessauer