The Outlook for Financial Markets: A Long Term view

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UCLA Anderson Forecast

A Series of 13 Year Cycles*

- 1918-1931
  - Sets the Clock.
  - Roaring 20's, Electrification, Autos and Radios
  - Stock Boom and Crash
- 1932-1945
  - Great Depression and WWII
  - Gov't Intervention in Economy, Unions and Social Safety Net

* Based on <u>Shulmaven: The U.S. Economy is Entering a New Thirteen Year Cycle</u>, May 2022

The Post War Era

- 1945-1958
- 1958-1971
- 1968-1981

- Transition from War Economy. Cars, Housing and Defense. Fears of a new depression.
- No depression. Fiscal Policy Reigns, Soaring 60's. Inflation Starts.
- Stagflation, Oil Shocks, No Trade-off between unemployment and inflation. Heyday of monetarism.

The Great Moderation Begins

- 1982-1995
- Volcker Breaks inflation. Reagan Tax Cuts and Stock Market Boom. Fear of Renewed Inflation Dominates.
- 1995-2008
- Greenspan pre-empts inflation. Heyday of the Fed. Dot.Com and Housing Bubbles. Full Flowering of Globalism.
- 2008-2021
- “Minsky Moment” as Markets Crash. QE, Zero Rate Policy, All-in Fiscal Policy in ‘09 and on Steroids in 2020-21.

The New 13 Year Cycle?

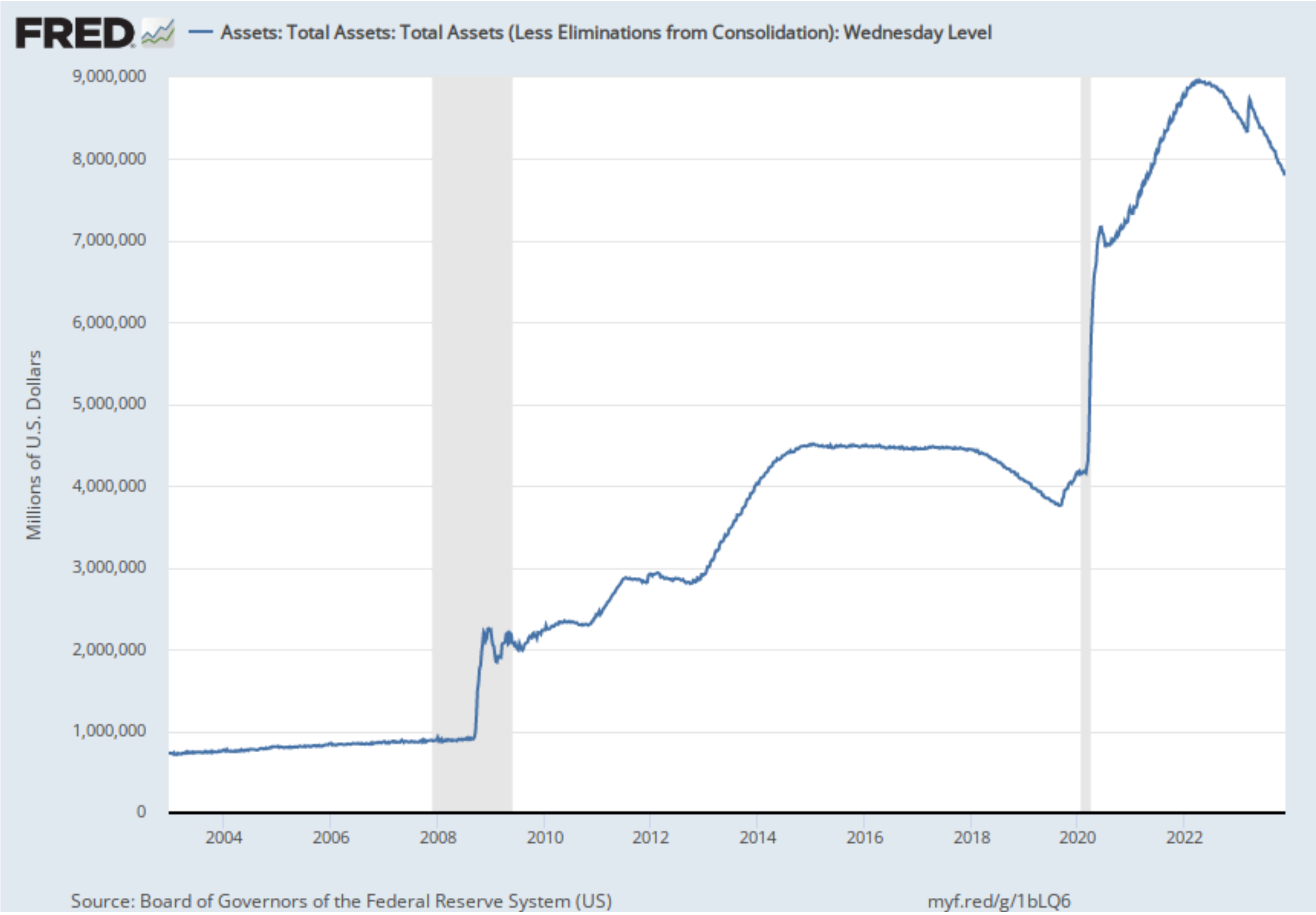
- 2022 - ???

- Interest Rates Normalize.
- Deglobalization
- Onshoring
- Rising Labor Costs
- Energy Transition
- Higher Defense Spending
- Huge Federal Budget Deficits
- Inflation Doesn’t Go Away

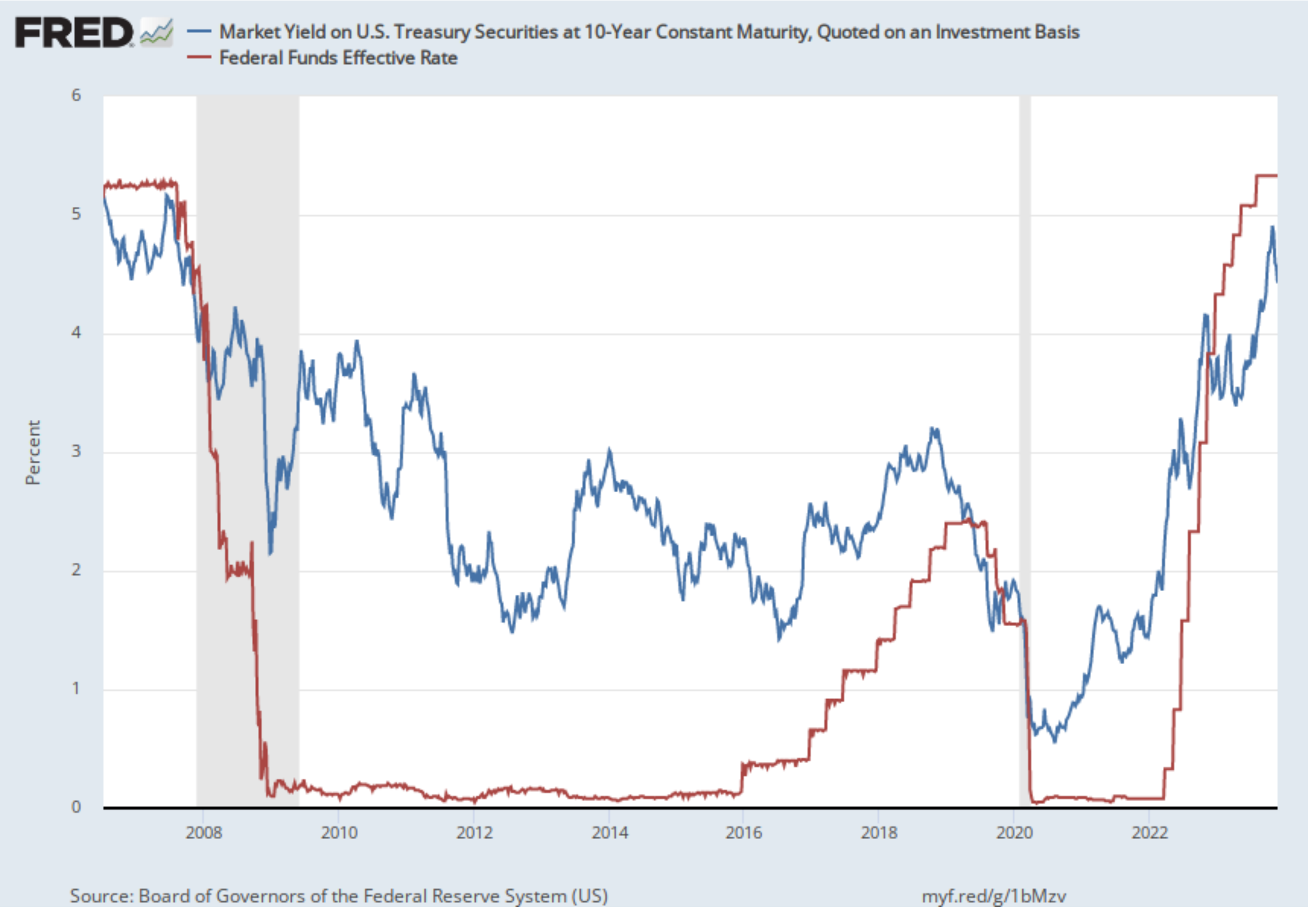
Another Long Cycle Over

- "End of an era: The coming long-run slowdown in corporate profit growth and stock returns" by Michael Smolyansky, NY Fed, June 2023
- Abstract: I show that the decline in interest rates and corporate tax rates over the past three decades accounts for the majority of the period's exceptional stock market performance. Lower interest expenses and corporate tax rates mechanically explain over 40 percent of the real growth in corporate profits from 1989 to 2019. In addition, the decline in risk-free rates alone accounts for all of the expansion in price-to-earnings multiples. **I argue, however, that the boost to profits and valuations from ever declining interest and corporate tax rates is unlikely to continue, indicating significantly lower profit growth and stock returns in the future.**

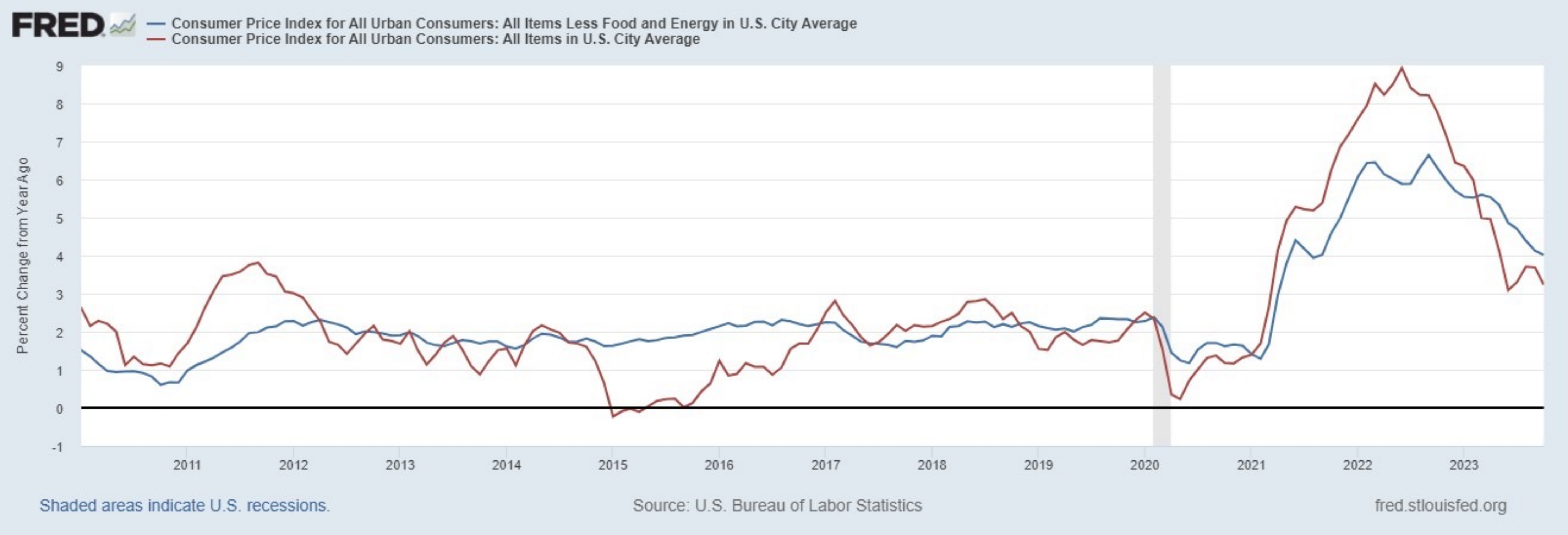
FED Balance Sheet: From QE to QT



Interest Rates Normalize form Zero Rate Regime: Modest Cuts in 2024

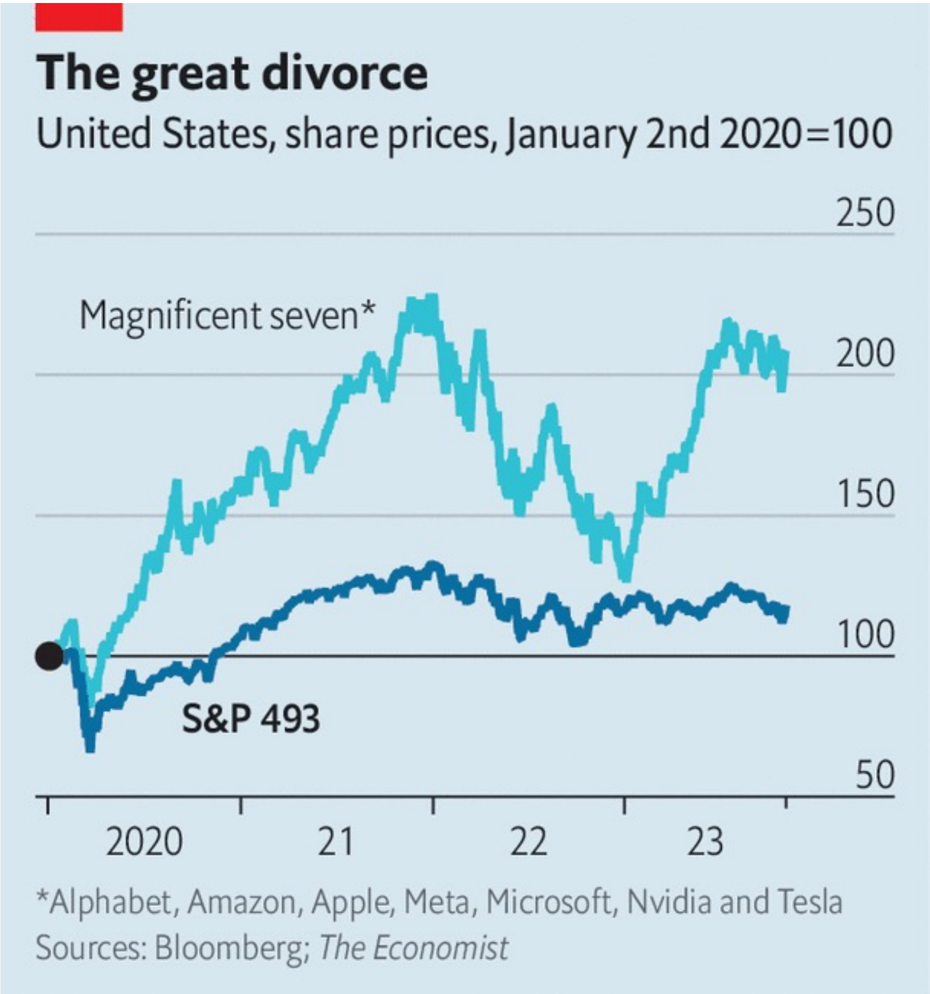


Inflation Cooling, but will Stay Above Fed's Target



S&P 500: A Top or a Consolidation
Outlook: Likely Sideways with Volatility

S&P 493: 7 Stocks Account for 29% of Index



S&P 500 Price/Earnings Ratio
On the Expensive Side of History

Year	Est. Earnings	P/E Ratio
2023	$225	20.3X
2024	$235	19.4X
2025	$250	18.2X

Conclusions

- Economy entering a new 13-year cycle.
- Accompanied by higher inflation, interest rates and higher taxes.
- Over the longer term, expect much lower returns from stocks.
- Over the near term expect a sideways stock market with more than the usual volatility and modest rate cuts. The 2024 election year dynamics will not help.