John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday December 16, 2020

November will go into the record books as one of the best months for stocks in decades. And as Argus Research says: "Good Novembers often set the stage for good Decembers." One reason is that after gains through the end of November pessimistic money managers have a problem. They have to do something or risk losing assets under management. What they often do is called window dressing, adding stocks that have been doing well to their portfolios. That year-end buying often results in a strong December.

At this point it looks like the S&P 500 stock average will finish 2020 up 12%. When dividends are added the total return for the year will be 13.5%. In years to come that will make 2020 look like an average year for stocks. However, this has been anything but an average year. By March 23 the S&P 500 was down 34%, a stock market crash. Number crunchers called that the end of a long running 11-year bull stock market. The economy looked very weak. Economists were predicting a long and deep recession. They were wrong. The economy proved to be far stronger than appreciated. As the data showed economic strength, stocks rallied 60% to new all-time highs. That performance indicates that a new bull market has begun.

Looking ahead, Argus Research says: "In broad strokes, we look for mid-single digit GDP growth and double-digit EPS (earnings per share) growth in 2021." That is consistent with Morgan Stanley's outlook for a 2021 gain of 10% in the S&P 500 stock index.

Last week the Labor Department reported job gains of 245,000. The break down was 344,000 new jobs in the private sector and a loss of 99,000 in the public sector. The report was described as disappointing by the media. It was below the consensus expectation of 500,000 new jobs. But the unemployment rate went down to 6.7% from the previous reading of 6.9%. The continuing rise in Covid-19 cases and the accompanying restrictions imposed by some governors and mayors is most likely the reason the number of new jobs was below expectations.

The FDA has approved the use of the Pfizer vaccine. The first vaccinations will likely start this month. It will take a few months to get the vaccine to the broad population, but the fact that we have a vaccine in record time is grounds for optimism on the economy and the stock market.

Inflation is likely to be higher in 2021, and that will be good news. Mild inflation is far better that the opposite, deflation. We had a taste of deflation earlier this year. Consumer prices declined between March and April as the Covid-19 crisis hit the economy hard. Since then, the unexpected economic recovery has lifted some prices. Last week the Labor Department reported that consumer prices rose 0.2% in November, putting them 1.2% higher than a year ago. Prices excluding food and energy, the so-called core inflation, that the Federal Reserve and many economists see as a better reflection of underlying inflation trends, were up 0.2% in November and 1.6% over a year ago. One big reason consumer price inflation is so low is the deflation of earlier this year.

As we move into 2021 the year-over-year price comparisons will look back on the extreme lows earlier this year. If over the next six months on a monthly basis prices rise by just half as much as they did in November, the Labor Department's consumer price inflation year-over-year reading next May would rise to 2.6%. But by then millions of

Americans will have been vaccinated, safety measure would be relaxed, and the service sector - especially travel - could see pent-up demand pushing prices higher. For example, as of last month airline fare prices were down 17% compared with last year. If fare prices simply recover by next Spring the price gain would be huge, adding to the core inflation rate. So, we could see a temporary spike in the posted inflation rate as prices recover from last Spring's plunge.

Will that mean a spike in interest rates? That is not likely. The Federal Reserve will be focused on the inflation outlook for the months after the recovery. The Federal Reserve has promised to keep interest rates low until inflation is decidedly above 2%. That would take a jump in GDP growth above expectations. However, by this time next year we will most likely be paying more attention to inflation. In other words, we will have a solid and growing economy providing fundamental support for the stock market.

The situation in Europe's euro-zone is quite different. The ECB (Euro Central Bank) was able to prevent a financial panic by introducing a Pandemic Emergency Purchase Program or PEPP. That was launched in March and has since been expanded to 1.35 trillion euros for buying government and corporate bonds. But that is the only euro-zone-wide response to the pandemic. A Brussels plan is bogged down in political wrangling. And there is likely to be more political challenges ahead. The ECB's balance sheet is overweighted with bonds from Italy, Spain and France, but underweighted in Germany and the Netherlands. This helps those who need it the most but makes the ECB look like a transfer mechanism from the finically prudent to the profligate. This is politically toxic in the eurozone. At this point the eurozone economy is down 4.4% from a year ago. That is much worse than the U.S. 2.9% decline.

The UK has been hammered by the combination of Brexit and the Covid-19 pandemic. The UK economy is down 9.6% from a year ago and struggling to stop the decline.

The vaccine will definitely help both the UK and the eurozone. And eventually both may see a strong recovery. But for now, the U.S. is looking best both for the economy and the stock market.

I will have the next market review and update one week from today on Wednesday December 23, 2020.

Happy Holidays,

John Dessauer