John Dessauer Investments, Inc.

www.johndessauerinvestments.com

John Dessauer's market review and update as of Wednesday July 20, 2016

The Dow Jones Industrial Average and the S&P 500 have reached new highs. Global stocks are following suit. The post Brexit world is far different than expected, at least as far as stock markets are concerned. The main reason is that central bankers in the UK, the US and the euro region are signaling further stimulus if growth slows. In the US, Federal Reserve board members who have been urging more interest rate hikes have backed off, and now worry about keeping growth alive. Japan is going farther and proposing fiscal spending to keep that economy growing.

Pessimists say stock markets are rallying based on a false hope that politicians and central bankers can prevent the next recession. They argue that after the Brexit vote, a slowdown in the UK and Europe is inevitable. They go on to argue that the US cannot escape the combination of slower growth in China, the UK and Europe. Of course the same pessimists did not see the global stock market surge coming. They predicted a post Brexit global stock market slump, or worse. Now wrong, they are doing what they always do: changing predictions rather than explaining how they came up wrong. Their problem is that the collective wisdom of millions of investors has far more often been right than wrong. Stock markets have earned their place as leading indicators.

Having said that, British stocks fell last week, after news that the Bank of England left interest rates unchanged. Apparently, British stock market pundits expected an interest rate cut to offset any downward drag from the Brexit vote. They forgot that the currency market is the great financial market watch-dog, ready to punish the currency of any country that moves monetary policy in the wrong direction.

You don't raise interest rates when a currency is strong. Paul Volcker made that mistake when he was chairman of the US Federal Reserve in the 1980s. He raised interest rates in a preemptive strike against non-existent inflation. The dollar soared, threating to crush the U.S. economy in a flood of cheap imports. Fortunately, he realized his mistake before too much damage was done. He brought US interest rates back down quickly. The opposite is also true. You don't cut interest rates when a currency is weak. The British pound has been a casualty of the Brexit vote. It is down sharply - to a 30 year low. The last thing the British economy needs now is a flood of cheap imports to threaten domestic manufacturers. That is why the Bank of England did not cut interest rates. It was the right move. British stocks will most likely follow the U.S. and global trends and recover quickly.

As I write this week's market review I am at 36,000 feet over the Atlantic Ocean, returning to Florida after two weeks in Europe, Switzerland and southern France. We were at the airport in Nice the day after the senseless massacre. We were headed to Zurich. I compliment the French police and airport security forces. They were there at the airport in force, but the process of checking luggage and clearing security went smoothly and quickly. The same was true when we left Zurich. As a French minister said, France must learn to live with terrorism because there is no easy or quick solution. The same can be said for the rest of Europe.

Even though recent acts of terrorism have been committed by local citizens, there are strong feelings against allowing more terrorists to sneak in disguised as refugees. Switzerland, for example, is challenging an EU requirement that people be allowed to move freely from one country to another. Switzerland is not a member of the EU, but has entered into a long list of trade agreements with the EU. One of the conditions imposed on Switzerland has been allowing people from any EU country to freely enter Switzerland and live and work there. The British vote to leave the EU was based on a strong desire to take control of immigration and break the EU rule of free flow of people. At first, EU officials from Brussels said there would be no breaking of that rule in negotiations with Britain. However, Brussels has a problem. The free flow of people rule is fast becoming more than unpopular. It is becoming a major political issue, threatening EU unity. Brussels does not have a strong hand in dealing with immigration. The EU needs reform, not only on immigration, but also in dealing with trade agreements. The Brexit vote is more and more looking like the force that will change the EU for the better.

At home, the Federal Reserve at their June meeting said the US economy continued to expand from mid-May through the end of June, but there was little indication that inflation would surge any time soon. In the Beige Book they said that wage pressures were “modest to moderate” in most of the central bank’s districts and that price pressures remained slight. Add the uncertainty following the British Brexit vote and bond traders now think U.S. interest rates will remain unchanged until mid-2017.

According to data from Morgan Stanley, the median U.S. stock yield is 3.2%, a historic high, especially when compared with yields on government bonds or corporate credit yields. Of course dividends have to be paid out of profits, so the outlook for final demand and corporate profits is important for the long term future of stock prices. But, with U.S. and global interest rates likely to stay low for a long time the attractive dividend yield on stocks provides support for current prices. If, as is possible, the U.S. economy keeps growing at a 2% or better rate, and Europe does better than expected post Brexit, stocks will likely continue marching to modestly new highs.

Patiently holding on to stocks has been the best strategy. That continues to be the case.

Note: For all who have long suffered with **Rite Aid**, odds on the Walgreens buy out are looking better. There are reports that Walgreens is in serious negotiations with FTC regulators on how to satisfy them by selling off **Rite Aid** branches. In my opinion, the deal will be approved because to turn it down would be too risky for the regulators. They would look foolish if they turned down the deal and then **Rite Aid** got in trouble because of the company's large debt. Hold on to **Rite Aid**. Odds are that Walgreens will pay $9 a share in cash this year.

I will have the next market review and update for you one week from today on Wednesday July 27, 2016.

All the best,

John Dessauer