John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday September 29, 2021

"Europe is showing the folly of trying to purge CO_2 from the economy. No matter how heavily subsidized, renewables can't replace fossil fuels in a modern economy" (*The Wall Street Journal*, Sept. 16)

In early September electricity prices in the UK jumped to a record $490 per megawatt hour, a 700% increase from the 2010 to 2020 average. Germany's electricity benchmark has doubled this year. Other European economies are suffering similar spikes.

"Europe's anti-carbon policies have created a fossil-fuel shortage. Governments have heavily subsidized renewables like wind and solar and shut down coal plants to meet their commitments under the Paris climate accord. But wind power this summer has flagged, so countries are scrambling to import more fossil fuels to power their grids.

European natural-gas spot prices have increased five-fold in the last year. Some energy providers are burning cheaper coal, but its prices have tripled. Rising fossil-fuel consumption has caused demand and prices for carbon permits under the Continents cap-and-trade schemes to surge, which has pushed electricity prices even higher.

The U.S. is the world's largest gas producer but isn't immune from turmoil in energy markets. Natural gas spot prices in the U.S. have doubled over the past year in part because producers have increased exports to Europe and Asia. Exports are up more than 40% during the first six months this year over last.

This underscores how fossil fuels are a U.S. economic and strategic asset. The Biden Administration's plan to curtail oil, gas and coal production by regulation would empower adversaries, especially Russia, Iran and China which are the world's three largest gas producers after the U.S." (*The Wall Street Journal, Sept. 16)*

President Biden had border security and energy independence as givens when he took office. The southern border is a huge humanitarian crisis, and his climate related policies will make the U.S. once again dependent on foreign suppliers of fossil fuels. After shutting down oil and gas providers in the U.S. he pleaded with Saudi Arabia and other OPEC nations to increase production of gas and oil. Why? Because his policies were driving up gasoline and home heating prices. In my view the editors of *The Wall Street Journal* are right to be sharply critical of the President and his Administration's climate policies. As can be seen here and abroad, going green is very expensive. Policies that diminish economic activity and wealth are counter-productive.

As we have seen in the past, rising energy prices can spill over and push overall inflation rates higher. The Federal Reserve has already nudged up their forecasts for core inflation. Last September the median forecast by the Fed officials was for core inflation in 2022 of 1.8%. The forecast released recently has 2022 core inflation at 2.3%. Fed Chair Powell has made it very clear that tapering and raising interest rates are separate considerations. It makes no sense to raise interest rates while buying bonds. The two are mutually exclusive. Raising interest rates is monetary tightening to rein in economic activity. Buying bonds is the opposite - a policy designed to keep interest rates low.

In the statement following the Fed meeting earlier this month the policy-setting committee said that a reduction in the central bank's monthly asset purchases "may soon be warranted." In other words, unless the economy deteriorates, the Fed will start tapering at the next meeting in November. By sometime in the middle of next year the bond buying will have fallen from $120 billion a month to zero. Quantitative easing will end and a rise in interest will likely follow. Nine of the 18 officials on the policy-setting committee expect to raise interest rates by the end of next year. Of course, it all depends on the state of the economy. Will the pandemic really be over, or at least almost over? Or will the Delta variant persist and keep workers and consumers at home? At this point no one - not even the Fed officials - knows what it will be like in the middle of next year. So what we are seeing in the Fed's plans is a hedge, getting ready to raise interest rates, when necessary, but not being specific on timing or amount. The bond market has taken all the news and discussion in stride. Bond yields declined slightly after the Fed meeting.

Whether the economy heats up, stays the same or cools down will largely be determined by consumers. The good news is that American households are sitting on a lot of savings. Last Thursday the Federal Reserve reported that the net worth of U.S. households was $134 trillion in the second quarter—up from $128.4 trillion in the first quarter. That figure was $110 trillion in the fourth quarter of 2019 before the pandemic took hold.

Much of the increase in wealth came from rising home and stock prices. But an increase in cash also contributed to the gain in wealth. The amount of cash and cash equivalents on household balance sheets rose to $16.5 trillion in the second quarter, up from $12.7 trillion at the end of 2019. The wealthy enjoyed a lot of the gain in wealth. But cash-holding levels among the bottom 50% of households by income were 37% higher than before the pandemic.

Clearly American consumers have the cash to spend. But will they spend or stay finically secure? In my view they are likely to hang on to more cash than they did before the pandemic. They have a new appreciation for having a financial buffer. And consumers are likely to be concerned about spending and taxing plans being discussed in Washington. I therefore expect the rate of economic growth to slow in 2022 but still be healthy. The economy should be able to remain strong enough that the Fed can stop the bond buying. But not so strong as to warrant a rise in interest rates. For now, the climate remains favorable for the stock market.

I will have the next market review and update for you one week from today on Wednesday October 6, 2021

All the best,

John Dessauer