John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday September 30, 2020

Remember the phrase "peak oil?" For at least three decades pessimists insisted that the amount of available oil had begun declining. They confidently predicted high and rising oil prices. Oil was supposed to take such a big bite out of consumers' income that the whole economy would suffer. For a short while this dismal view looked correct. Oil prices did rise, reaching roughly $149 a barrel in June of 2008. However, since then oil prices have come down. It turned out that there is a whole lot more oil than the "peak oil" crowd believed. American ingenuity made a major contribution with the creation of fracking and horizontal drilling. So, for the last twelve years oil prices have been declining. OPEC oil producers have done their best to counter the decline by limiting production. But supplies have been so plentiful that shifts in OPEC production have had very little impact on prices.

Then came the COVID-19 pandemic, which took a big bite out of global economic activity. That, in turn, took a bite out of demand for oil. While the pandemic has been a shock for everyone, it has been an awakening for oil producers. Instead of "peak oil" experts now talk about "peak demand." As they look out to the long-term, post-pandemic world they see demand for oil steadily declining. The reasons are a combination of several factors including governments supporting renewable sources of energy and consumers favoring lower energy appliances and electric cars.

Executives at the oil giant BP argue that 2019 might be the peak in demand for oil. Others think the peak will come later in the mid-2020s or possible as late as the mid-2030s. But all agree that demand for oil is headed for a long-term decline.

In the 1970s OPEC all but strangled the U.S. economy. Rising oil prices sparked a surge in inflation and interest rates. The economy sagged and the stock market plunged. It took until the late 1980s for the U.S. and global economies to adjust to the new reality of OPEC power and high oil prices. And it would be several more decades before American ingenuity boosted the supply of oil and ended OPEC domination.

Now the oil story has come full circle. We are back in a world with plenty of oil at affordable prices. And better yet, oil and OPEC are no longer a threat to the rate of inflation and economic activity. Yes, there are and always will be threats to worry about, but the oil monster is gone and may never come back. This is very good news for the stock market. The long-term outlook for stocks has improved. Now we need a vaccine to end the pandemic. Thanks to the big pharmaceutical companies there are resources that will produce a vaccine soon. It used to take a decade to produce a virus vaccine. But companies including Johnson and Johnson have been working on virus vaccines for more than a decade. As a result, we will have a COVID-19 vaccine in record time.

Consumers account for roughly two-thirds of the U.S. economy. That is why retail sales are closely watched. The Commerce Department reported that retail sales rose 0.6% in August. That was slightly less than the 0.7% expected by economists. It was also down from the July 0.9% rate. And the July rate has been revised down from the earlier report of a 1.2% increase.

The moderation in retail sales growth is most likely due to a rise in Consumer savings. The U.S. personal savings rate was 8.1% in August of 2019. For August this year the rate is up to 24.6%. That is a huge change, probably unprecedented.

According to new research by Morgan Stanley economist Ellen Zentner U.S. consumers, between April and July this year, have accumulated an astounding $12.5 trillion in cash. Zentner added that the cash hoarding has been across all income groups. This runs counter to past instances of cash hoarding. In the past wealthier households would accumulate cash during tough economic times, while lower income households were forced to spend savings due to job losses.

The trillion-dollar question is what consumers will do with all the cash once the pandemic is over. Big retailers like Walmart are warning that consumers are being very cautious about back-to-school spending in September. But I doubt the pandemic has permanently changed consumer saving and spending habits. I believe consumers will go back to the familiar pattern once there is a vaccine and the pandemic winds down. In support of that opinion are data showing that household credit card debt was at an all-time high in May of this year. My conclusion is that American consumers are much better at managing their finances than they are given credit for. Pessimists often pointed at American consumers as spendthrifts with no financial discipline. The dramatic rise in the savings rate and cash accumulation says that consumers will adapt and change their spending patterns when required. The bottom line is that American consumers and therefore the economy is in better condition than was feared back in March.

Regional surveys from the Federal Reserve Banks of New York, Philadelphia, Richmond, and Kansas City show that the number of manufacturers that expect to increase capital spending is on the rise. Capital spending by business is a key component of economic growth. The fact that it is on the rise during the pandemic is welcome news. It suggests that there be will adequate capacity to serve pent up demand after the pandemic. Consumers will find the goods they want when they decide to spend some of the accumulated cash. In other words, there is likely to be a burst of economic activity once a vaccine is available. Of course, things will settle down after the savings rate gets back to 8.1%. But that will be good news. We don't want growth to surge too long because that would lead to unwanted inflation. A short-lived spending spree will be fine, enough to lift confidence but not so much as to be followed by inflation and rising interest rates.

I will have the next market review and update one week from today on Wednesday October 7, 2020.

All the best,

John Dessauer