John Dessauer Investments, Inc.

www.johndessauerinvestments.com

John Dessauer's market review and update as of Wednesday October 12, 2016

In the most recent University of Michigan Consumer Sentiment survey, more American consumers today are feeling "uncertain about business conditions over the next 12 months" than at any time since the survey began in 1978. If the survey had begun ten years earlier, in 1968, the readings during the 1970s would likely have been as low as they are today. The difference is that today we have low inflation, low interest rates and stocks near record highs. There were good reasons to be gloomy in the 1970s. Whatever the reason, today's pessimism is having an effect on what people are doing with their investments. According to the American Association of Individual Investors, we are close to an all-time record percentage of investors who are "neutral," neither bullish nor bearish. In other words investors are "frozen" - afraid to buy and afraid to sell.

Economists, including Harvard's Larry Summers, argue we are stuck in a secular stagnation that can last for decades. Market pundits argue the Federal Reserve has done all it can, and that it is only a matter of time until the next recession. Working Americans are frustrated. Eight years after the financial crisis, personal per-capita income is stagnant. No wonder so many investors are "frozen." Can the collective wisdom of so many be wrong? Analysts, economists and investment advisors at Morgan Stanley Wealth Management not only think the crowd is wrong - they see a future much brighter than most believe possible.

In the October issue of *On the Markets* Morgan Stanley Wealth Management's team makes the case that: "We are closer to a new dawn than consensus positioning reflects and, for patient investors, significant wealth-creating opportunities are on the horizon."

Point 1: "For us, the marvel is that the U.S. economy has actually managed to do as well as it has given that we have endured a perfect storm."

The perfect storm has been a hurricane of four colliding supercycles – demographics, productivity, commodities and debt. Morgan Stanley calculates that collectively these reduced growth rates by one to two percent a year. And in their words: "Equally provocative is the contemplation that these drags have been massively amplified by anti-growth policy priorities….and counterproductive regulation…"

"In fact the most distinguishing feature of the cycle is the extent to which animal spirits have evaporated, leaving the level of investment completely out of balance with savings."

Point 2: The oldest millennials, already 6 million stronger than the baby boomers, turn 35 this year. This does not mean the demographics have completely reversed, but it does mean that the worst of the deceleration in our working age population is over. The rate of growth in working age population is likely to increase from the current trough of 0.5% annual rate.

Point 3: Productivity growth has fallen to a level not seen since the last great recession of 1982. While most lament and see little hope for improvement, Morgan Stanley sees a turn for the better.

"Research and development (R&D) as a share of GDP is closing in on 3%--near the levels of the mid 1960s and mid 1980s, periods that presaged huge productivity gains."

Point 4: "The worst of the headwinds from debt and commodity supercycles is also behind us."

The days of 110% mortgages are over. Banks have been chastened. Credit standards have been raised to sensible levels. Banks' capital ratios are healthy. Consumers likewise have learned hard lessons from the debt crisis. The federal government, with its huge debt, is a beneficiary of low interest rates. The cost of carrying the federal debt is 1.2% of GDP, a 40 year low.

Commodity markets are trading at 1998 levels, meaning they have adjusted to the slowdown in growth in China. Here again Morgan Stanley is not making a case for a surge in growth, but simply saying the worst is over. Debt and commodities are no longer a drag on growth.

Point 5: "With supercycles poised to recover, we need to attack the so-called permanent impediments to growth that are nothing more than the result of stale, sclerotic and man-made solutions to yesterday's problems."

The number one need identified by Morgan Stanley is the need for government fiscal spending on infrastructure. They point out that the average age of our nation's real assets is close to 22 years, a level not seen since 1938. Of course this raises the question of how to pay for the new roads, bridges and airports. Last week I wrote about the possibility of government partnering with the private sector to raise the needed money.

Here is Morgan Stanley's view on the subject of paying for the infrastructure projects: "Rather, comprehensive corporate and personal tax reform, elimination of bureaucratic red tape, a review of entitlements and amended regulations might yield the most powerful longer term palliatives without imperiling deficits. We estimate that close to two-thirds of the $2.5 trillion gap could be closed by attacking private investment incentives, regulation and income inequality. These actions could become multiplicative, as fundamentally restoring confidence in government and reducing policy uncertainty could reignite entrepreneurial and animal spirits."

Changing attitudes among politicians and bureaucrats in Washington is never easy and at times impossible. Tax reform and infrastructure repair are not going to happen this year. If they develop, it will take time. Meanwhile, Morgan Stanley thinks the end of the drag from the supercycles will be enough to keep overall growth alive and also enough to lift corporate profits back into positive growth territory. They have raised their twelve month target for the S&P 500 stock index from 2,200 to 2,300. That indicates a twelve month capital gain of 7% which, with dividends, means a total return in high single digits. That is far better than cash even if the Federal Reserve raises interest rates, and better than bonds as well. Stocks are still an investor's best choice.

I will have the next market review and update for you one week from today on Wednesday October 19, 2016.

All the best,

John Dessauer

©October 2016