John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday September 28, 2022

We are home. The Northwest Passage cruise turned out to be more exciting than we expected. The typhoon really made a mess out of the last few days of the cruise. We spent two extra days on the ship anchored in a safe sheltered bay. The biggest concern for us was not so much the wind as the sea condition. There were reports of waves 40 and 50 feet high in the open sea. That would have been too much for the small Silver Wind. The captain did a great job, and we are safe and sound.

To get home we flew from Nome to Anchorage, then to Seattle, then to Minneapolis and finally to Ft, Myers and home. All four of the flights were fully booked. Gate agents asked for volunteers to check their carryon bags. One flight was oversold, and they offered $1,000 cash to anyone who would change their flights. The airports were also very busy. The airlines have cut back on the number of flights but with planes flying fully booked they must be doing well financially. When you see busy airports and fully booked flights you wonder if the economy is in a recession or near a recession. No wonder there is so much confusion about the state of the economy and the Fed's inflation battle.

The stock market has been acting as if we are in for a long inflation fight with much higher interest rates and a nasty recession. The stock market could be very wrong. Consider the following analysis from MorningStar

"Why we Expect Inflation to Fall in 2023."

“A deeper look at the data suggests less reason for concern around longer-term inflation.

Inflation in 2022 is set to peak at its highest level in four decades.

High demand has conspired with supply constraints to cause price surges in many industries, hitting energy and autos especially hard. But once these supply constraints eventually resolve, we expect the various price spikes to unwind in a deflationary rush. Combined with the effect of the Federal Reserve interest-rate hikes, we expect inflation to recede back to normal in 2023 and thereafter.

We forecast inflation to average 2.4% over 2022-26 as a whole (in terms of the personal consumption expenditures price index), only slightly above the Fed's 2% target. The year 2022 will deliver the worst for inflation (5.9%), but over 2023-26, we expect inflation to average just 1.5%.”

Morningstar is not alone. T. Rowe Price says: “Signs of inflation cooling quicker than expected.”

The stock market has been falling because of fear that the Fed will have to raise interest rates to a level higher than inflation as they did in the 1980s. However, that is not likely to be the case. Today’s bout of inflation is very different from the 1970s.

“Though the short-term inflation rate is striking, a deeper look at the data suggests less reason for panic around longer-term inflation.

For one thing, a handful of categories are responsible for today's high inflation, and we don't expect pricing pressure in these categories to persist. In a repeat of the

1970s “Great Inflation,” we should be witnessing broad, economywide inflation, but we haven't seen it occurring. If inflation is attributable to specific issues in a few industries, then it is a problem that can be eventually fixed.

A key reason we're sanguine about inflation is expected lower energy prices. Morningstar's energy team forecasts oil prices to fall from an average $97 per barrel in 2022 to $55 per barrel in 2025 (West Texas Intermediate)—about where prices were in 2019 before the pandemic.

Oil prices have skyrocketed as sanctions and boycotts have disrupted Russia's oil supply. Compensating for Russia will take some time, but we expect producers in the U.S. and elsewhere to steadily ramp up production until prices fall back to the marginal cost of production, which we assess at $55.

The contrast with the 1970s oil price shock could not be greater. Oil prices first tripled in 1973 and ended the decade up 11 times versus 1970 levels. There were short-run disruptions that contributed to that surge, but the long-term story was the awakening of OPEC's market power, which never returned to the rapid production growth exhibited in the 1960s. Also, other cheap sources of crude had been tapped out by this time, necessitating a shift to offshore drilling and other, more-expensive sources.

These kinds of secular drivers of higher prices explain why the 1970s oil shock never fully receded—but secular drivers aren't at work in today's oil price surge.” (Morningstar September 7, 2022)

If the analysts at Morningstar are right, stocks will, at the least, fully recover.

Analysts at T. Rowe Price independently agree with the Morningstar outlook. Inflation is not just coming down - it is effectively going away. Notice that the Morningstar outlook is more 2023 focused. That means the really good inflation news will not develop until after the midterm elections. Stocks could react positively after the November elections and then get another boost when the 2023 outlook improves.

Meanwhile we have to live with a weak and volatile stock market. But this is late September so we will not have to endure the wild stock swings much longer.

I will have the next market review and update for you one week from today on Wednesday, October 5, 2022.

All the best,

John Dessauer