John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday November 27, 2019

It turns out that last month's interest rate cut was far more controversial among Fed policy makers than was widely appreciated. The vote during the Fed's October 29-30 meeting was 8-2 to lower interest rates by 0.25%. The rate cut brought the target range for Fed Funds to 1.50%-1.75%.

Following that meeting Fed Chair Jerome Powell said the Fed was now effectively on hold with interest rates and added that that would only change if there was a "material" change in the U.S. economic outlook. When the full minutes of the meeting were released that phrase was missing. The policy statement indicated that October's rate reduction would be the last rate move over the short term.

Dallas Fed President Robert Kaplan is obviously upset. He has since said that the price for his vote in favor of the October rate cut was that the final policy report would make it plain that another rate cut would be unlikely in the near term unless there was a significant slowdown in the pace of economic activity.

While economic growth has slowed this year, fears that sector weakness could spread to the wider economy have not materialized. The economy continues to expand at a moderate pace with unemployment near a 50-year low and consumer spending, which accounts for roughly 70% of U.S. economic activity, still holding up.

Reuters concluded: "That dissonance has left the committee increasingly divided. Boston Fed's Eric Rosengren and Kansas City Fed's Esther George voted against October's rate cut and since the meeting several other non-voting policymakers have said they were against the October decision.

Here is what the minutes of the meeting actually said: “Many participants judged that an additional modest easing at this meeting was appropriate in light of persistent weakness in global growth and elevated uncertainty regarding trade developments.

By contrast, “some” policymakers were against the reduction, viewing the economic outlook as still favorable, inflation moving back to the Fed’s goal and in light of lags in the transmission of monetary policy, preferred to take some time to assess the economic effects of…..previous policy actions.”

The Fed has one more interest-rate setting meeting before the end of this year, on Dec. 10-11. In light of the division among Fed policymakers, odds now favor keeping interest rates unchanged. And that may well be the policy unless and until growth slows materially.

The trade war with China remains the number one concern for the U.S. economic outlook. The phase one deal was supposed to be signed on November 17 at the Asia-Pacific Economic Cooperation Summit in Chile. But because of civil unrest, Chile backed out of hosting that event. In addition, China is reluctant to commit to a specific amount of agricultural purchases from the U.S. And the U.S. is reluctant to remove all tariffs ahead of the formal agreement on the phase one trade deal.

Spokespeople from both countries have praised the ongoing negotiations as “constructive” and said that “progress is being made” on the text of the agreement.

Never-the-less, trade tensions remain high. President Trump has made it clear that if they can’t come to an agreement, he’ll raise tariffs on China even more.

The U.S. Congress has complicated the U.S.-China negotiations by passing the "Hong Kong Human Rights Democracy Act", which would require an annual review of Hong Kong to determine if China is interfering in their governance, and sanctions would be imposed on officials who commit human rights violations. The bill will now be sent to the White House where President Trump will either sign it or veto it. That will be a tough call for the President. I'm sure he favors protecting human rights in Hong Kong. But China has threatened to retaliate if he signs it. However, China has not specified precisely what actions they would take. That makes it look like there could be some wiggle room if he signs the bill and it becomes law.

Both countries want and need the phase one deal. The Hong Kong bill might hamper negotiations on phase 2. So, optimism on a phase 1 deal remains high.

Mark Zandi, chief economist at Moody's Analytics agrees that the greatest threat to the U.S. economy is the trade war with China. He says: "What happens on that front will determine what's next. If the President follows through on his threat to raise tariffs again on China in December, a recession next year is likely. However, if the President stands down and provides a clear path to winding down the tariffs, the economy will likely avoid a recession."

He adds: "The uncertainty of the tariffs is a pall over business investment and hiring."

So far President Trump has navigated the tricky trade war waters. However, it is taking far longer than even he expected to get a deal signed. We are now slightly less than a year from the next elections. The last thing the President wants is a looming recession as voters go to the polls. My view therefore is that he will get a phase one deal signed before year end.

As for the stock market outlook, Wall Street heavyweights are sharply divided. There are optimists including Goldman Sachs and Credit Suisse who respectively see stocks up 8.9% and 9.7% next year. Then there are pessimists including Morgan Stanley and UBS who see stocks down 3.9% in 2020.

The editors at the "Morning Brief" had this to say about the division: "To be clear, none of this is to suggest that you should feel better if all the strategists were equally bullish or equally bearish. Most strategists are usually way off."

That said, stocks usually go up. That works for long-term investors willing to stomach short-term declines.

In my view the greatest threat to us, as long-term investors, is the frightening shift to the left among so many U.S. politicians. For us there is a lot at stake in next year's election. Hopefully the "tear the system down" rhetoric will frighten all those millions who have, at last, found a good job with rising wages.

I will have the next market review and update for you one week from today on Wednesday December 5, 2019.

All the best,

John Dessauer