John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday December 7, 2022

Secretary of the Treasury Janet Yellen blames American consumers for inflation. Fox News responded saying: "Stop Yellen at Us." And she should. American consumers had nothing to do with the surge in oil prices that triggered the burst of inflation. That was 100% due to President Biden's anti fossil fuel policies. As far as consumer spending is concerned Ms. Yellen should focus on where the billions came from that flooded the economy with excess cash. The answer of course is the Biden big spending programs that pumped billions of dollars into an economy that did not need such a massive stimulus.

Ms. Yellen knows better. She was the Federal Reserve Chair before becoming secretary of the Treasury. Why she is now so supportive of Biden's inflationary economic policies is a mystery and a big disappointment to me. Thank goodness Republicans will soon control the House of Representatives. That body has control of government spending programs. Republicans may not be able to reverse what has already been done, but they can stop any further big spending plans.

The November jobs data shows the economy is still solid. There were 263,000 new jobs created last month and wages rose at a 5.1% rate. The Federal Reserve board will still keep raising interest rates, but at a slower pace. An increase of 0.5% is expected. Is the economy now headed for a recession? Remember the yield curve? When short-term interest rates rise above long-term rates the yield curve becomes inverted, and every time that has happened in the past 40 years a recession followed. At the moment the yield curve is not just inverted. The gap between short and long-term interest rates is as wide as

it was back in 1981. And that was followed by a nasty recession and a big jump in unemployment. Is today’s inverted yield curve signaling a repeat - a nasty recession? Some economists say yes, maybe not such a nasty recession, but a recession never-the-less. However, there is a big difference between today’s inverted yield curve and the 1980s. In the 1980s Fed Chair Paul Volker was aggressively raising short-term interest rates to combat inflation. Today the Fed is not so aggressive. Short-term interest rates have been going up but are still near historic lows. What has been happening is that interest rates on ten-year treasury bonds have been falling sharply.

The basic measure of the yield curve is the difference in yields between two-year and ten-year treasury bonds. In a single week at the end of last month the yield on a ten-year treasury fell to 0.78% below that of the two-year treasury, the biggest negative gap since 1981. The question is why would anyone buy a lower yield ten-year treasury rather than enjoying a higher yielding two-year treasury? The answer is that investors believe the short-term yield is headed lower as inflation comes down. Because the inverted yield curve has been caused by sinking long-term interest rates, many analysts and investors see this inverted yield curve as a predictor of falling inflation and a return to a more normal economy, rather than an approaching economic disaster.

Taking cues from Fed officials, investors and analysts expect the fed funds rate to be pushed up to 5% by early next year. Later in 2023 the Fed is expected to start cutting short-term interest rates to prevent a recession. Mitch at Zacks investment management agrees:

“If a recession is on the way, the U.S. consumer has not received the memo. According to Commerce Department data released in mid-November, U.S. retail sales rose by a seasonally adjusted +1.3% in October, signaling a sharp increase in activity from September’s print. Shoppers spent more on everything from staples like gas and food to bigger ticket discretionary items such as cars and furniture.

This brings up another very distinct possibility when it comes to the yield curve: investors may be pricing in a future with lower inflation, not an impending economic downturn. On one level, when longer-term Treasury bond yields are lower than short-term yields, it means investors think the fed-funds rate will be lower in the future than it is now – likely because the Fed will need to cut rates to revive a slowing economy. The market may be betting that inflation will be low enough next year to allow the Fed to take this action.”

Consumers account for almost 70% of the economy. Instead of trying to blame them for inflation, our Secretary of the Treasury should be thanking them for keeping the economy on solid ground.

Stocks tend to react to changes in long-term interest rates. When long-term rates were rising stocks pulled back. Lately stocks have partially recovered and that is thanks to sinking long-term interest rates. If this inverted yield curve really is predicting lower inflation ahead, then stocks will climb higher. The midterm election history may be repeated this time moving stocks to new highs next year.

I will have the next market review and update for you one week from today on Wednesday, December 14, 2022.

All the best,

John Dessauer

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