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Economic & Financial Outlook

Robert Genetski **December 9, 2024**

A Tectonic Shift in Policies Will Shape the Next Four Years

Trump's overwhelming victory sets the stage for monumental changes. Dramatic domestic and international changes are already underway in anticipation of a Trump Administration.

After five years of destructive government policies, the US has the opportunity for a once-in-a-century restructuring of government and culture that will impact the US and the world.

Two most significant economic changes will come from the Departments of Government Efficiency (DOGE) and a reform of Health and Human Services (HHS).

DOGE will identify and eliminate waste from government programs. Federal spending and regulations account for an estimated $10 trillion a year—1/3 of all final spending (GDP), Without the discipline inherent in the private sector, government spending is half as productive as spending in the private sector. Hence, $5 trillion a year, half of all federal spending, is waste. Elon Musk and Vivek Ramasamy are strong and highly creative individuals who should be able to identify and effectively eliminate at least $2 - $3 trillion of that waste.

HHS is responsible for providing guidance that improves the health and well-being of Americans. Americans and are less healthy than those in other developed countries, but we pay twice as much for healthcare. As with so many government agencies, HHS has failed in its mission.

HHS reliance on the pharmaceutical industry for its funding and for testing the effectiveness of drugs is both a fundamental structural flaw and a conflict of interest.

The response to Covid by subagencies (National Health Institute (NIH), FDA and CDC) exposed serious weaknesses that led to a significant increase in excess American deaths.

RFK Jr. has been at the forefront of warnings of the dangers from certain chemicals and food additives. He raised serious questions about the lack of science surrounding the testing of pharmaceutical drugs and vaccines. RFK also has objected to the conflicts of regulatory agencies and personnel being funded by the companies they regulate and self-evaluating the safety of their own drugs.

Trump's appointments to head NIH, FDA and CDC are all leaders who followed the science and recommended effective low-cost solutions—which were rejected by current administrators. The reforms proposed by Trump's appointees will not only make American healthier, but will drastically lower the cost of healthcare.

Trump's efforts to restructure government won't be easy. Powerful interest groups will lobby and do more to protect their incomes and profits. However, given US fiscal safety challenges, reforms are essential.

In addition to potential reforms from DOGE and HHS, Trump's naming of Scotte Bessent for Treasury Secretary is good news. Bessent is an extremely talented classical economist who understands economic history, financial markets and global dynamics. He will shape sound economic policies.

Historically, America has recovered from misguided policies. A unique characteristic of these resets is that America not only recovers, but also makes up for losses from destructive policies by growing faster and getting stronger. Our extended forecast assumes Trump will be highly successful in *Making America Great Again*.

The Economy's Growth Over the Next Four Years

The difference between the past five years and the next will be breathtaking. The move away from free-market classical principles took a toll on consumer sentiment and living standards. The move back will produce the opposite.

Many viewed 2% to 3% growth of the past four years as a sign of economic strength and prosperity. It really wasn't. The reported growth was due to federal programs that wastefully redirected private resources. This waste hurt living standards.

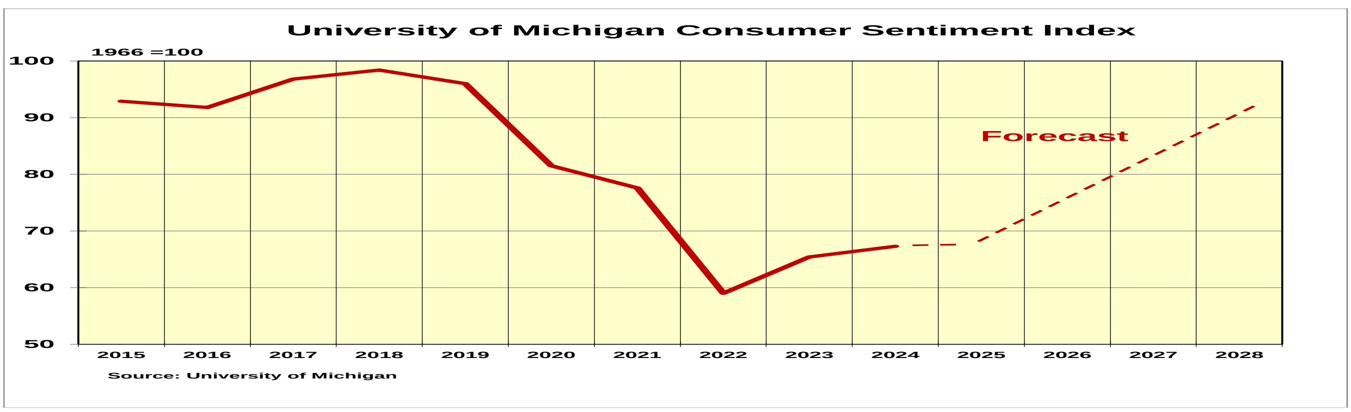
A chart on Consumer Sentiment (CS) captures how many felt about their economic situation. The forecast of a steep rise in CS reflects an expected successful shift in policies.

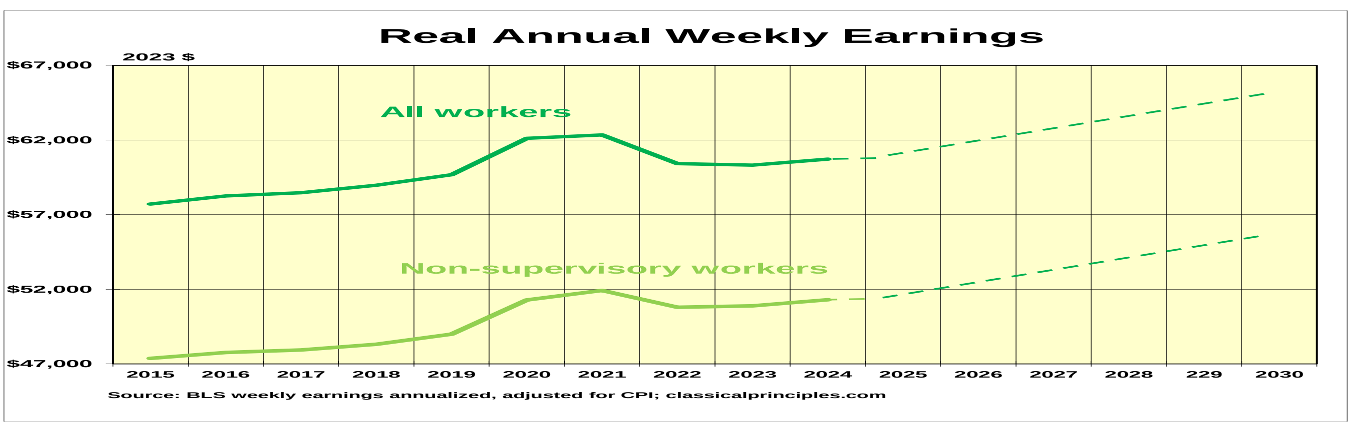
Real annual wages are another guide to how well workers are doing. The steady increase of 1% a year from 2015 to 2019 was typical of what happens when federal spending and regulations are contained and tax rates are lowered.

Statistical fluke: The sharp jump in annual wages in 2020 and 2021 was a statistical abnormality. It was created by a decline in lower-paying jobs during Covid. With many of higher-income individuals still working and fewer workers, average salaries per worker soared. By the end of 2021, the workforce was back closer to normal. From that point until October, 2024, real earnings have been flat to down.

The stagnant wages in the face of inflation were only one aspect of what happened to living standards. A sharp rise in mortgage rates, car loans and insurance premiums had most families feeling like they were in a recession or worse.

If Trump's team is as effective as we expect, the economy will soar. Workers' wages rise rapidly as resources are reallocated into products people value. The greater the cuts in government, the greater the increase in real wages.





Inflation and Interest Rates in the Next Four Years

Inflation occurs whenever spending grows faster than output. Inflation is always a monetary phenomenon.

The talk about tariffs causing inflation is due to a misunderstanding of economics. Tariffs, if they occur, would produce a one-time increase in prices for certain goods and services. Without an increase in spending, individuals would have to shift their spending from the higher-priced tariff goods to buying more non-tariff goods. Net, there would be no overall increase in spending or inflation.

The inflation rate over the next four years will depend on two things—the rate of change in spending and the growth in output.

Money and Spending

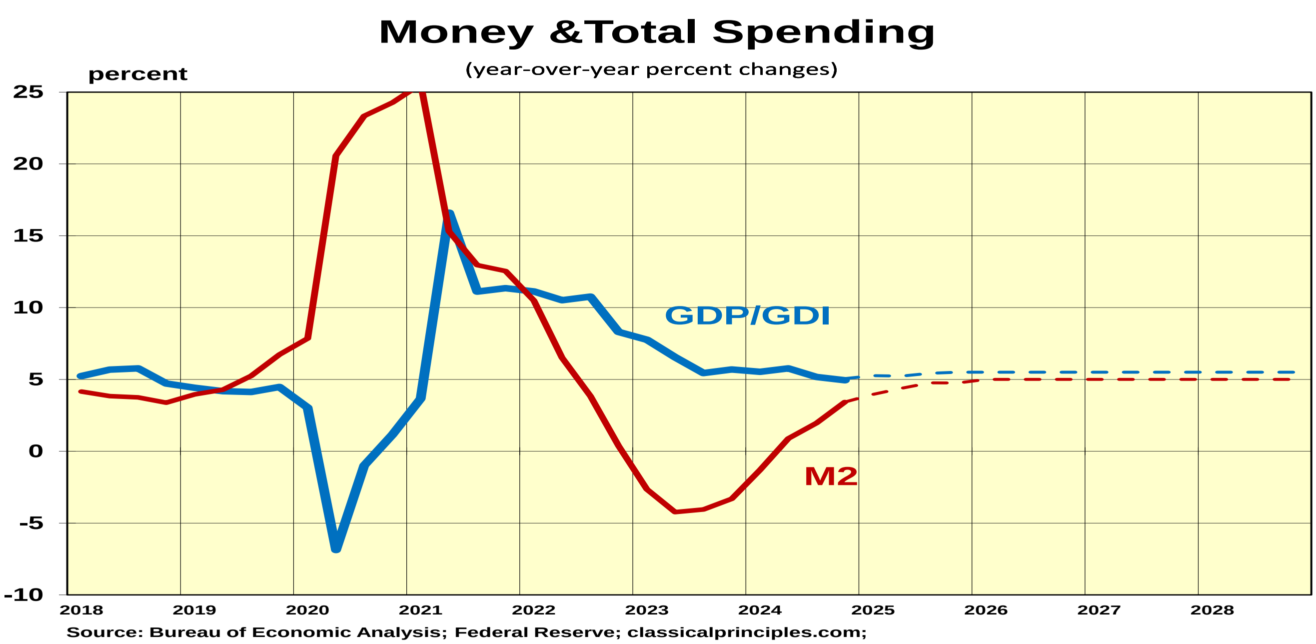
The money supply is the key driver of inflation because it impacts spending (GDP). The chart below shows annual changes in spending as well as annual changes in M2, the most traditional measure of money.

When the government shut down the economy in 2020, there was a surge in government spending and money. The excess money led to a surge in spending.

Without the Federal Reserve purchasing trillions of dollars of securities, neither the surge in money nor the surge in spending would have occurred. The double-digit increase in spending in 2021 and 2022 produced the double-digit inflation that followed.

For the past two years, the Fed has been selling securities, which took some excess money out of the economy. As a result, spending slowed from its peak of 17% in 2021 to the recent 5% vicinity.

In predicting Fed behavior over the next four years, we have to assume that the Fed has learned how much damage their flooding the system with money caused. Doing so ignited a destructive inflation and drove up interest rates. Although the Fed should have seen this coming, there is nothing like the highest inflation in 40 years to remind them of the importance of money. We expect an extended period of relatively stable monetary growth averaging close to 5% a year in the period ahead.



Output and Inflation

Inflation occurs when spending increases surpass the economy's ability to produce. If money and spending were to increase at a 5% annual rate over the next four years, the inflation rate would depend and how fast the economy could increase output to match it.

Historically, real output in the US has grown at an average rate of 3%. Of this increase, 2% represents productivity or efficiency. The remainder is from an increase in hours worked by the labor force. When either productivity or the labor force grows faster than their historical averages, real growth can exceed 3% a year.

The following chart shows the pattern of real growth since 2018. It highlights the Covid collapse and the recovery surge. With an expected stable monetary policy and the expected shift to free-market classical principles, productivity should not only increase but make up for the prior misallocation of resources.

Real Growth

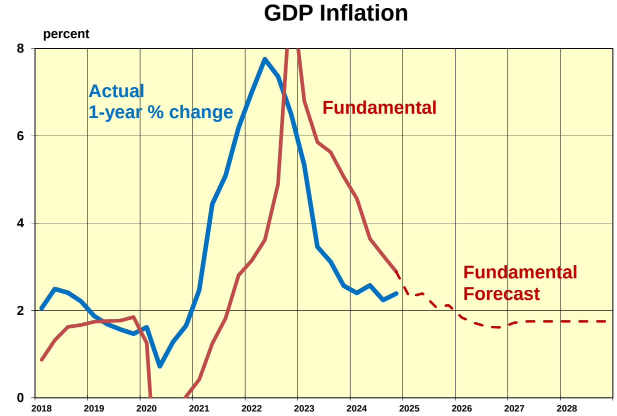
Source: Bureau of Economic Analysis; Federal Reserve; classicalprinciples.com;

One interesting aspect of US history is that the economy has the capacity to recoup the damage from prior periods of destructive economic policies.

The extent of the growth improvement will depend on how successful Trump's policies are and the level of bureaucratic resistance. We expect these policies will be very effective, raising the real growth rate to 3¾% by 2026 and beyond.

An acceleration in real growth will make it easier for the Fed to keep inflation down. The combination of stable monetary growth and rapid real growth will enable the GDP inflation index to move gradually below the Fed's 2% target. Other inflation measures, such as the CPI would be slightly above that target.

GDP Inflation



Source: Bureau of Economic Analysis; classicalprinciples.com; fundamental inflation is 2.5-year gdp annualized minus 3.0% or average growth rate. Forecast is based gradual increas in real growth toward 3.75%.

The transition back to free-market classical policies will not be easy. There will be progress and setbacks, each of which will have important implications for the economy and financial markets,

All forecasts are based on the effectiveness of policy assumptions. It is best to look at the forecasts as a framework for where the economy is heading under those assumptions. These monthly reports will closely monitor changes in policy along with their impact on the economy and financial markets.

Monetary Indicators

Near-term monetary indicators point to a stable monetary environment. As noted in prior reports, there is an ongoing conflict between high-powered money, which the Fed controls directly, and the traditional M2 money measure.

The Fed continues to sell securities each month, taking money out of the economy. In September, the Fed began cutting interest rates. This led some to assume the Fed was easing monetary policy.

However, since September until the end of November, the Fed sold $80 billion in securities. This action removed the same amount of high-powered money. Over this period, banks added $22 billion to their deposits at the Fed, bringing the total reduction in high-powered money to roughly $100 billion.

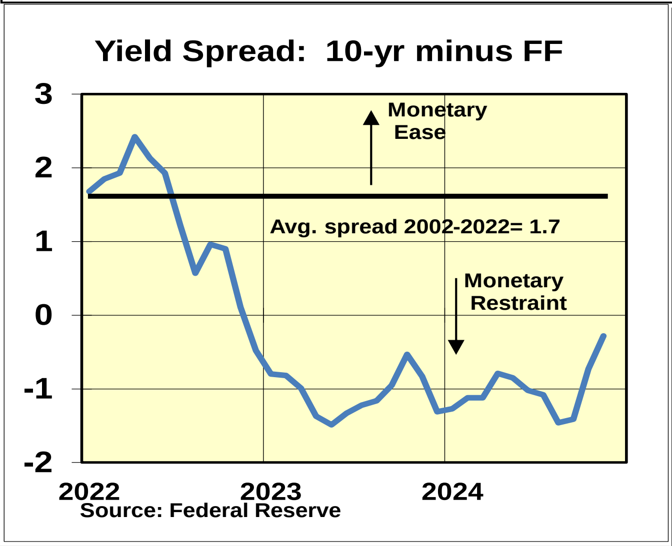
Despite this reduction, the M2 measure of money continues to increase. We estimate M2 was up 3½% for the year ending in November and 4.2% (annualized) over the past six months.

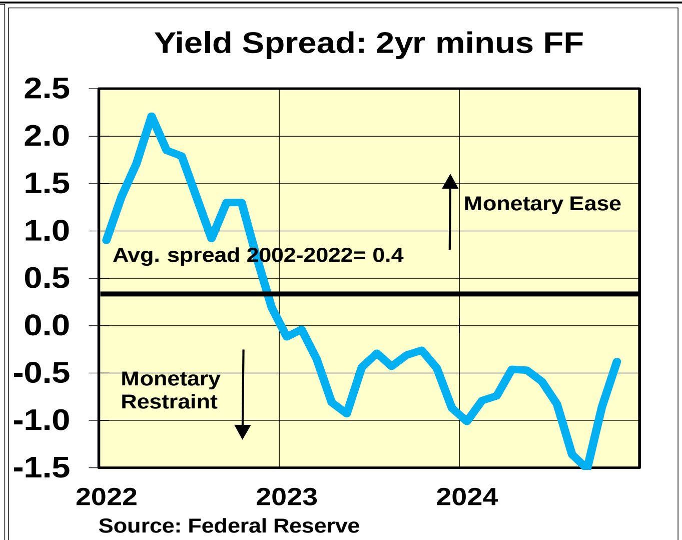
By most measures, the economy continues to behave well despite of the Fed reducing the supply of high-powered money. This suggests there is sufficient money for businesses to continue to produce.

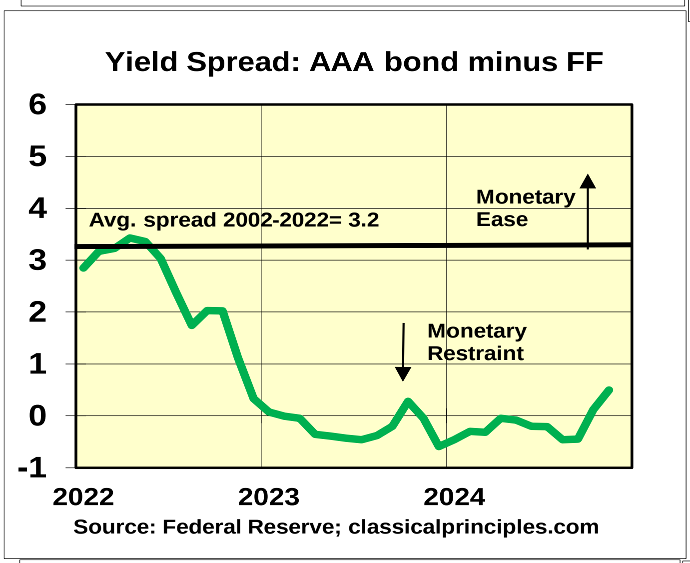
Yield curves also have pointed to a less restrictive policy. The charts on the following page include our projection if there is a ¼% cut in the fed funds rate at the Fed’s upcoming meeting. They show that while yield curves remain inverted, they have become less so.

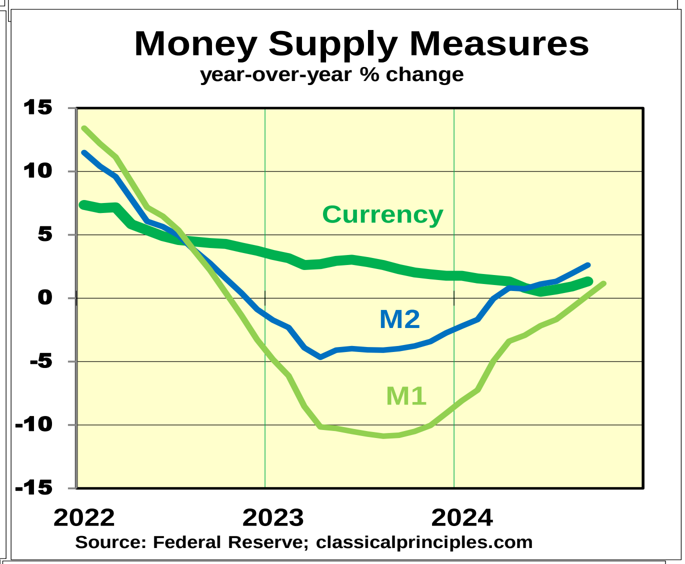
We believe the optimism associated with Trump’s election and the anticipated positive policy changes will continue driving spending and the economy into the coming year. Business plans that were in abeyance are now going forward and are not likely to be canceled due to a lack of money.

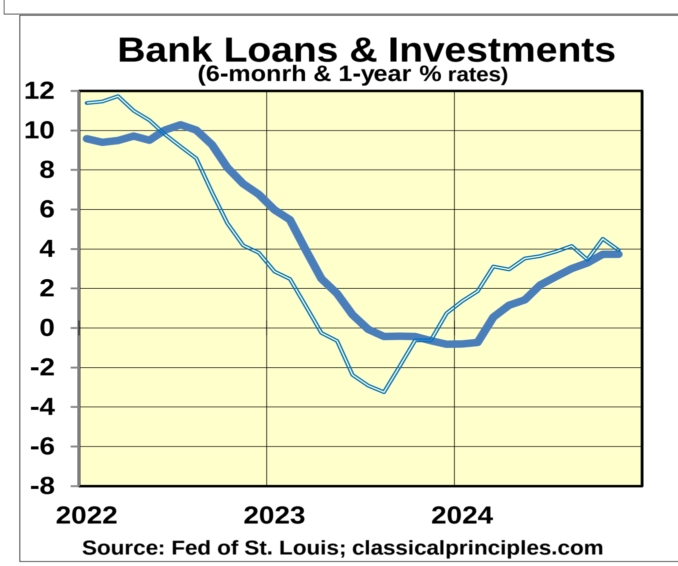
MONETARY INDICATORS

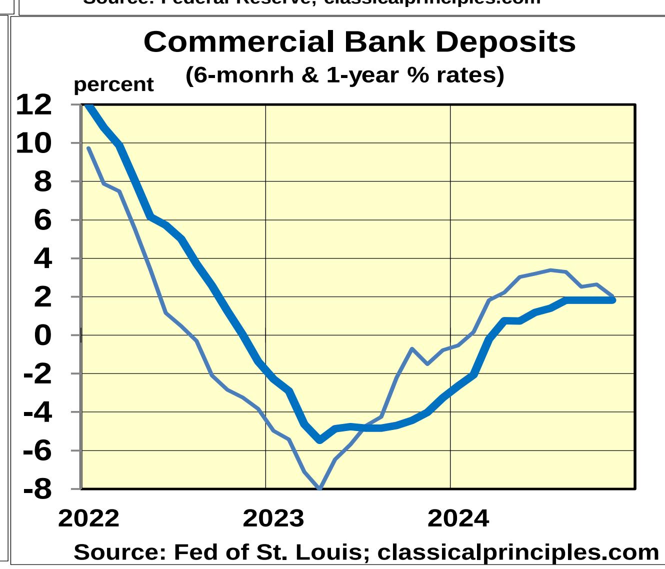












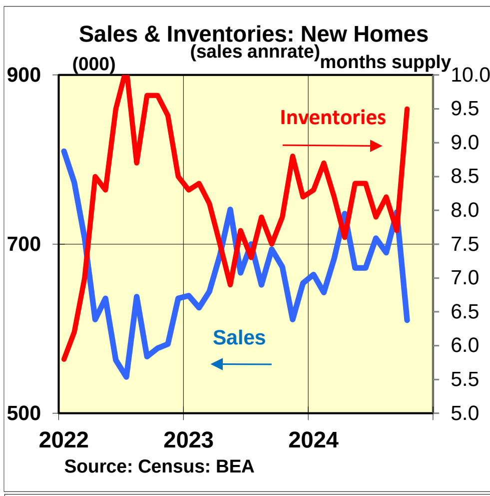
Leading Indicators

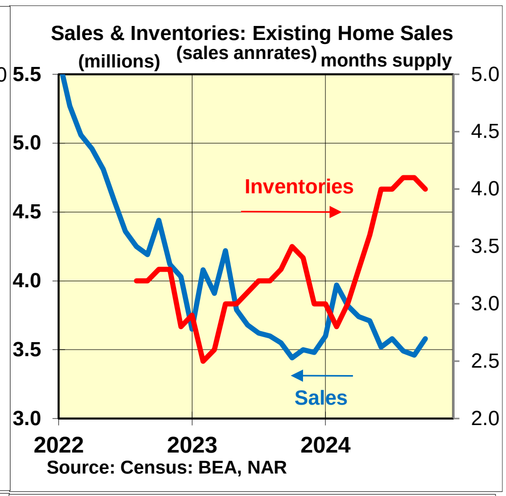
Leading indicators remain mixed. The upward trend in stocks, low initial unemployment claims and surveys showing positive new orders all point to more business growth.

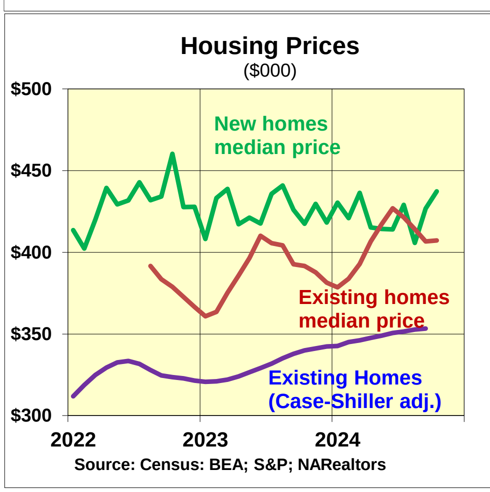
In contrast, housing, one of the most reliable early indicators, points to weakness in terms of both sales and new home activity. High mortgage rates and relatively high inventories point out vulnerabilities in the economy.

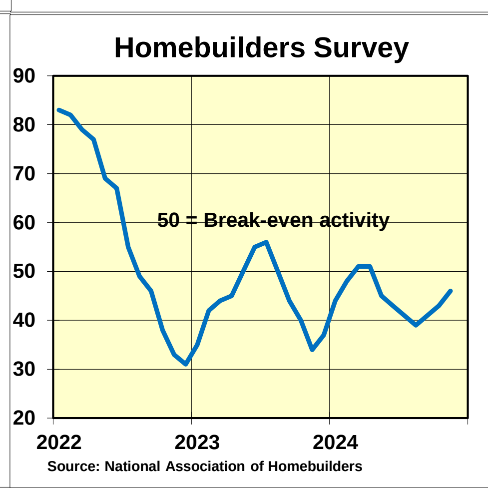
The service sector of the economy appears strong, with healthy new orders and growing employment. In contrast, manufacturing remains weak with no growth in orders and shipments for the past two years.

Bottom line—the economy continues to grow at a 2% to 3% annual rate, but weaknesses continue to exist in manufacturing and housing.



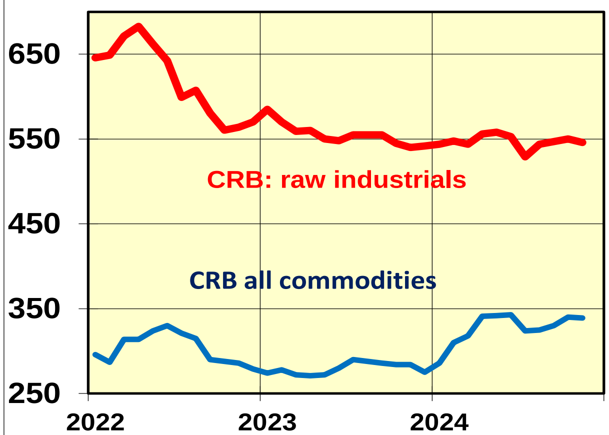






SENSITIVE INDICATORS

Commodity Prices



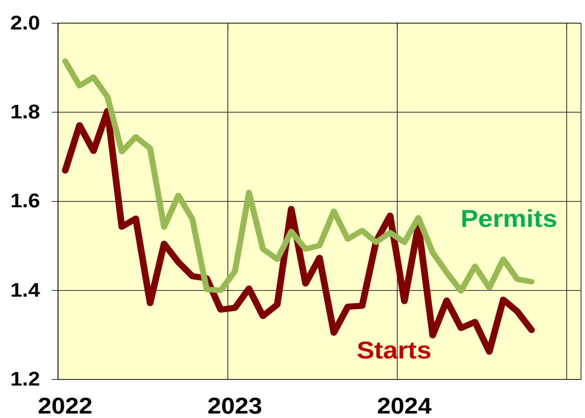
Source: Moody's analytics; Trading Economics

S&P500

Source: S&P-Dow-Jones

Housing Starts & Permits

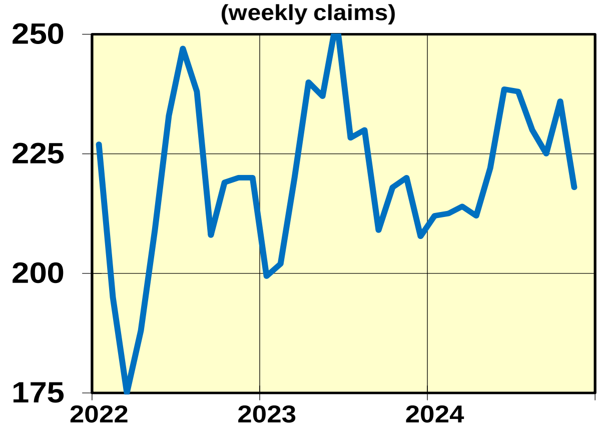
(thousands of units)



Source: Census: BEA

Unemployment Claims

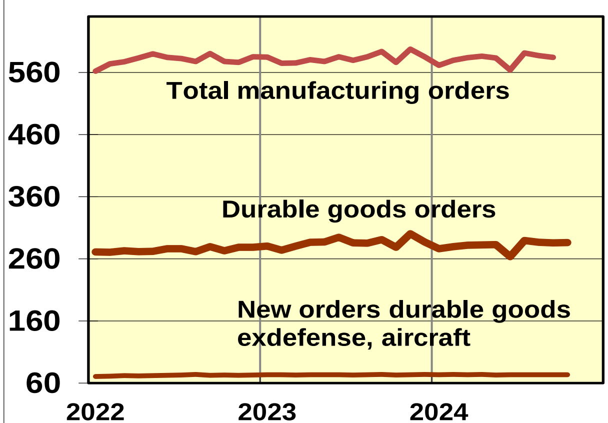
(weekly claims)



Source: BLS

Manufacturing Orders

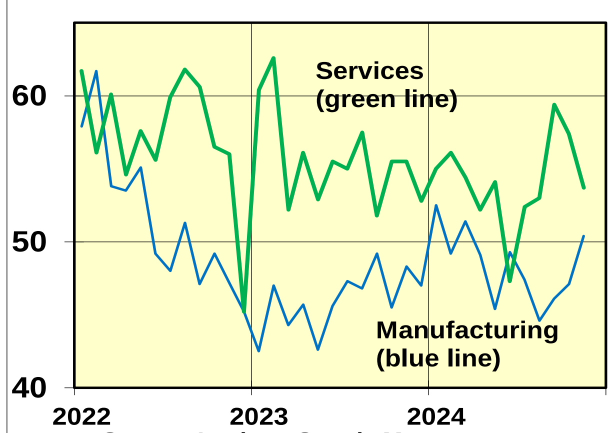
billions of $



Source: Census: BEA

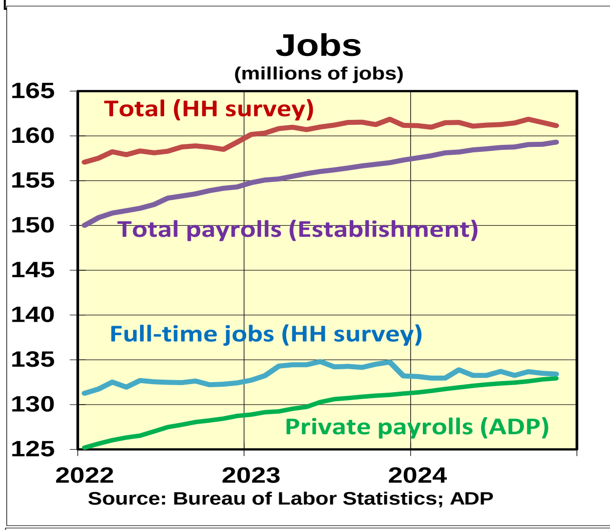
ISM: New Orders

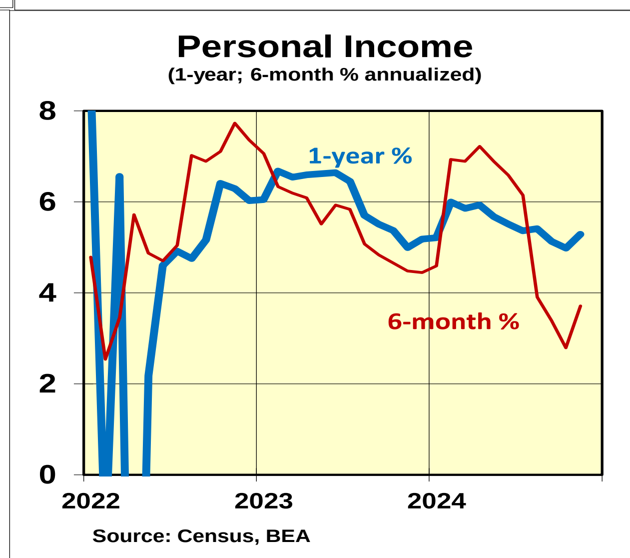
(above 50 represents expanding activity)

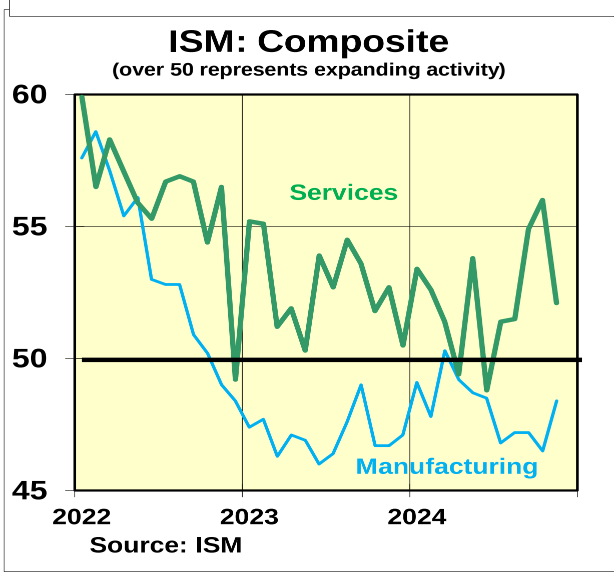


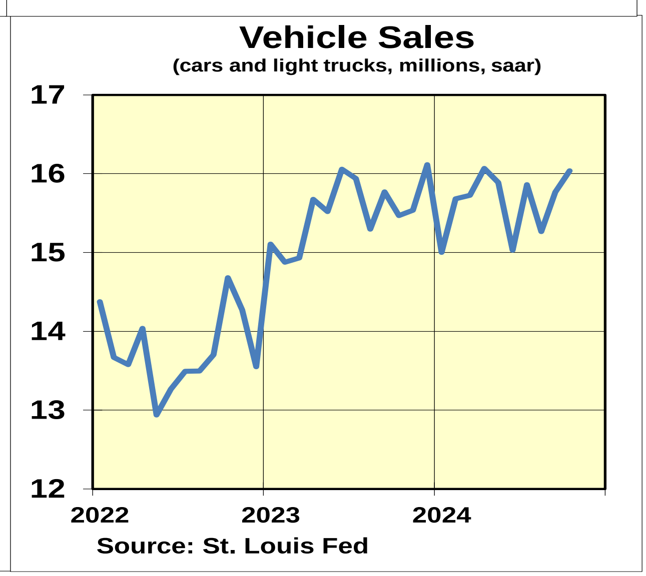
Source: Institute Supply Management

ECONOMIC INDICATORS









Inflation Indicators

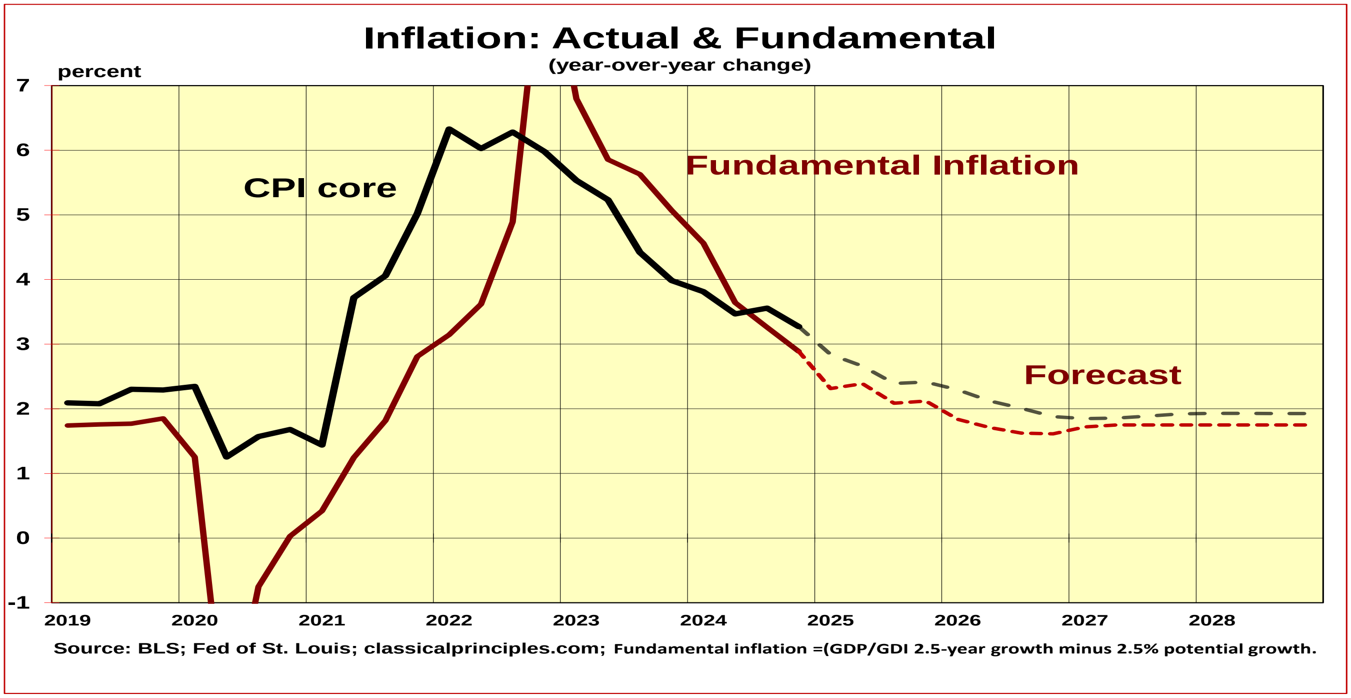
There has been significant progress in reducing inflationary pressures. Inflation continues to decline, albeit slowly, with most current measures of inflation indicating rates of 2½% to 3½%.

The Fed's monetary restraint did produce a slowdown in current dollar spending (GDP), which has reduced inflationary pressures.

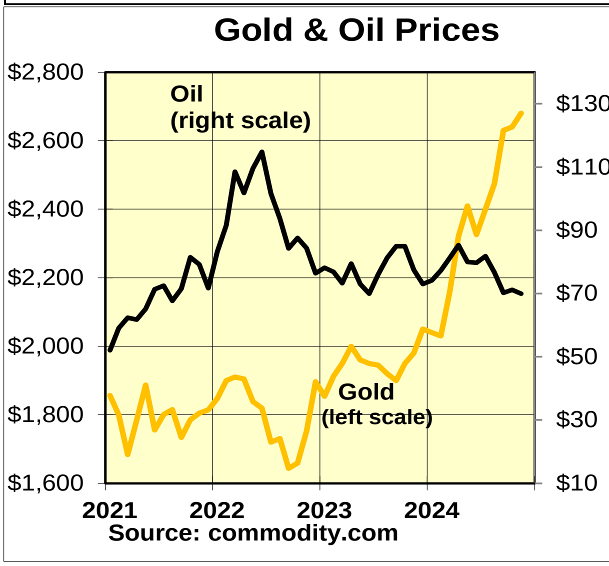
Current dollar spending and incomes have slowed to a 4% to 5% annual pace in the past six- to nine-months. This should continue to help contain inflation.

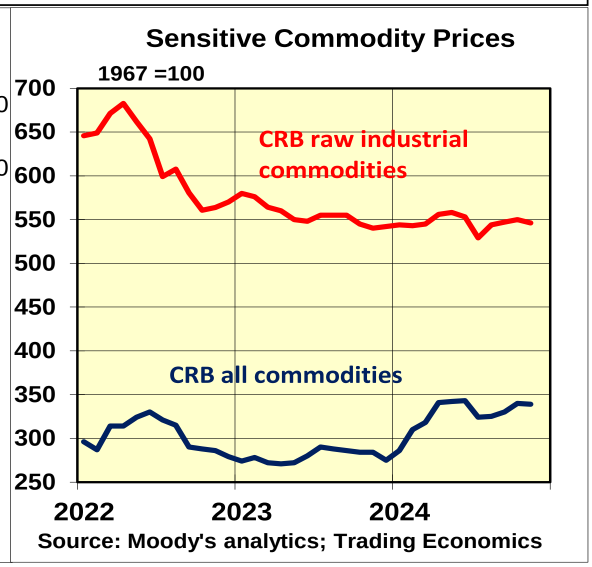
Oil and other commodity prices, which are sensitive to increases in demand, have been stable to down.

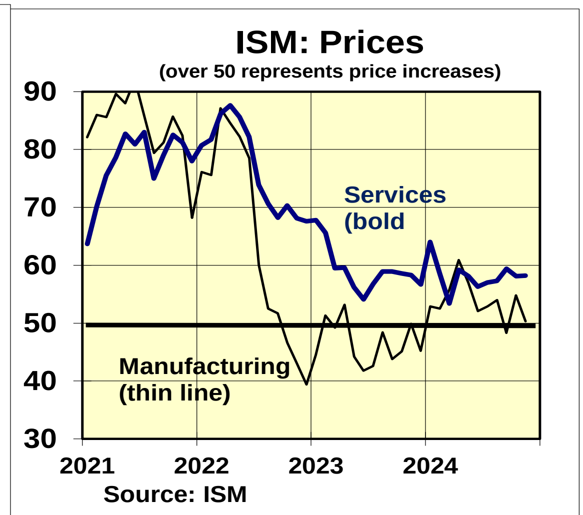
The key to keeping inflation at the Fed's target of 2% involves a combination of spending and growth. Holding increases in spending to the 5% vicinity while enabling the economy to grow by 3% or more will help contain inflation. Our forecast assumes upcoming policy changes will allow this to happen.

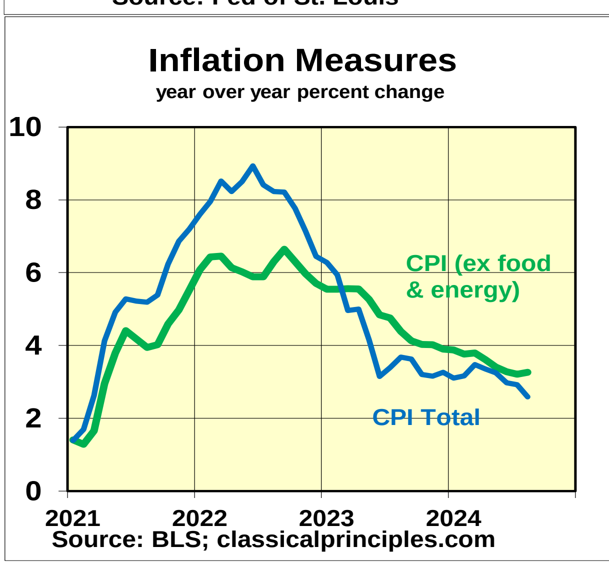


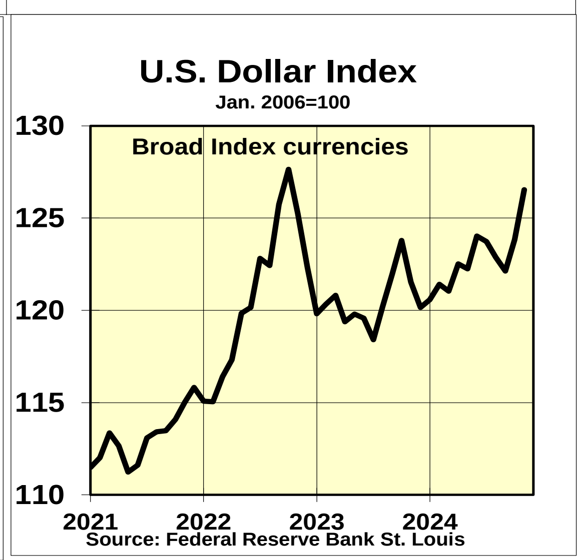
INFLATION INDICATORS











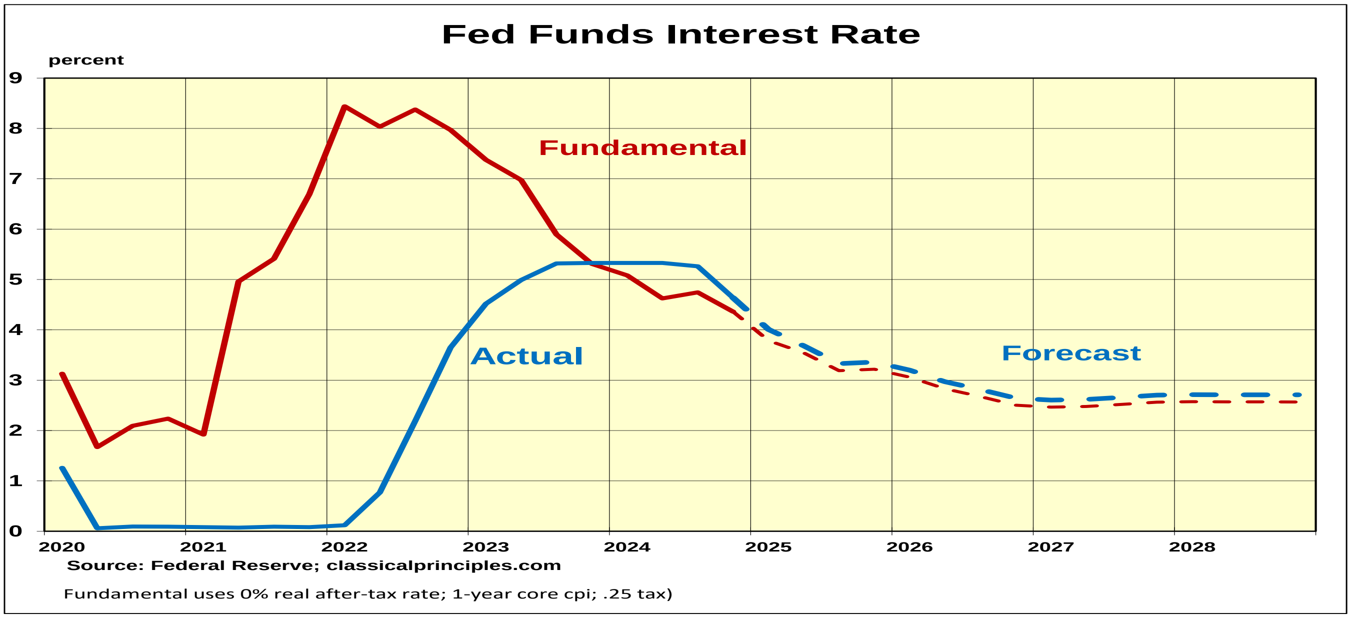
INTEREST RATES

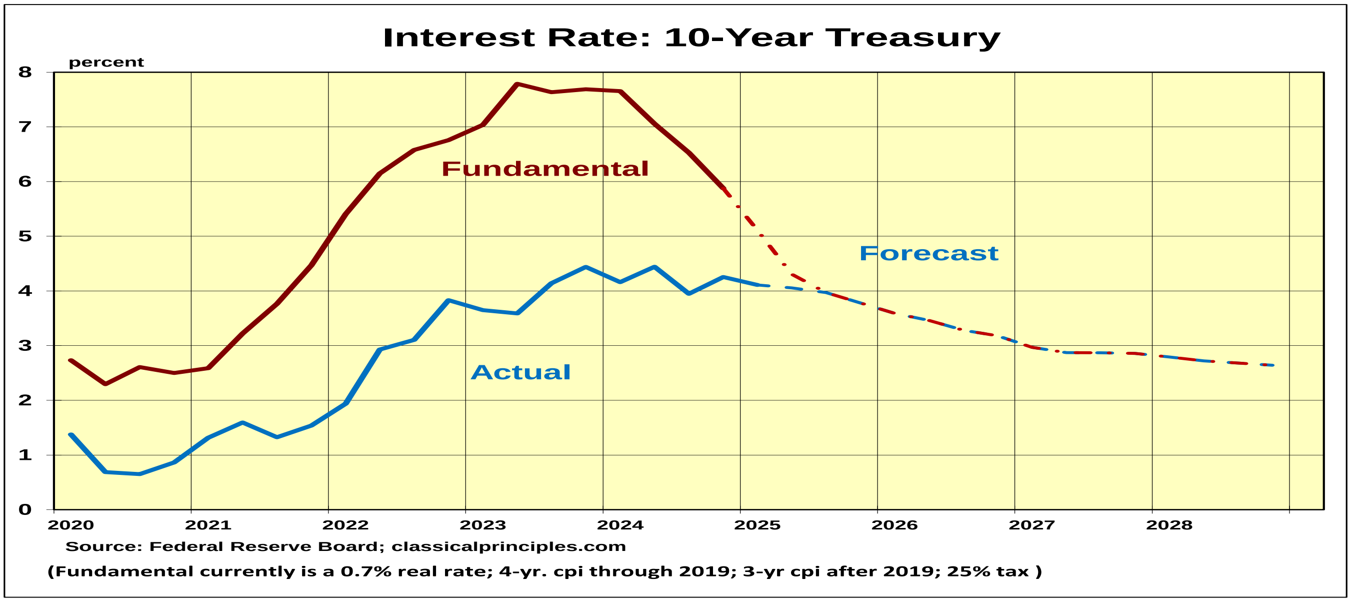
The Fed continues to bring normality back to the yield curve. Although inflation remains above the Fed's 2% target, we expect the Fed still will reduce its key rate to 4.3% at the December meeting. We also expect the Fed to moderate expectations regarding future cuts.

The precise pattern of interest rate cuts will depend on upcoming data. If current dollar GDP remains in the 4% to 5% range, and real growth remains close to 3%, inflationary pressures will continue to ease.

Expect the Fed to use the yield on 10-year T-Notes as a guide to setting their target rates. If the 10-year is at 4½%% or higher, the Fed will delay further cuts.

As inflation moves lower, our analysis shows the fundamental fed funds rate moving toward 3% by 2026. The fundamental rate for the 10-year T-Note also will decline. Expect the yield on the fed funds rate to move below the 10-year in the spring or summer of 2025.





STOCK PRICES: S&P500

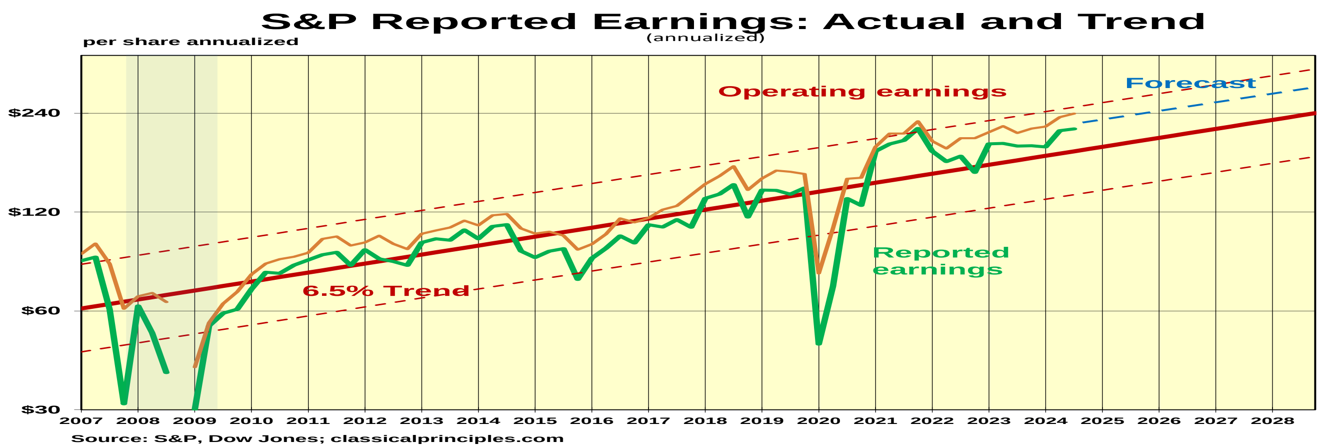
With the S&P500 already in the 6000 vicinity, the market is 43% above its fundamental value. One reason for this overvaluation is the strength in earnings. Third quarter S&P company reported earnings were 17% above trend while operating earnings were 30% above trend.

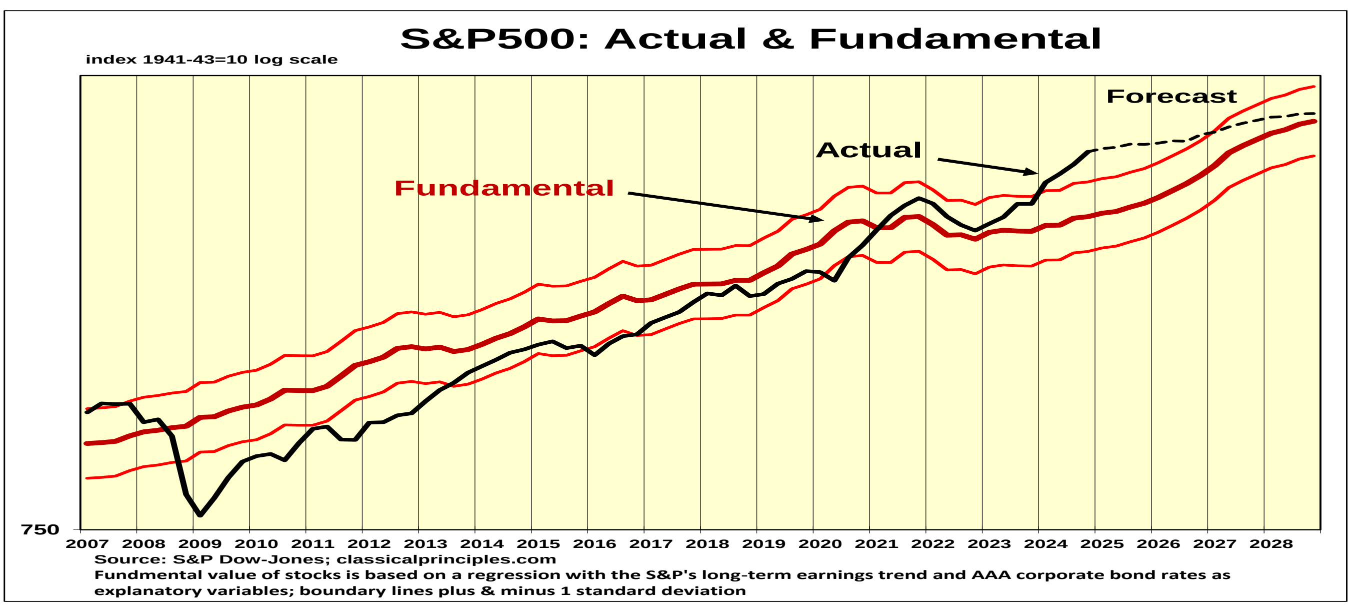
Under normal conditions earnings would gradually return to trend. However, with the expected major positive policy changes, expect S&P500 earnings to grow at their historical 6½% annual rate *from current third quarter level.*

Our profit assumption is that corporations will be able to retain their very high profit levels relative to GDP and benefit along with the rest of the economy.

As the S&P is overvalued by 43%, investors should always remain cautious. Successful attempts to block President Trump's pro-growth agenda would severely impact the current overvalued market.

While our fundamental longer-term model is flashing potential warning signals, our short-term momentum model remains very positive. As a result, barring any major policy setbacks, stocks should continue to move higher.





Stock Market Momentum

Our short-term stock market forecasting model gauges market momentum on a scale of 0% to 100%. At 50%, the model is neutral.

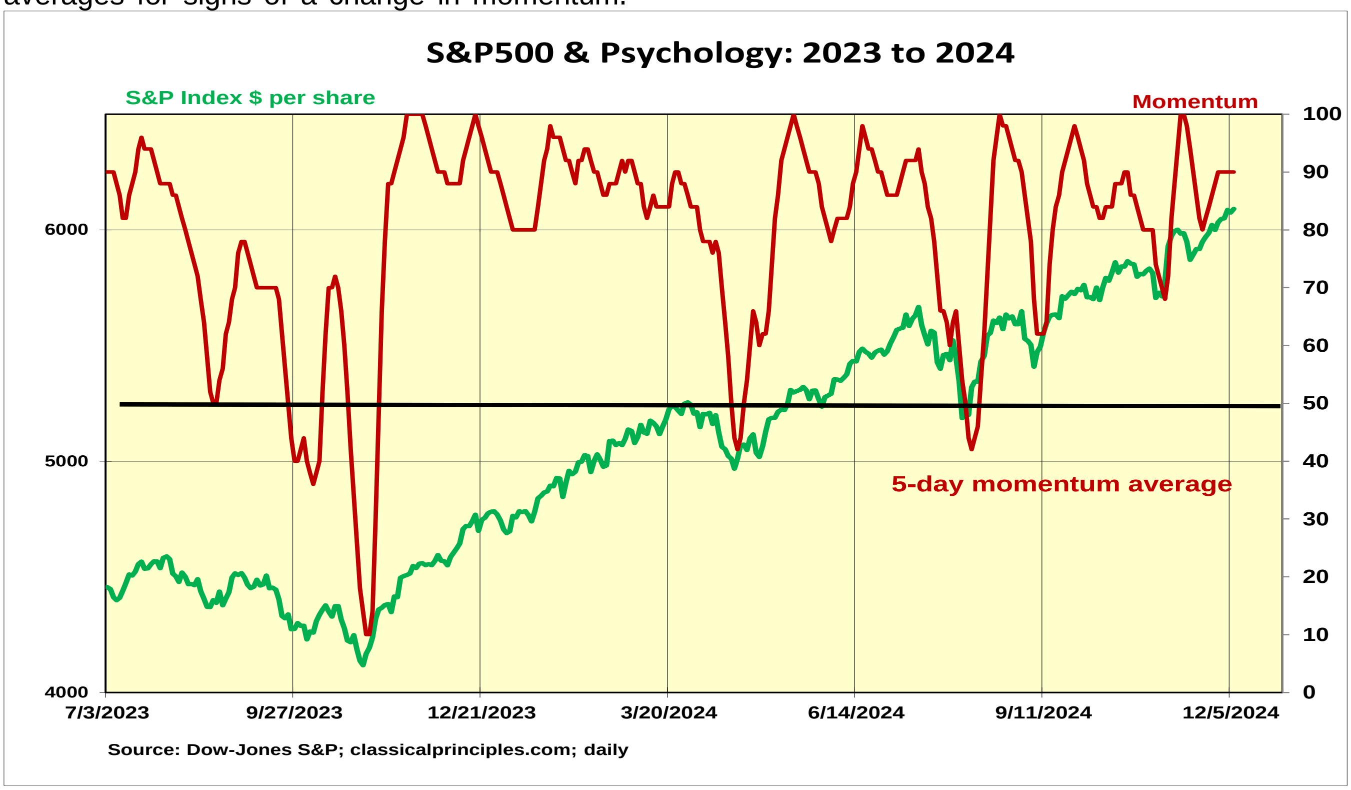
Inertia. The logic underlying the model is that a force in motion tends to stay in motion unless confronted with equal or greater opposing force. Our analysis of daily changes in the S&P500 over the past quarter century confirms this.

For over a year, our model has been fairly consistently positive, often placing an 80% to 100% likelihood of further stock gains. Historically, this pattern of consistent momentum also occurred during periods of down markets, where momentum builds for further declines.

We keep close watch on the daily and 5-day averages for signs of a change in momentum. There were two such signs over the past year where the 5-day average briefly fell below 50%.

Investors with a low tolerance for market risk might want to respond more quickly to even mild signs of weakness in momentum. Investors with a longer-term investment perspective are more likely to ignore daily movements and use either weekly or monthly signs of change before making any decisions.

We recommend using the model along with other factors (the economy, over- or under-valuation, Fed policy, etc.) when considering the extent to hold stocks in your portfolio.



12/7/2024	Actual		Estimate	Forecast							
	2024	2024	2024	2025	2025	2025	2025	2023	2024	2025	2026
	II	III	IV	I	II	III	IV				
GROSS DOMESTIC PRODUCT	29017	29354	29729	30129	30535	30947	31364	27721	29181	30744	32435
%ch	5.6	4.7	5.2	5.5	5.5	5.5	5.5	6.6	5.3	5.4	5.5
REAL GDP	23224	23387	23560	23735	23911	24117	24326	22671	23306	24022	24856
%ch	3.0	2.8	3.0	3.0	3.0	3.5	3.5	2.9	2.8	3.1	3.5
CHAIN PRICE INDEX	1.249	1.255	1.262	1.269	1.277	1.283	1.289	1.223	1.252	1.280	1.305
%ch	2.5	1.9	2.1	2.4	2.4	1.9	1.9	3.6	2.4	2.2	2.0
CPI- ALL URBAN%ch	2.8	2.0	2.0	2.5	2.6	2.3	2.3	4.1	3.0	2.3	2.1
FUND. INFLATION%ch	4.3	4.0	4.2	3.7	3.9	4.0	4.0	3.1	3.6	2.2	2.2
PRETAX PROFITS adj. all	3817	3807	3865	3917	3970	4023	4077	2922	3190	3997	4217
%ch	15.2	-1.1	6.2	5.5	5.5	5.5	5.5	-11.9	9.2	25.3	5.5
Afet-tax corp. profits adj. all	3142	3141	3440	3486	3533	3581	3629	2921.8	3189.8	3557.1	3752.7
%ch	14.5	-0.1	43.8	5.5	5.5	5.5	5.5	6.7	9.2	11.5	5.5
After-tax profifts adj. domestic	2662	2700	2924	2963	3003	3043	3084	2432	2706	3023	3190
%ch	20.9	5.8	37.6	5.5	5.5	5.5	5.5	6.1	11.2	11.7	5.5
PERSONAL INCOME	24660	24881	25198	25538	25882	26231	26584	23403	24771	26059	27492
%ch	5.3	4.7	5.2	5.5	5.5	5.5	5.5	5.9	5.8	5.2	5.5
REAL DISPOSABLE INCOME	17497	17532	17619	17719	17824	17935	18050	17052	17525	17882	18365
%ch	1.0	0.8	2.0	2.3	2.4	2.5	2.6	5.1	2.8	2.0	2.7
PRODUCTIVITY	1.138	1.145	1.152	1.159	1.166	1.174	1.182	1.116	1.124	1.131	1.137
%ch	2.1	2.3	2.4	2.5	2.6	2.7	2.8	1.8	0.7	0.6	0.5
CIVILIAN EMPLOYMENT	161.3	161.4	161.1	161.6	162.0	162.5	163.0	161.1	161.2	162.3	164.5
%ch	0.2	0.4	-0.6	1.1	1.1	1.2	1.3	1.7	0.1	0.6	1.3
UNEMPLOYMENT RATE	4.0	4.2	4.2	4.2	4.2	4.1	4.0	3.6	4.1	4.1	3.8
MANUFACTURING PRODUCTION	99.9	100.2	100.0	100.3	100.6	101.0	101.4	99.9	100.0	100.8	102.8
%ch	0.3	1.4	-0.8	1.1	1.2	1.6	1.8	-1.8	0.0	0.9	0.0
VEHICLE SALES	15.7	15.4	15.4	15.4	15.5	15.6	15.8	15.5	15.5	15.6	16.2

%changes are at annual rates
Profits adjusted for capital consumption and inventory adjustment.
Vehcle sales ar millions at seasonally adjusted annual rates.

12/7/2024	Actual		Estimate	Forecast							
	2024	2024	2024	2025	2025	2025	2025	2023	2024	2025	2026
Monetary Aggregates quarterly:	II	III	IV	I	II	III	IV				
M2 %ch at annual rates	0.9	2.0	3.4	4,0	5.0	5.0	5.0				
Securities less excess reserves (bil$)	3417	3400	3324								
year over year % change	-28.0	5.4	4.8								
Interest Rates:											
Moody's BAA corp bonds 15+years	5.92	5.62	5.73	5.71	5.51	5.47	5.28	5.9	5.8	5.5	4.9
Moody's AAA corp bonds 15+years	5.22	4.89	5.03	5.01	4.76	4.67	4.48	4.8	5.0	4.7	4.1
Mortgage rates 30-year fixed	7.01	6.58	6.75	6.61	6.56	6.47	6.28	6.8	6.8	6.5	5.9
10-YR GOVT SECURITIES	4.44	3.95	4.25	4.11	4.06	3.97	3.78	4.0	4.2	4.0	3.4
5-YR GOVT SECURITIES	4.00	3.96	3.95	3.90	3.83	3.74	3.59	4.1	4.0	3.8	3.4
2-YR GOVT SECURITIES	4.40	3.96	3.64	3.70	3.60	3.50	3.40	4.6	4.1	3.6	3.5
FEDERAL FUNDS RATE	5.33	5.26	4.64	4.01	3.69	3.33	3.36	5.0	5.1	3.6	2.9
STOCKS:											
S&P 500	5254	5540	5930	6035	6078	6183	6175	4266	5533	6118	6327
S&P 500 fundamental value	3969	4124	4157	4235	4278	4383	4475	3839	4054	4343	4902
S&P 500 reported earnings annualized	212.5	215.1	218.5	222.0	225.5	229.1	232.7	192.4	208.9	227.3	242.1
S&P 500 p/e on reported earnings	24.7	25.8	27.1	27.2	27.0	27.0	26.5	22.2	26.5	26.9	26.1
S&P 500 operating earnings annualized	233.4	239.4	243.2	247.1	251.0	255.0	259.1	213.5	233.7	253.0	269.5
S&P 500 p/e on operating earnings	22.5	23.1	24.4	24.4	24.2	24.2	23.8	20.0	23.7	24.2	23.5
S&P 500 reported trend earnings	180.9	183.7	186.7	189.6	192.6	195.7	198.8	171	182	194	207
S&P 500 p/e on trend earnings	29.0	30.2	31.8	31.8	31.6	31.6	31.1	24.9	30.3	31.5	30.6

*reported earnings based on a 6.5% long-term growth rate
Fourth quarter 2024 S&P500 earnings are forecasts.