John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday December 4, 2019

Last week the U.S. Commerce Department flooded us with quarterly economic data - this time revisions for the third quarter. Pessimists hungering for a recession were disappointed. The U.S. economy soldiered along at a 2.1% annual growth rate in the third quarter. That is up from the 1.9% rate reported in the preliminary third quarter economic data. Better yet, at least for the optimists, the upward revision was in part thanks to an upward revision in business investment. Mainly because of the 16-month-old trade war with China, business investment has been lagging behind historical data. While the upward revision is good news, business investment is still relatively weak. Nonresidential fixed investment, which reflects business spending on software, research and development, and equipment fell at a 2.7% rate in the third quarter. While better than the 3% drop reported earlier, a decline is still a decline.

When it comes to the current quarter there is a wide range of forecasts. A forecasting firm, Macroeconomic Advisors, expects U.S. GDP to grow at a 1.9% rate in the fourth quarter. The Federal Reserve Bank of Atlanta sees fourth quarter GDP growth coming in at a 0.4% rate.

Consumer spending accounts for more than two-thirds of total economic output. The recent Commerce Department report shows that while consumer spending did slow in the third quarter, it still grew at a solid 2.9% rate. The decline in consumer spending follows a parallel decline in consumer confidence. Consumer confidence peaked at 137.9 in October 2018. Last month that index stood at 125.5, down but still comfortably within positive territory. Why has consumer confidence and therefore consumer spending declined? The 16-month-old trade war with China gets the blame. Business gets the headlines, but consumers pay attention.

President Trump says the negotiations are going well. Hopefully he is right, and a phase one deal will be signed soon.

Housing generally accounts for a fraction of U.S. GDP, but it is nevertheless a significant factor. People buy homes when they feel financially secure. Housing starts surged in October and building permits vaulted to a 12-year high. If the President can make a phase one deal soon the fourth quarter could be far better than the current optimistic 1.9% growth forecast.

Federal Reserve Chair Powell, speaking in Rhode Island last week said: "As this expansion continues into its 11th year—the longest in U.S. history—economic conditions are generally good. If the outlook changes materially, policy will change as well."

In other words, the Federal Reserve is ready to provide support to keep this expansion rolling along. The next recession is still too far off to see. And with the yield curve having turned positive, odds are this expansion will continue through next year and perhaps into 2021.

Two weeks ago I wrote about a UBS survey of millionaires. More than half of those surveyed said they expect a significant U.S. stock market sell off by the end of next year. Louis Navellier is the founder and head of Navellier Associates, an advisory firm with a stellar record. Louis himself has a remarkable record when it comes to forecasting stock market behavior. I am sure those gloomy millionaires and stock market pessimists were shocked when they heard about his recent 2020 forecast for the Dow Jones

Industrial average. Louis expects the Dow Industrials to reach 40,000 next year. That would be close to a 43% gain.

The gloomy millionaires are concerned with global politics. They think politics will overwhelm fundamentals and drive stocks down. The ongoing trade war and the unrest in Hong Kong are truly scary. If either escalates, equity markets around the world would likely decline. However, if the trade war winds down and China makes concessions in Hong Kong, those global political fears would go away, eliminating the downward threat to Stocks.

To give the pessimists' point, the current corporate profit situation in the United States is discouraging. A broad measure of U.S. corporate profits fell 0.6% in the third quarter after rising 3.3% in the second quarter. Third-quarter profits per share for the S&P 500 companies are expected to be down 0.4% this year compared with 2019. If so, that will be the first year-over-year decline since early 2016.

So why is Navellier so optimistic? His logic is both simple and compelling. In this historic low interest rate environment investors are looking for income. The ten-year Treasury bond yields a scant 1.78%. Stocks in the Dow Jones Industrial Average currently yield 2.73% and stocks have a history of raising the dividends. The Dow Jones Industrial Average would have to rise above 40,000 before the current dividend yield fell to 1.78% and matched the ten-year Treasury bond. Will income hungry investors keep buying dividend paying stocks and push the Dow that high next year? Time will tell, but that certainly is a possibility given the very low interest rate environment.

Whether Navellier's forecast turns out to be correct or not, his yield analysis makes a strong counterpoint to the gloomy millionaires' expectation. As long as stocks provide a yield that is comfortably better than the ten-year Treasury bond, stocks are not likely to suffer a significant decline. We can expect mild selling sprees from time to time, but they should not alarm us as long-term investors.

Zacks Investment Research expects stocks to double in the next five years. That forecast was made some months ago. While Zacks' forecast is based on broader economic and profit expectations, it is in line with Navellier's forecast. Put the two together and there is a strong case for holding on to our stocks.

I will have the next market review and update for you one week from today on Wednesday December 11, 2019.

All the best,

John Dessauer