John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday November 17, 2021

For something we're told is "transitory," inflation sure is persistent. The latest evidence arrived with a jolt when the Labor Department reported that consumer prices jumped 0.9% in October, or 6.2% from a year ago and the fifth straight month higher than 5%.

That's also the fastest rate since 1990, despite reassurances since March from the White House, Federal Reserve and Keynesian economists that inflation would soon fall back to 2%. It follows Tuesday's report that wholesale prices rose 0.6% in October or 8.6% from a year earlier. Rising producer prices are often followed by rising consumer prices as businesses pass on their higher costs.

The recent steep rise in home prices is a concern, because "shelter" is the biggest factor in computing the CPI, accounting for 32% of that inflation index. But rising home prices are not a direct component of the CPI because a home is regarded as an investment. Home ownership costs are captured as "owners' equivalent rent" what a homeowner could collect if the house was rented. Actual rent paid by tenants is the basis for the "shelter" calculation. The problem with "shelter" calculations is that leases usually run year by year, so rising rents show up latter than say the cost of gasoline or food. House prices rose 20% in the year to July. That indicates that the "shelter" component of the CPI is likely to rise sharply in coming months. In addition, actual rents paid by tenants are also likely to rise because the pandemic moratorium on evictions has lapsed. Goldman Sachs thinks there will be 750,000 evictions by the end of the year. Estimates are that rents paid by the new tenants will be up 17%.

The bottom line is that the "shelter" component of the CPI is likely to add 1.5%-2% to the CPI in coming months, twice its average contribution in the 10 years before the pandemic.

Looking at "shelter" along with the persistent supply-side and labor shortage issues, Goldman Sachs thinks inflation is going to get worse before it gets better. And that it will be late next year or into 2023 before inflation pulls back to less than 3%.

"It's important to understand that the current burst of inflation isn't an accident, like getting hit by a reckless driver. This is the result of reckless policy.

Congress and the White House flooded the economy with $1.9 trillion in new spending in March, after about $4 trillion in Covid relief in 2020. The goal was to goose economic demand, though the economy was recovering smartly by summer 2020. That needless demand stimulus has coincided with Biden policies that squeeze the supply. The Biden Administration has no idea what to do about this other than demand more of the same. Mr. Biden issued a statement last Wednesday claiming all is well because "in the few days since the data" before the October price report was collected, natural gas prices have fallen. Oh, and he's asked the Federal Trade Commission "to strike back at any market manipulation or price gouging." He said his infrastructure bill will solve supply shortages, though most of the money won't be spent until 2024. We haven't seen such incompetence since Jimmy Carter." (*The Wall Street Journal, 11/10)*

The U.S. stock market continues to do well, holding at record highs. Part of the reason for that is the massive shift of money to index funds rather than actively managed funds. For years many stock market pundits have said that “buy and hold” is dead. They argue that active trading is the best way of increasing wealth in today’s volatile markets. The growing popularity of index funds says that they are way off the mark. Index funds buy and hold the stocks in the index they are targeting. Managers of index funds do not select the stocks they think will do best, they buy all the stocks in their targeted index, the good and the bad. They also do not trade the stocks in their index.

In the 1960s index funds were an academic curiosity. In the 1970s, they were a commercial flop because of sky high inflation, a stock market plunge and a recession. They have been a runaway success in the 2000s, now accounting for 40% of the total assets managed by funds in America. A journalist from the *Financial Times* estimates that there is $26 trillion in passive managed index funds.

One reason index funds have become popular is the failure of actively managed funds. Not only do they charge fees of 1%-2%, the vast majority has failed to beat the market over the years. Index funds on the other hand charge very little, 0.04% and they do a good job of matching the performance of their targeted index. If you want to match the S&P 500 index, there are low-cost index funds available. Remember that when it comes to funds in general the best returns come from funds with low costs. That is the principle behind the late John Boggle’s founding of Vanguard.

It remains to be seen what will happen if we ever get caught in an inflation spiral like the 1970s. If trillions of dollars were suddenly to exit index funds any market “correction” could be amplified dragging stock market indices sharply lower. Meanwhile the opposite is the case. The popularity of index funds supports stocks, the bad along with the good.

Of course, individual investors still focus on the underlying company's performance. Growing sales and profits does push up individual stocks which is why stocks in well managed companies do so well.

I will have the next market review and update for you one week from today on Wednesday November 24, 2021

All the best,

John Dessauer