John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday October 21, 2020

World Bank chief economist Carmen Reinhart warns that the pandemic is "morphing into a major economic crisis, with very serious financial consequences." Her concern is that too many of the loans now being financed by banks will not be repaid. Central banks are flooding economies with cash and keeping interest rates low by buying bonds. This is encouraging borrowing from banks by businesses and consumers. She added: "the longer the uncertainty, the longer the pandemic works its way through the global economy, the bigger the balance sheet damage."

Banks have given extensions to businesses and households in loan repayments. Reinhart says: "When the dust settles, some of those loans are not going to be repaid." And that, she added, would likely have big consequences for bank balance sheets.

Maybe, but that is far from certain. Central banks are well aware of the COVID-19 threat and have been buying bonds and keeping interest rates low. Inflation so far is subdued and no threat to banks or consumers. No doubt there will be long-term consequences from the pandemic, we probably will be working our way through those consequences for years to come. However, forecasting a global financial crisis does not help. The current challenge for governments and central banks is mitigating the damage being done by this highly contagious and lethal virus. The threat will not diminish until there is an effective vaccine that is widely available. And scientists at major pharmaceutical companies are likely to achieve that goal in record time.

"It is important to remember the 2020 recession was caused by a self-induced shutdown and not structural or cyclical imbalances. As such, and with the help of

absolutely massive global fiscal and monetary stimulus, the economy was able to restart fairly quickly.” (Zack’s Investment Management 10/17)

Yes, Ms. Reinhart is correct to think about all the long-term consequences from the massive fiscal and monetary bailout. But where would we be now if central banks and governments had been more timid? Common sense says we would already be in a very serious economic crisis. Far better to provide the stimulus, keep the U.S. and global economies from collapsing, and have confidence that after the pandemic, economic growth will return and provide support to deal with banking and other consequences. Success in mitigating the current damages is a strong, positive indicator that post-pandemic challenges will also be met with success.

Closer to home the focus is on the soaring U.S. federal government budget deficit. The U.S. Treasury says the budget deficit tripled to a record $3.1 trillion in fiscal 2020. Government spending soared 47% in the year ended September 30, as the government rolled out spending programs to battle coronavirus and recession.

The budget gap in 2020 hit roughly 16.1% of GDP, the largest since 1945 when the country was financing massive military operations during world wat II. Federal debt has reached 102% of GDP, the first time it has exceeded GDP in more than 70 years. That puts the U.S. in a league with Greece, Italy and Japan - not good economic company.

The International Monetary Fund last week said that global public debt is likely to approach a record 100% of output but urged policy makers to maintain spending to help vulnerable groups and promote a strong recovery. The IMF said the global recession

won't be as deep as it projected earlier, thanks in part to massive deficit spending by advanced and major emerging-market economies.

To cover the budget deficit, the Treasury has sold a flood of new securities, boosting total government debt held by the public to $21 trillion, a 25% increase from the beginning of the fiscal year. Investors have been quite relaxed about the massive debt increase. Yields on government bonds were little changed after news of the huge increase in spending and borrowing. One concern is how much can the U.S. borrow before running into market limits. But so far there is little evidence that the U.S. is approaching the limit of its ability to borrow. Investors - domestic and foreign - are eager to keep buying Treasury debt that is considered to be ultra-safe. Solid demand for Treasury debt has kept interest rates near record lows. That has translated to lower debt-servicing costs for the government, which declined 9% in fiscal 2020 from a year earlier.

Until the pandemic gripped the economy the federal deficit was about the same in fiscal 2020 as in 2019. Federal spending from October through March was up 6.8%, while revenue rose 6.4%. By contrast, from April through September, spending was nearly twice as high as it was during the same six-month period a year earlier and revenues fell 7.1%. That combination caused the deficit to climb 715% in the second half of fiscal 2020 compared with the same period in fiscal 2019.

William Hoagland, senior vice president at the Bipartisan Policy Center, a centrist Washington think tank, said: "Unprecedented times call for unprecedented deficits. Today's deficit figure is the result of six months of fighting the pandemic and its economic fallout."

To put the pandemic in perspective, this has been the steepest economic downturn since the Great Depression. There was a return to growth and an economic recovery after the Depression. Arguably that recovery would have been quicker and stronger if the government had responded with greater fiscal measures. We have learned from the Depression and are doing a far better job dealing with the pandemic. Odds are the full recovery when it comes will be stronger than the post-Depression recovery in the 1930s.

A Pennsylvania bakery says that cookie sales have predicted past presidential election outcomes. The bakery makes blue cookies for Biden and red cookies for Trump. The bakery owner last week said that Trump cookies sales are winning by a 3-1 margin.

Then there is the S&P 500 stock index. At the close last week, the index was well ahead of its August level, another Trump victory indicator. We shall see.

I will have the next market review and update one week from today on Wednesday October 28, 2020.

All the best,

John Dessauer

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