John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday December 30, 2020

It's that time of year again - time to get out the crystal ball and see what might lie ahead in the New Year. In the days when I was a panelist on Wall $treet Week with Louis Rukeyser there was a contest. Each panelist would make a forecast and pick some investments. At mid-year and again at year's end Lou would announce the scores. The top panelists would get special recognition on the year end show. I made the final group a few times. This year seems to me to be a relatively easy call on the outlook for the economy, but quite difficult when it comes to stocks and bonds.

Thanks to the vaccines there is very likely going to be an increase in economic activity as millions of Americans feel safe to visit stores, restaurants and theaters. Likewise, travel - including airlines, hotels and cruise ships - should pick up nicely. What is not so easy to calculate is how consumers' spending patterns will have changed permanently. Will Internet shopping and home delivery continue to be popular? Or will we quickly return to our pre-pandemic patterns and habits? Economists are digging into data state by state to look for clues. So far, the data suggest that there will be some permanent changes both by businesses and consumers. Convenience accounts for some of the data but cost savings is looking like the biggest driver. It can be cheaper for consumers to stay home and shop on-line. But that raises delivery and logistical costs for retailers. Businesses are finding that there are real cost savings, such as reduced office space, when employees work from home.

Over the past 20-30 years technology has changed consumer and business behavior. It is hard to remember the days before smart phones and laptop computers.

How did we get by without Amazon, Google and the Internet? And technology has made it easier for consumers and businesses to adapt and survive the devastation of the pandemic. But there is a big difference with technology today versus the last 20-30 years. The technology companies that are leading the way today are generating significant cash flows in record time. As Zacks Investment Management says: “Instead of spending years and massive amounts of capital to build a network of plants or stores, they can sell a product or service over the internet, or via a smart phone. The “asset-light” technology companies of today can spend their resources and profit reaching new customers, instead of maintaining and growing capital assets.

2020 saw rapid-fire adoption of many new technology services and ways of shopping, from businesses implementing new digital infrastructure, to retailers rolling out e-commerce channels, and consumers trying services like grocery delivery for the first time. These technological trends were underway already, but 2020 served as a catalyst propelling them forward.”

The bottom line is that there will likely be significant long-term economic benefits once the pandemic is over.

In the near term, while the vaccine rollout develops, the economy can use some more help from Uncle Sam. The Congress has approved another stimulus bill, this time for $900 billion. But the political wrangling goes on. President Trump wants more money for consumers. Democrats want more money to bail out Blue states that are deep in debt over underfunded pensions. Truth is that states are not suffering as much as predicted. The Census Bureau reported last week that total state and local government tax revenues for the 12 months ending in September were up $46.4 billion or 3% year over year.

Personal income tax revenue increased 3.3% and property tax revenues 4.7% while sales taxes have dipped a mere 0.4%.

As the *Wall Street Journal* editorial boards says: “Democrats aren’t talking about all this because they want to plead poverty as the Biden Administration takes power. But state and local governments have already received plenty of federal cash. They want more so they can pay off public unions and avoid reforming their runaway pensions. The next Congress should do taxpayers a favor and just say no, we already gave at the office.”

Stocks came under pressure as the final week of 2020 drew to a close. The reason is that stocks performed so much better than bonds. As of the days just before Christmas a basket of high-grade corporate bonds, mortgage-backed securities and government debt had returned just over 7% year to date. The S&P 500 returned over 14% during the same year-to-date period. Balanced funds saw their equity holdings swell. This meant that fund mangers had to do some rebalancing at year end, reducing stock holdings and increasing bond holdings. Analysts at BNP Paribas estimated that between $63 and $85 billion would be shifted from stocks to bonds. And that does not include individual portfolios that also needed to be rebalanced as equity values rose.

On the equity plus side, interest rates remain very low and are likely to stay that way for the next year or two. This means that stocks continue to look better than bonds. The free cash flow yield on the S&P 500 is a whopping 10 times the yield on a 2-year U.S. Treasury bond. So once the rebalancing is completed stocks should continue to do well.

Finally, for all who still worry about a double dip recession, take note of the huge cash reserves held by both businesses and consumers. In early December, personal savings were $1.3 trillion higher than the pre-pandemic levels- a result of households socking away cash because they could not travel or spend as before. That $1.3 trillion in household cash amounts to over 6% of GDP. Even the Federal government has stashed away lots of cash. There is $1.7 trillion in cash in the U.S. Treasury's General Account.

At some point, as the vaccine distribution takes hold, that cash will, at least in part, be spent to satisfy pent-up demand giving the economy and corporate profits a boost. Our best strategy continues to be to hold our stock positions and be patient.

I will have the next market review and update one week from today on Wednesday January 6, 2021.

Happy New Year,

John Dessauer