John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday December 29, 2021

The new Omicron variant is making things difficult for the recovery. Fortunately, it has not stopped the recovery or forced lockdowns. On a positive note, vaccination does help to prevent or at least significantly reduce the intensity of the virus including the Omicron variant. And more and more Americans continue to get vaccinated and then get a booster shot. With the number of people getting vaccinated rising rapidly it is unlikely that Omicron will have a major impact on the recovery.

The November data on consumer spending indicate a loss of momentum. Consumer spending rose 0.6% in November, down from 1.4% in October. The loss of consumer spending momentum is likely due to the end of major government stimulus. In October consumers were saving at an annual rate of $1.322 trillion. While that is well above pre-pandemic levels, it is well down from the $5.764 trillion savings rate last March. With a much smaller share of worker incomes coming from government stimulus spending, wage growth will become a more important source of income and spending power in coming months. That would mean more workers re-entering the labor force and helping businesses fill job openings. Staff shortages have been a problem for many businesses. To provide services and meet production goals, businesses need more workers.

Economists at Oxford Economics have looked at all the recent data and concluded that their earlier forecast of first quarter 2022 GDP growth at a 3.4% annual rate is too optimistic. They now forecast first quarter growth at an annual rate of 2.5%. If they are right the Federal Reserve will have to re-think the tapering and potential 2022 interest rate hikes. Those are not good policies when the rate of economic growth is slowing significantly. However, they are good policies to fight inflation. And inflation may also slow, but will it come down enough from the current 39 year high of more than 6%? As I wrote last week, because of the virus, we are in a brand-new situation. It is possible that the Federal Reserve will find itself between a rock and a hard place with a slowing economy in need of help and inflation too high to be comfortable. Which will become the Fed's top priority, knocking down inflation or keeping the economy growing? That is hard to tell from recent comments from Fed Chair Powell or other members of the Fed's board. In fact, they seem to be split, with some worried about inflation and others worried about the slowing economy.

My guess is that economic growth will win out at the Federal Reserve. I say that because there is evidence that some of the inflation pressure will ease as supply side issues are resolved. However, we will have to be patient and watch the data as it develops.

As for the stock market, 2021 has been very interesting and informative. I am always happy to see stocks go up, but there are some stocks that have climbed to record high valuations based on sales, earnings, and other fundamentals. Like so many others, I have expected a "correction" - a market pull back of 10% or so. There have been dips. December has been quite volatile. But stocks have recovered quickly. Brian Frank, chief investment officer of Frank Capital Partners and portfolio manager of the Frank Value

Fund recently wrote an article about how the increasing popularity of passive investing in Index Fund and Exchange Traded Funds has structurally changed the stock market.

Brian Frank wrote: “Passive funds, such as exchange traded funds that invest in the S&P 500 Index have been gaining market share for decades and are now at a critical mass of all professionally managed assets. In recent years, traditional valuation metrics like price-to-sales and market-capitalization-to-GDP have rocketed beyond historical highs, and this is no coincidence. Passive strategies are valuation-agnostic and buy whenever new money arrives. Consistent inflows from vehicles including 401(k) retirement accounts enable constant passive buying, and this dynamic could continue and perhaps even accelerate in 2022.”

There is some selling pressure from retirement accounts. That comes from the Required Minimum Distribution (RMD) requirement for investors over age 70 ½. As the number of retired workers rises, it is possible that passive investing will lose some of its upward bias. But for now, the inflows continue and not just from retirement accounts. Investing in index and exchange traded funds has become increasingly popular among investors of all ages.

In December of 2018 the U.S. stock market suddenly fell 9%. Selling by RMDs probably was a contributing factor. But once the selling stopped, the inflows continued and stocks soared in January 2019, recovering almost all the December loss.

In early 2020, as Covid forced lockdowns, there was panicked selling of stocks that overwhelmed passive buying. That turned out to be a buying opportunity as stocks in quality companies traded at discounts. Can selling overwhelm passive buying again? The answer is yes, but aside from RMD forced selling; it is impossible to predict the timing of the next round of panicky selling.

The good news is that passive investing continues to gain popularity. Inflows of money to index and exchange traded funds means there is structural support for stocks even at elevated levels.

With that, I say Happy New Year and hold on to your quality stocks. They will most likely be the best investment choice in 2022.

I will have the next market review and update for you one week from today on Wednesday January 5, 2022

All the best,

John Dessauer