John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday September 7, 2022

Investors are worried about three things: interest rates, inflation and the economy. There are some signs that the economy and therefore inflation are cooling. Home sales have softened as rising mortgage rates make high priced homes less affordable. Used car prices have stopped rising and come down a bit. The Labor Department's report on jobs in August was initially followed by a sharp rise in stocks. But as the day wore on stocks gave up the gains and ended down for the week.

There were 315,000 new jobs created in August. While that is still a good number it was down sharply from July's 526,000 new jobs. The red-hot jobs market is at last cooling off. The unemployment rate ticked up to 3.7% in August, from 3.5% in July. That is also going in the right direction as far as inflation is concerned. Employers are finding it easier to hire workers. That will ease the upward pressure on wages. Average hourly earnings rose 5.2% in August, down from 5.6% in July. Some economists now think the Fed funds rate will go to only 4% to bring inflation under control. Whether "under control" means the Fed's 2% target or higher remains to be seen.

Clearly deflation is just as destructive as high inflation. That is why the Fed and other central banks have an inflation target. But why 2%? It turns out that the central bank of New Zealand was the first to choose 2% as their inflation target. The country's lawmakers agreed. That was back in 1989. The 2% rate was not the result of tedious economic study or analysis. It was the result of a casual comment by a finance minister. And over time central banks around the world, including the United States, followed New

Zealand's lead and chose 2% as their inflation target. Should that arbitrary rate be changed? Raising the target to 3% or 4% would make bringing inflation under control a lot easier and require less in the way of interest rate hikes.

The editors of *The Economist* have this to say on the subject: "If the costs of a slightly higher inflation rate are small, the benefits are potentially sizeable. Chiefly, it could help central bankers avoid the so-called zero lower bound on nominal interest rates. Interest rates cannot go too far into negative territory, because they risk destabilizing the banking system: depositors could always choose to empty their bank accounts and hold cash, which in effect carries an interest rate of zero instead.

Higher inflation targets are a different solution to the problem of the lower bound. If the public expects the central bank to generate more inflation in future, then the interest rate, in real terms, can still be sharply negative, stimulating the economy even without nominal interest rates needing to venture below zero. Allowing moderately higher inflation in normal times could therefore make it easier for the central bank to give a boost to the economy when trouble hits."

Will our Federal Reserve formally change the 2% inflation target? Perhaps, but they could simply allow inflation above the 2% target without formally making the change. In fact, that is what I expect. The Fed will stop raising interest rates as soon as the inflation rate shows real signs of declining.

Meanwhile Fed Chair Powell has to deal with political leaders like Senator Elizabeth Warren who is showing her economic ignorance. She has been bashing the

Federal Reserve, arguing that 9% inflation is better than driving the economy into a recession and higher unemployment. She is 100% wrong. With wages rising at about 5%, 9% inflation is destructive. Workers are losing buying power. That leads to slower growth and financial misery. In addition, 9% inflation erodes contracts that were signed when inflation was lower. People despise high inflation because it is so financially painful. Senator Warren should climb down from her ivory tower and connect with people, especially those in the lower income brackets. They are being severely punished by the inflation that was initially ignited by her President and fellow Democrats. Go ahead and blame the Fed if a recession develops. And then give the Fed the benefit when worker real wages increase, and the economy enters a new cycle of real growth. I am sure she will not do that. Instead, she will try and take credit for the good times when they return.

Meanwhile, as I wrote last week, I expect investors to remain cautious until inflation really starts coming down. When that happens stocks will rebound.

We are still in the far north winding our way through the ice and visiting the few settlements in this part of Canada. Natives have been living here for a very long time. To my eye the land looks barren, and the wildlife are few and far between. It is amazing that people have managed to generate electricity, build schools and small hospitals. In Resolute, our farthest north stop we met a Royal Canadian policeman. He has been in Resolute for several years, making about 60 arrests a year. Now he and his wife have purchased a home in Ohio and are headed there before winter arrives in Resolute.

The internet is good when it is available, but still spotty. I will try to have the next market review and update for you one week from today on Wednesday September 14, 2022

All the best,

John Dessauer