

# John Dessauer Investments, Inc.

[www.johndessauerinvestments.com](http://www.johndessauerinvestments.com)

## **John Dessauer's market review and update as of Wednesday January 4, 2017**

For the past week we have been cruising the Antarctic Peninsula, landing on various beaches, photographing penguins and watching whales bubble feeding. The weather has been remarkable, sunny and warm. We know from a previous cruise to Antarctica that this is unusual. On our previous cruise we had one day with sunshine and the rest were cloudy, gray, windy and snow showers. The crew and expedition team tell us that we are truly lucky to be enjoying several days of good weather here in Antarctica. This time of year the waters around this part of Antarctic are full of wildlife, birds and marine animals. We have already seen dozens of humpback whales, lots of elephant and crab eater seals, plus thousands of birds and penguins. The scenery is magnificent. Marilynn and I heartily recommend taking a cruise to Antarctica. There are ships that just cruise the area. We saw the Holland America Vaandam. Others use zodiacs to take passengers ashore. We are on the Seabourn Quest with 400 passengers and go ashore for about an hour and a half almost every day. For example, we visited a Chilean research station on a small island that is also home to several hundred Gentoo penguins. As I write, we are dodging two weather systems on our way to South Georgia, a unique island in the southern Atlantic. Cruising to Antarctica is a great adventure.

The internet can be spotty down here, but fortunately we have been able to connect a few hours a day for the last week. Once we start sailing north the internet will be available all day every day.

**U.S. consumer confidence continues to surge. The December reading of the University of Michigan consumer confidence index rose to the highest level in 15 years. The index stood at 113.7 in December, up from 109.4 in November. However the rise was 100% due to expectations. The reading for current economic conditions dipped slightly. Clearly the dramatic improvement in confidence is a positive, but it remains to be seen if confidence alone will lift economic activity. Bob Johnson, chief economist for Morningstar, is a doubter; he sees economic growth in 2017 remaining lackluster at 1.9%. Others are more optimistic. It will take time for the Trump administration and the Congress to change economic policies, but each step will be against the positive background of much improved consumer attitudes. Don't be surprised if the rate of growth accelerates sooner than Bob Johnson expects.**

As we now know, the third quarter growth rate was a very respectable 3.5%. Of course that is an annualized rate, which is not expected to be repeated in the fourth quarter. The consensus among economists is that the rate for the final quarter of 2016 will be 2.4%. The new Congress will be in session and taking action before the Trump inauguration on January 20. If the Congress is successful in enacting changes soon, the rate of economic growth could start to improve fairly quickly. President-elect Trump promises 4% growth in 2017. That may be difficult to achieve, but a lift to 3% would be welcome and an indicator of a new trend to faster growth for the U.S. economy.

One inhibitor for the U.S. economy has been the strong dollar. That is likely to continue. In less than a year the euro is down about 8% versus the U.S. dollar. The

outlook for the euro is for continued weakness due to continued major issues among European banks.

Deutsche bank, Germany's largest, has been hit hard with lingering bad loans and suffered because of mishandling of mortgage backed securities in the U.S.

Now the world's oldest bank, Monte dei Paschi de Siena, in Italy, is in desperate need of a government bailout.

Monte dei Paschi emerged as the weakest of some 51 European banks subjected to stress tests earlier last year by the European Central Bank. It was given until the end of the year to sort out its problems or face being wound down. The collapse of Monte dei Paschi would have threatened the savings of thousands of Italians and could have devastated the wider banking sector, which is saddled with 356 billion euros of bad loans - a third of the euro zone's total. The initial plan was to raise 5 billion euros in new capital from investors. That plan failed. Only 2 billion euros were pledged even though the offering time was extended. This is the Italian version of "too big to fail."

In response, the Italian government has announced plans for a 6.5 billion euro bailout for Monte dei Paschi. Under European Union rules, bank bond holders must suffer the loss before taxpayers can be asked to pick up the bill. Some years ago when Italy faced another major bank bailout issue, the government changed the tax rules so that retail investors would be encouraged to buy bank bonds. Now thousands of ordinary Italian savers are at risk. It is not clear that the government's plan meets all the European Union requirements. The government says full details of the rescue plan have yet to be worked out, but it outlined the contours in a statement.

It said the bank's Tier 1 bonds, which are mostly held by professional investors, would be converted into shares at 75 percent of their nominal value.

Tier 2 bonds, which are mostly in the hands of retail investors, will be converted instead at 100 percent of their face value. To further insulate small savers from losses, Monte dei Paschi will offer to swap the shares they end up with as a result of the forced conversion with regular bonds and sell the same shares to the state instead.

European Union officials have a history of bending the rules when a crisis arrives. Odds are the Italian bailout plan will be approved without major change.

There are at least six other Italian banks in need of new capital. The government has created a 20 billion euro fund to help banks in distress. Monte dei Paschi will reduce that to 13.5 billion euros. Using much more of the fund would endanger Italy's government debt situation. Italy's government debt now stands at 133% of GDP, second only to Greece.

This story of Italy's bank crisis is another example of European banks' poor history of bad loans. Digging a bit deeper, the question is why so many European borrowers fail. The answer of course is the complex tax and regulatory climate in Europe.

No wonder the euro has come down versus the U.S. dollar. If the U.S. economy begins to pick up steam, the dollar will look even more attractive. While a strong dollar may continue to trim a bit off U.S. economic growth and reported profits from major U.S. companies, it is far better than the opposite. Dollar strength thanks to a strong and vibrant economy is a positive for jobs and stock prices.

I will have the next market review and update for you one week from today on Wednesday January 11, 2017.

All the best,

John Dessauer

©January 2017