**John Dessauer Investments, Inc.**

**John Dessauer's market review and update as of Wednesday November 6, 2019**

Third quarter data confirm that the U.S. economy is slowing. U.S. GDP grew at a 3.1% rate in the first quarter, a 2% rate in the second and a 1.9% rate in the most recent quarter. Slower growth among our trading partners and in the broad global economy is impacting the U.S. But a close look at the data indicates that the prime culprit in the U.S. is the fifteen-month old trade war with China. President Trump argued that his tariffs would not hurt Americans. But history and now current data say otherwise. Third quarter data show a clear split in the U.S. economy. Thanks to rising wages and low unemployment, U.S. consumers are saving and spending while U.S. manufacturing and business investment have weakened. The ISM manufacturing purchasing managers' index for August slipped below 50 for the first time since 2016. It weakened further to 48.7 in September, its lowest level in 10 years.

Fortunately, history tells us that this index can swing back to positive quickly. The index has fallen below 50 twice during this long economic expansion, once in 2011 and again in 2016. In both cases the economy avoided a recession and quickly bounced back to solid growth. The problem is that the trade war has gone on longer than the President predicted or business expected. While a high-level meeting between the two Presidents is being scheduled, confidence that a final deal can be reached is low. Business managers have been making - and likely will continue to make - decisions based on the trade war continuing indefinitely. If President Trump and President XI surprise us and manage to resolve most of the sticky points, business confidence would improve significantly. And if that happens, the rate of overall growth in the U.S. economy would bounce back to 2+%-3%.

During the third quarter there was a 3% drop in business investment, the sharpest contraction in more than 3.5 years. No wonder so many pundits were talking about or predicting a recession. The U.S. avoided an overall contraction in the third quarter because consumer activity remained very strong. Personal consumption expenditures expanded at an annualized rate of 2.9% in the third quarter as spending on big ticket items grew. Also keep in mind the long strike by General Motors' workers. That also was a drag on the economy, another push in the direction of recession. The bottom line is that American consumers are in a sweet spot, supporting economic growth in what otherwise would be a recession prone economy. And consumers are likely to continue supporting solid economic growth.

The Labor Department reported the U.S. economy created 128,000 new jobs in October. And job creation for August and September was revised upwards by a net 95,000 jobs. Wage gains continue to outpace inflation. Average hourly earnings rose 3% from October 2018. Economists surveyed by *The Wall Street Journal* had forecast 75,000 new jobs in October. They continue to underestimate the underlying strength of the U.S. economy.

Another data point showing strength is the share of Americans working or looking for work. That rose to 63.3% in October, up from 63.2% in September. This indicates that the strong labor market is drawing Americans off the sidelines. However, there is still plenty of room for improvement. The record high for this data point was 67% in the early 2000s.

The U.S. Federal Reserve has now cut interest rates by 0.25% three times. This easing of monetary policy is clearly aimed at supporting manufacturing and business investment. It may not fully counter the downward pull of the trade war, but it sends a clear signal that the Fed will do what it can to keep growth alive.

Will the Fed cut rates again? Let’s hope that is not necessary. If more rate cuts are needed, “then something is very wrong with the economic backdrop, which will eventually weigh on equity performance,” said Todd Sohn, director of technical strategy at Strategas.

The Fed hinted it was done lowering rates for now. It would take a significant change in the labor market, wage gains and unemployment to make another rate cut necessary. Fortunately, all current data point to continuing strength in the consumer sector. The long expansion is not over yet.

The stock market has performed better than many expected. The S&P 500 stock index was up 18.7% as of the end of September. That is the best nine-month gain for any year since the bull market began in 2009. And stocks rose again in October bringing the year to date rise to 21.5%.

We are nearing the end of third quarter earnings season. About 75% of the 342 companies in the S&P 500 that have reported third quarter earnings have beaten expectations. That is better than the 72% five-year average.

When all companies have finally reported, analysts expect a 2.7% decline in earnings from a year ago. That will be the steepest decline in earnings since 2016. The good news is that analysts are calling this quarter the bottom. They predict earnings growth to accelerate next year. Current forecasts are for earnings growth of 5.8% for the first quarter of 2020 and 6.9% for the second quarter.

Supriya Menon, senior multiset strategist at Pictet Asset Management says: “Essentially all of us came into the earnings season with very low expectations.” Looking out to next year he adds: “The problem is that earnings expectations are still too high next year.” He may be right about companies with significant earnings from foreign operations. But earnings from domestic operations are likely to remain strong.

The S&P 500 stock index closed last Friday above 3,000. That looks to be a bit ahead of fair value based on third quarter earnings and fourth quarter expectations. A modest correction of 3%-5% would not be a surprise and should be ignored.

I will have the next market review and update for, one week from today on Wednesday November 13, 2019.

All the best,

John Dessauer