John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday September 9, 2020

Thank goodness the progressive economists' pessimistic predictions came up wrong. In June and early July, as COVID-19 cases and deaths were surging, they confidently warned that the worst was yet to come and that we should expect the economy to be falling off a cliff in August. That view gained popularity because the Virus is so scary and is forcing major changes in consumer behavior. But last Friday we learned that the scary economic forecasts were wrong. The jobs report for August is described in *The Wall Street Journal* as a "blowout." The economy added 1.4 million jobs in August and the unemployment rate declined 1.8% to 8.4%

Job growth was especially strong in lower paying businesses such as retail, leisure and hospitality. Unemployment rates fell sharply among teenagers, blacks and Hispanics.

Here is *The Wall Street Journal's* conclusion: "All of this means the economy is growing again as the lockdowns ebb and despite the lack of another spending blowout from Washington D.C. The downturn was a recession, not the depression that many feared in March. The Atlanta Federal Reserve's GDPNow formula is predicting third-quarter growth of nearly 30% year-over-year."

While that would not be enough to get the economy all the way back to pre-pandemic levels it would be a shock to pessimists and welcome good news for the rest of us.

Good news about manufacturing confirms the optimistic outlook.

"Manufacturing is usually one of the worst places to be when a recession strikes. But not this time. The Institute for Supply Management on Tuesday said that its index of manufacturing rose to 56 in August from 54.2 in July, extending its rebound from March when it fell to 41.5. Anything above 50 represents expansion." (*The Wall Street Journal, 9/2*)

The good news does not cover the whole economy. Manufacturing is being driven by consumer spending on goods such as cars. That is not the case for services. Spending on services in July was still 9.3% below its February level. That means there is room for improvement, and when spending on services recovers the economy will get another boost.

The stock market has been following the good news, at least that was the case until last week's one day 900+ point plunge in the Dow Jones Industrial Average. The technology heavy Nasdaq was hit even harder. To be sure, a correction of some sort was overdue, but that sudden and steep fall was not expected. Now as analysts look at the details, we see some interesting data. There has been a boom in individual investor stock market trading. It seems that many individuals who are staying home because of the virus have taken up stock market trading as a way to keep busy and maybe make some money.

According to Larry Tabb, head of market-structure research at Bloomberg Intelligence, trading by individuals accounts for a greater chunk of market activity than at any time during the past 10 years.

During the first six months of this year, individual investors accounted for 19.5% of the shares traded in the U.S. stock markets, up from 14.9% last year and nearly double the level from 2010.

Joe Mecane, head of executions services at Citadel Securities, an electronic-trading firm, says that on some days this year, about 25% of market volume has been individual-investor activity.

Individual investors have also been very busy buying call options, especially on the big technology companies. Data by the Cboe Options Exchange shows that U.S. equity call-options volume has risen 68% this year. That compares with 32% for put options. The gap is strong evidence of individual or amateur investors trading in call options.

A call option gives the buyer the right, but not the obligation, to buy a stock at a fixed price over a specified period of time. Call options are attractive because an investor can bet on the stock rising at a much lower cost than buying the shares. In addition, the call option limits the downside if the overall stock market tanks.

The question is who supplies the call options? Who is on the other side of the deal? The answer is banks. When the number of call options surged this year, banks had an incentive to buy the underlying stocks in case the call options were exercised. With the call options heavily weighted in technology shares, that meant bank buying provided a further lift to those stock prices, encouraging more call option activity. That set the stage for increased volatility, especially in technology stocks. All options, including call options, expire on a Friday. That means lots of activity on the previous Thursday in anticipation of the expiring options. And that is why last Thursday the stock market came down, led by technology stocks.

Prior to Thursday's decline the U.S. stock market had been very strong, reaching new highs. So it isn't right to put all the blame on individual investor call option activity.

But clearly the call option activity aggravated the decline. The lesson from this is: don't change your investment strategy when there is a scary stock market decline, because it may be overdone due to unusual undercurrents. Will there be more scary stock market days? Most likely yes.

SunTrust Investment Advisory Group Points out: "Another sign of strength is that the S&P 500 is now set to have risen for five straight months. This has only occurred 27 previous times since 1950. Following 26 of those previous instances, or 96% of the time, stocks were higher 12 months later. This is consistent with other studies we have highlighted over recent months that provide evidence that strong momentum in the first stage of a bull market is common and typically a good longer-term sign."

Here we are, trying to be patient while waiting for the vaccine that will relieve us from the virus, worried about the future for our portfolios, and SunTrust Advisors think a new bull stock market has begun! Well, they are not alone. Here is a quote from Morgan Stanley in the September issue of *On the Markets*, written by Michael Wilson, chief investment officer: "In Late August, the S&P 500 index struck *all-time highs* six days in a row. While this may seem inconsistent with the state of the economy, high unemployment and new cases of COVID-19, markets are forward looking and the stock market is telling us the future is bright. I agree with this view, and believe that a new bull market began with the onset of the current recession."

If these professionals are right, we will enjoy significant future profits as a reward for our patience.

I will have the next market review and update one week from today on Wednesday September 16, 2020.

All the best,

John Dessauer

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