# John Dessauer Investments, Inc.

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**John Dessauer's market review and update as of Wednesday April 19, 2017**

**Everyone, including investors, analysts, economists and the Federal Reserve is focused on the short-to-medium term outlook for economic growth in the United States. Perhaps instead, we all should be breathing a big sigh of relief and thanking former Federal Reserve Chair Bernanke for saving the economy from a depression. A look at the really long term tells us that minimizing the downward drag from recessions is more important in the long run than the rate of growth during the good times.**

The following is from the April 8, 2017edition of *The Economist*.

"“Throughout history, poverty is the normal condition of man.” wrote Robert Heinlein, a science-fiction writer. Until the 18th century, global GDP per person was stuck between $725 and $1,100, around the same level as the World Bank's current poverty line of $1.90 a day. But global income levels per person have since accelerated from around $1,100 in 1800 to $3,600 in 1950, and over $10,000 today.

Economists have long tried to explain this sudden surge in output. Most theories have focused on factors driving long-term economic growth such as the quantity and productivity of labour and capital. But a new paper (Growing, Shrinking and Long Run Economic Performance) takes a different tack: faster growth is not due to bigger booms, but to less shrinking in recessions. Stephen Broadberry of Oxford University and John Wallis of the University of Maryland have taken data for 18 countries in Europe and the New World, some from as far back as the 13th century. To their surprise, they found that growth during years of economic expansion

has fallen in the recent era- from 3.88% between 1820 and 1870 to 3.06% since 1950 - even though average growth across all years in those two periods increased from 1.4% to 2.55%.

Instead, shorter and shallower slumps led to rising long-term growth. Output fell in a third of years between 1820 and 1870, but in only 12% of those years since 1950. The rate of decline per recession year has fallen too, from 3% to 1.2%.

So why have these "growth reversals" decreased in length and depth? In another paper, Messrs Broadberry and Wallis find that conventional explanations- such as demographic change or a sectoral shift from volatile agriculture to the more stable services sector- do not fully explain the shift.

More important is the rise of the rule of law, enabling disputes to be settled by impartial courts. Before the modern era, elites would fight between themselves for the spoils of growth and send the economy back to square one through wars, corruption and the like. Respect for courts to resolve disputes prevents this from happening. With populist politicians challenging the authority of judges once again across the world, that is food for thought."

I respect the editorial prowess of *The Economist,* but believe that rule of law is rising and that poverty is still declining. China stands out in that respect. I remember being in central China in the 1990s seeing banners urging people to buy insurance. That was a clear message about respecting the rule of law. Instead of settling disputes after an accident with fists, corruption or political power, China embraced the rule of law and insurance provided the monetary component of settlements. It was startling to be in China in those days and realize how important the rule of law really is and how much we simply take that for granted. In my view the lesson to be taken for today from the study by Broadberry and Wallis is the importance of minimizing the damage done during times of economic contraction. The United States and other developed economies

are not going to abandon the rule of law. That is here to stay. The great challenge, as we have seen from the great depression to the recent deep recession, is to keep the underlying seeds of economic growth alive during times of economic contraction.

The financial crisis of 2008-2009 was the greatest economic threat since the Great Depression. We now can see that the aftermath of the Great Depression would have been much better if there had been a Ben Bernanke and a Federal Reserve Board willing to take unprecedented steps to revive the economy. Expanding the Federal Reserve's balance sheet from $900 billion to $4.5 trillion was unprecedented, bold and controversial. But the results - a sustained revival in economic growth, albeit modest - speak for themselves. Clearly the economy would have suffered without the help of the Federal Reserve. And central bankers around the world have studied and copied Bernanke's leadership. The result is the current synchronous global economic recovery.

Economists are still learning. The current question is when and how much to reduce the Federal Reserve's balance sheet. And there are associated questions, including interest rates and interest on excess bank reserves. But these are being addressed in a much-improved economic climate.

What all this means for investors is that there is less fundamental risk in equities than is commonly understood. Stock prices will fluctuate as investor sentiment ebbs and flows, but the long term trend is towards higher stock prices.

What stocks need now is a return to sustainable growth around 3%. That isn't the case so far this year. The Atlanta Federal Reserve team has cut their estimate of first quarter growth to 0.6%. However, that is expected to be temporary - the result of late arriving tax refunds and bad weather. Growth is expected to rise this quarter to at least a 2% annual rate. The Federal Reserve

is still optimistic and is expected to raise interest rates again in June. The optimism is largely based on the dramatic improvement in consumer sentiment since the November election. Although in the latest University of Michigan survey there is a wide gap when it comes to the economic outlook between Republicans and Democrats. Republicans are optimistic while Democrats are gloomy. The difference is a 50.5-point gap. The nation remains deeply divided. But so-called core retail sales rebounded last month, gaining 0.5% after a February 0.2% decline. Odds are the optimists will be correct and growth will improve this quarter.

Stocks remain our best choice.

I will have the next market review and update for you one week from today on Wednesday April 26, 2017.

All the best,

John Dessauer
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