John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday November 13, 2019

It seems the media and others are so bent about President Trump that they cannot abide good news. Two months ago, the yield curve inverted. That became a media hot data point because in the U.S., sustained yield curve inversions have preceded nearly every post-World War II recession. The anti-Trump crowd cheered, hoping that a recession next year would sink the President's reelection bid. However, the yield curve has not stayed inverted. The Federal Reserve cut interest rates and the bond market responded. The yield on ten-year treasury bonds is now higher than the yield on three-month and two-year treasury securities. In other words, the yield curve has turned positive and is no longer signaling a recession. The media and the anti-Trump crowd has ignored the change. The "recession is coming" narrative continues. Zacks Investment Research argues this is good news for stocks for three reasons.

"For one, it was not very well disseminated that while yield curve inversions almost always precede recessions, it does not necessarily happen right away. Recessions triggered by the inversion of the yield curve don't, on average, materialize until 22 months after the event, and during that time, the S&P 500 has tended to rally. In the post-World War II era, on average, the S&P 500 has rallied more than 15% in the eighteen months following an inversion.

The second reason is that we have not seen anywhere near the deterioration in the labor (jobs) or credit markets that we have seen historically with yield curve inversions. Lending growth at banks remains positive and net interest margins are higher than what the yield curve implies. The rates banks are charging on mortgages, credit cards and

business loans are materially higher than the yields on the 10 and 30-year U.S. treasury bond.

Finally, it is important to take note when positive economic developments are largely ignored. When the yield curve inverted over the summer, it grabbed headlines and fueled recession chatter on a near-daily basis. But when the yield curve turned positive – which should have brought relief to the markets that a recession fear faded – it was largely tuned out by most pundits and the press. When pessimism rules the day, expectations are often lowered too far and recession risks get priced in – giving way for underappreciated economic positives to ultimately drive stock prices higher.

In my view, we're in an environment where even the slightest bit of negative news adds to the "wall of worry," but positive news is largely ignored. The yield curve in 2019 offers a perfect example of how this plays out. A yield curve inversion happens over the summer and signals forthcoming recession, followed by the yield curve turning back to the positive a few months later and receiving no air time."

Another hot topic as the election year posturing intensifies is the idea that there is a huge wealth gap in the United States with some earnings many multiples of what most others earn. Phil Gramm is a former chairman of the Senate Banking Committee. John F. Early served twice as assistant commissioner at the Bureau of Labor Statistics. They recently joined forces and on November 3, published an editorial exposing the truth about the American free market system, current taxation and income distribution.

"Never in American history has the debate over income inequality so dominated the public square, with Democratic presidential candidates and congressional leaders calling for massive tax increases and federal expenditures to redistribute the nation's

income. Unfortunately, official measures of income inequality, the numbers being debated, are profoundly distorted by what the Census Bureau chooses to count as household income.

The published census data for 2017 portray the top quintile of households as having almost 17 times as much income as the bottom quintile. But this picture is false. The measure fails to account for the one-third of all household income paid in federal, state and local taxes. Since households in the top income quintile pay almost two-thirds of all taxes, ignoring the earned income lost to taxes substantially overstates inequality.

The Census Bureau also fails to count $1.9 trillion in annual public transfer payments to American households. The bureau ignores transfer payments from some 95 federal programs such as Medicare, Medicaid and food stamps, which make up more than 40% of federal spending, along with dozens of state and local programs. Government transfers provide 89% of all resources available to the bottom income quintile and more than half of the total resources available to the second quintile.

In all, leaving out taxes and most transfers overstates inequality by more than 300%, as measured by the ratio of the top quintile's income to the bottom quintiles. More than 80% of all taxes are paid by the top two quintiles, and more than 70% of all government transfer payments go the bottom two quintiles.

America's system of data collection is among the most sophisticated in the world, but the Census Bureau's decision not to count taxes as lost income and transfers as gained income grossly distorts its measure of the income distribution. As a result, the raging national debate over income inequality, the outcome of which could alter the foundations of our economic and political systems, is based on faulty information.

The average bottom-quintile household earns only $4,908, while the average top-quintile one rans $295,904, or 60 times as much. But using official government data sources on taxes and all transfer payments to compute net income produces the more complete comparison.

The Average bottom-quintile household receives $45,389 in government transfers. Private transfers from charitable and family sources provide another $3,313. The average household in the bottom-quintile pays $2,709 in taxes, mostly sales, property and excise taxes. The net result is that the average household in the bottom-quintile has $50,901 of available resources.

The average top-quintile household pays on average $109,125 in taxes and is left, after taxes and transfer payments with only 3.8 times as much as the bottom-quintile: $194,906 compared with $50,901. No matter how much income you think government in a free society should redistribute, it is much harder to argue that the bottom-quintile is getting too little or the top-quintile is getting too much when the ratio of net resources available to them is 3.8 to 1 rather than 60 to 1 (the ratio of what they earn) or the Census number of 17 to 1 (which excludes taxes and most transfers).

Any debate about further redistribution of income needs to be tethered to these facts. America already redistributes enough income to compress the income difference between the top and bottom quintiles from 60 to 1 in earned income down to 3.8 to 1. If 3.8 to 1 is too large an income differential, those who favor more redistribution need to explain to the bottom 60% of income earning households why they should keep working when they could get almost as much from riding in the wagon as they get from pulling it."

In my view the objective should be to provide opportunity so the people in the bottom-quintile can lift themselves up. And I think the current, very strong labor market is doing just that.

I will have the next market review and update for, one week from today on Wednesday November 20, 2019.

All the best,

John Dessauer

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