John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday December 23, 2020

The vaccine news is exciting. A second vaccine from Moderna has been approved and is ready for initial distribution. Now we have two vaccines which means the end of the pandemic will come sooner than many expected. It is remarkable that major pharmaceutical companies have been able to develop vaccines in such a short time. It used to take at least ten years to develop a new vaccine. Thank goodness our politicians failed to denigrate the big pharmaceutical companies. I remember Hillary Clinton bashing the pharmaceutical companies back when her husband was president. She did do some real damage. President Clinton signed a bill that over ten years eliminated a special tax break for U.S. pharmaceutical companies operating in Puerto Rico. And by 2006 those companies had all left Puerto Rico. Several went to China. Our supply of basic pharmaceutical products shifted to China. The economy of Puerto Rico suffered from the loss of thousands of jobs. Thankfully, the damage to our pharmaceutical companies was limited. Hopefully the Covid-19 pandemic and the record-breaking vaccine production has cooled political criticism of U.S. pharmaceutical companies. Covid-19 may not be the last pandemic. We may need the financial and research capabilities of our pharmaceutical companies to crush a future virus attack.

Now that the vaccination process has begun, economists are looking at the next few months. It may be March or early April before enough people have been vaccinated to get the economy back to something near pre-pandemic levels. Some think the economy could sink in the opening quarter of 2021, resulting in a double-dip recession.

The number of new infections is rising. There were 1.52 million new cases in the week ending December 17. That is nearly twice the number reported in the first week of November. The CDC expects 1.76 million new cases in the week ending January 9. This rise in Covid-19 cases is what makes some economists think the economy will contract in the first quarter of next year. But there is an opposing point of view. The Atlanta Federal Reserve bank's model for predicting economic growth, called GDPNow, is predicting an 11.1% annual growth rate for this quarter. Officials at the Federal Reserve now anticipate real GDP to fall just 2.4% this year, thanks to the stronger than expected rebound from the first quarter's plunge. Looking forward, the Fed expects unemployment to fall to 5% from the current 6.7% rate by year end 2021.

Federal Reserve Chair Jerome Powell says, "The next four, five, six months will be difficult." The rate setting Federal Open Market Committee said last week that it would continue to buy at least $120 billion of bonds ($80 billion worth of Treasurys and $40 billion worth of mortgage-backed securities) each month until the recovery is entrenched, and maximum employment and price stability have been achieved. This means the Federal Reserve will continue providing massive liquidity to support the economy for the foreseeable future. Will that be enough to prevent a first quarter contraction? The median projection of Fed governors and regional bank presidents is now that for all of 2020, the U.S. GDP will be down 2.4%. That is up from their September projection of minus 3.7% and a huge improvement from their minus 9.3% projection last June. The economy clearly has proven stronger than expected. The ongoing recovery may not be quite enough to prevent a decline next quarter. But if there is a double-dip recession it will be mild and short.

Another reason to be relaxed about a possible double-dip recession is that America's private sector balance sheet is in far better shape than it was when the 2008 recession struck. One economist, Richard Koo, dubbed that a "balance sheet recession." And it took U.S. households and businesses years to reduce debt and get their balance sheets back at more reasonable levels. I remember economists describing the recovery process as a "deleveraging." Yes, debt levels have risen this time as they did 12 years ago. Borrowings of U.S. nonfinancial companies were 8.5% higher at the end of September than a year earlier. And at that point they were above the 2009 peak both in absolute levels and as a percentage of GDP.

However, this time businesses and households have been hoarding cash. As Jon Sindreu writing for the *Wall Street Journal* says: "Investors can afford to relax. Balance sheets are about assets as well as liabilities."

Flow of funds data recently published by the Federal Reserve shows that businesses have accumulated more cash than debt this year. Their liquid assets were up 25% in the third quarter. And the personal savings rate has soared as consumers increased cash holdings. The real estate market has been strong, in sharp contrast to 2008. This means household net worth remains high and has not declined as it did in the wake of the 2008 financial crisis.

Which leaves politics as the remaining potential problem for the economy and the financial markets. The January 5 runoff election in Georgia is the focus for economists and investors. A republican win on one of the two Senate seats in contest would mean that the Senate will continue to have a Republican majority and we will continue to have a divided government. A divided government means that neither party can push through legislation. In this case it would mean that radical change in taxes would be blocked. Likewise, radical energy policies that would sharply raise the cost of energy from gasoline to home heating and basic electricity would be blocked. If the Republicans win both Georgia Senate seats their majority would be more secure, making radical tax or energy changes even more unlikely.

For the moment investors are focused on the virus and the arrival of two vaccines. Politics is taking a back seat, probably because Republicans are expected to win in Georgia. However, stocks in particular could be more volatile between now and when the January election results are known.

I will have the next market review and update one week from today on Wednesday December 30, 2020.

Happy Holidays,

John Dessauer