John Dessauer Investments, Inc.

www.johndessauerinvestments.com

John Dessauer's market review and update as of Wednesday May 11, 2016

Until recently, the concern has been about slowing growth in China and slow growth in Europe. Now attention has shifted to the United States. Europe had a respectable first quarter. Growth in China, while slower, is still above a 6% annual rate. The United States was supposed to be the reliable engine of growth for the global economy. But the U.S. economy barely grew at all in the first quarter. Now there is another disappointment. Job creation in April - at 160,000 - was well below the 240,000 expected, and below what is needed to prevent unemployment from rising. The only good news is that wages rose at a 2.5% annual rate in April. However, that is below the 3%-3.5% rate considered normal after a recession.

Eight years after the great recession and the U.S. recovery appears to be slowing. That has made investors nervous. Stocks have stalled. Pessimistic stock market pundits are signing an old song: "Sell in May and Stay Away."

The Obama administration is not helping. After jolting multinational businesses at home and abroad with its attack on the Pfizer-Allergan merger, the Treasury Department has placed five countries - China, Japan, Germany, South Korea and Taiwan - on a new monitoring list designed to pressure those governments to take steps to reduce the large trade imbalances with the United States.

The Treasury is required by law to submit to Congress a report on trade matters every six months. The new action was disclosed in the recent mandatory report. The Treasury did not designate any country as a currency manipulator, but it did say it is employing new tools to more closely monitor countries where the United States is running large deficits. If there ever was any doubt, this makes it clear the Treasury Department does not understand the basic economics of trade. You would think they must know that imports and exports are two sides of the same coin. At the least they should understand the accounting. A trade deficit is balanced by a current account surplus.

The five countries being monitored have large stakes in the health of the U.S. economy. If the U.S. economy falters and their exports decline, they suffer job losses and other economic setbacks. They are very much trade partners and should be treated as such. If the Obama administration wants to increase U.S. exports, they should take steps to encourage U.S. providers of goods and services to become more competitive on world markets. Serious reform of U.S. business taxation would be a good start. Instead, the Treasury Department is moving in the direction of protection, a policy that has never worked for any government. If carried too far it can be destructive to the U.S. economy. That is the lesson from the Smoot Hawley Tariff Act of the 1920s that preceded the great depression. Unfortunately, that is a lesson candidate Trump has also apparently forgotten.

The United States consists of 50 diverse states, each with its own economy. Can you imagine the State of Florida imposing restriction on “imports” from other states? We move goods and services great distances, from one coast to the other and from north to south without ever even considering protecting one state from another. But when another country is involved - even one with an economy smaller than that of Texas or California - trade suddenly becomes a big issue. Free trade between the 50 states enhances the overall economy. It is bewildering that so many politicians cannot grasp the simple basics of the benefits from free trade. At the least, they should understand that U.S. consumers have benefited from international trade. Some may complain about jobs lost to China, but they ignore the fact that goods made in China are cheaper for U.S. consumers than similar goods made in Germany or the United States. Plus there are the jobs created at home distributing and selling the imports. The U.S. economy certainly would benefit from a change in government trade policies. Unfortunately both political parties currently suffer from protectionist attitudes.

At the moment, economies - emerging and developed - are still battling the aftermath of the financial crisis of 2008 and the great recession that followed. Restoring growth is the top priority and major investor concern. But never-the-less, we should pay attention to the emerging protectionist policies and hope they fade away.

The economists and analysts at Morgan Stanley do not think this is a time to sell and stay away. On the contrary, they think the U.S. economy will improve and stocks will continue to reward patient investors. The following is from the May issue of the Morgan Stanley monthly "On the Markets."

"However, markets and economic data tend to move in cycles; so, just as everyone buys into a trend, it changes and moves in the opposite direction. We think 2016 will mark one of those important turning points, and there is mounting evidence to suggest why that is the case.

First, the economic data and activity in China is much stronger than last year, when the Chinese economy was slowing rapidly. Second, the US dollar has been decidedly weak this year against most currencies—even emerging markets (EM) currencies. A weak dollar takes pressure off global prices and thus, global trade. It also supports commodity prices which, in turn, has stabilized EM equity and credit markets—a big change from last year. Third, manufacturing and industrial data shows orders and inventories improving, unlike last year when they were heading in the wrong direction. Fourth, cyclical and value-oriented stocks are outperforming growth stocks much more convincingly than during last year's rally—a strong signal that growth is going to accelerate. Finally, company earnings revision breadth this quarter is exhibiting some of the most positive moves we have ever observed. That's the best leading indicator we have for future earnings trends—the ultimate driver of stock prices."

Given the dismal state of investor sentiment at the moment, the Morgan Stanley analysis qualifies as a contrary point of view. However, Morgan Stanley's experts cover global markets and economies in depth and have a habit of being right more often than wrong. Our best strategy continues to be to stay invested in stocks.

I will have the next market review and update for you one week from today on Wednesday May 18, 2016.

All the best,

John Dessauer