John Dessauer Investments, Inc.

www.johndessauerinvestments.com

John Dessauer's market review and update as of Wednesday April 27, 2016.

Europe did not address the post 2008 recession banking mess as quickly as did the United States. We complain about sluggish economic growth and tediously slow age gains. Europe has far more to complain about from austerity to chronic unemployment and anemic economic growth. In an effort to stimulate growth central banks here have turned to imposing negative interest rates. It is too soon to tell if this will help stimulate economic activity. But we do know that negative interest rates are challenging savers and distorting markets.

The Swiss central bank has, once again, imposed negative interest rates, but not in the same way as years ago when the Swiss franc soared. Back then the negative interest rates were used as a tool to discourage foreign buying of Swiss francs. The negative interest rates applied only to foreign depositors. This time they are being used in an attempt to improve the rate of economic growth. They apply to the Swiss as well as foreign depositors. There are some exceptions, but they apply to only a few. Ordinary citizens now must pay the bank a fee to hold their savings. As you would guess, this is causing enormous problems for the Swiss people and distorting the entire Swiss financial system.

The Swiss social security system relies on private pensions that are regulated by the government. Employees, including the self-employed, must take part of their income and invest in a pension. The managers of Swiss pensions have been severely challenged ever since the 2008-2009 recession. Faced with extremely low interest rates many managers decided to invest in Swiss real estate for low risk, a decent income and a possible capital gain. Of course, the pension fund buying pushed up real estate prices. Now negative interest rates have been added to the mix. Since Swiss real estate has been a good investment over the last several years, the pension funds have been adding to their Swiss real estate portfolios. The result is that Swiss real estate is now so expensive that only big funds and the very wealthy can afford to buy. The Swiss are upset. They have historically been good savers, but they have never seen financial conditions like today. Everything available looks risky and anything safe either pays nothing or costs a fee. So far the Swiss financial system continues to function as an intermediary, but Switzerland needs real economic improvement soon. The solution of course is for the Swiss economy to grow at a faster rate so interest rates can return to positive territory. But, the Swiss economy is so closely tied to the European Union that growth in Switzerland is not likely to improve on its own until their neighbors find a way to lift economic growth to a much higher level. Switzerland once was an economic island, and many times prospered even when its neighbors suffered economic setbacks. However, over the years since the European Union (EU) was founded Switzerland has adopted ever more official agreements to follow the EU rules and regulations. The net is that Switzerland might as well be a full member of the EU. So far the Swiss have not made a fuss and seem likely to stay with their EU agreements. In Great Britain the situation is very different. So many British citizens see the EU as a burden that exiting the EU is subject to a referendum. The vote comes up on June 23 and is scaring economists, investors and many politicians, including President Obama.

The Brexiteers, as those in favor of leaving the EU are called, are upset at the costs of EU membership, more than 6 billion pounds a year, are deeply disturbed about immigration and do not like having the EU leadership making laws that apply to all members, Britain included. They favor leaving the EU, making Britain fully independent once again. Immigration became a sticky issue after the 2008-2009 recession. People can move freely from one EU member country to another. They do not need to apply for a work permit to go job hunting. When unemployment rose and jobs became harder to find, many British resented having to compete with people from other countries for jobs in their backyards. The recent flood of immigrants from the Middle-East has added to the Brexiteers' fears. Now they worry not only about jobs, but also about terrorists joining the immigrants. Once in the EU the new immigrants could migrate to Britain.

There is plenty of opposition. The British treasury has recently published a detailed analysis of the costs of leaving the EU. As an EU member British business has free and open access to the 500 million people in the EU. Goods and services cross the English Channel without red tape or customs duties. The British treasury calculates that leaving the EU, even if a Canada or Norwegian type trade agreement could be reached, would severely damage the British economy. While there are disagreements on the amount of damage, it seems quite clear that Britain would pay a heavy price for leaving the EU.

London's real estate market would take a big hit as major banks were compelled to move their headquarters and staffs to elsewhere in the EU.

A British exit from the EU coming on top of sluggish growth, negative interest rates and the associated financial strains, could push the EU economies as well as Britain back into recession. No wonder many government officials, including President Obama, are urging the British to stay in the EU. The polls at the moment indicate that the British majority favors staying in the EU. But, until the actual results are known a possible British exit from the EU is a serious concern. While the U.S. economy most likely would not feel any significant immediate consequence of a British exit, in the longer run softer growth or recession in any part of Europe would cause issues for the U.S. We have already seen how a strong dollar hurts corporate profits and U.S. exports. A British exit could be followed by a much stronger dollar as uncertainty gripped all of Europe. Like it or not, we have a stake in the British June 23 referendum.

Closer to home first quarter earnings are coming in mixed, but so far, on balance, better than analysts expected. The broad U.S. stock market averages have edged higher, and are likely to trade in a narrow range as quarterly earnings continued to be reported. Stocks remain our best investment choice.

Just in case there is anyone who does not realize the connection between economics and politics here is a story from Argentina.

For the last fifteen years Argentina has been exiled from world bond markets. That followed a default on $100 million in debts in 2001. In 2014 Argentina defaulted for a second time. That resulted in a protracted, nasty legal battle between Argentina and its creditors. Then, last November Argentina's voters elected a new, market friendly President, Mauricio Macri. While the battle for control, of Argentina's legislature goes on, the new president has already made significant changes, including revoking regulations on exports. Anthony Simond, an investment analyst at Aberdeen Asset

Management says this about Argentina today: “Argentina has one of the best economic policy teams in emerging markets and they have the potential to transform the economy.”

Others clearly agree. Argentina recently went to the market to borrow $15 billion. The offering attracted $50 billion in bids. Argentina is proof that when voters get the politics right, prosperity follows.

The next market review and update will be one week from today on Wednesday May 4, 2016.

All the best,

John Dessauer