Brian Lynn, C.P.A., P.A.

Certified Public Accountant

Two South University Drive, Suite 215
Plantation, Florida 33324
Phone: (954) 474-1111

E-Mail: Brian@BrowardCPA.com
Website: www.BrowardCPA.com
Fax: (954) 474-5373

January 15, 2020

2020 Economic Forecast

The Boring Twenties

The New Decade in a World of Low Returns

Preamble: The 31st edition of this annual forecast is designed to inform my readers of my assessments of the state of both the domestic and global economies and forecasting the outlook for 2020. My findings are predicated upon employing demographic theory and analysis as they relate to the economy and effect on the financial markets. I will begin by discussing geopolitical risks and then my political analysis before moving forward on the economic forecast.

Geopolitical Risks and Uncertainties in a World of Disorder

The pursuit for peace and democracy persists in a year fraught with danger and high anxiety. We have witnessed crisis, conflict and chaos consisting of the Trump re-election/impeachment, Iranian military conflict, China's debt and trade war, North Korea's "Rocket Man," looming demographics and the catastrophic effects of climate change. Trump's most pronounced long-term geopolitical failure lies in the disengagement of American global leadership. On the domestic side, the Senate's refusal to hear witnesses in the **impeachment trial** will make the Republicans appear as co-conspirators in obstruction of Congress. These first-hand witness' failure to testify in the House is at the heart of the obstruction charge. There is no doubt that we can expect cyber and social media interference in the **Trump re-election**. What makes this interesting is the opposing foreign players. Both Russia and Israel will be pro-Republican while China and Iran will be pro-Democrat. Trump has conducted an economic war against **Iran** since he vacated the Nuclear Arms Treaty. These economic sanctions have paralyzed their oil exports and decimated their economy, driving inflation to 50%. Their citizens were protesting in the streets against their government until they became united and rallied around their flag after the current military action. Iran is literally in dire straits. Any hope of renegotiating a nuclear agreement has now vaporized in the near-term. They can't afford a war. It is more probable they will disrupt oil shipments in the Strait of Hormuz before sitting down at the table. **China** remains the wildcard. The trade war and their enormous debt that represents more than 200% of their GDP laid the framework for their worst recession. The manner which they address their recovery will determine the direction of the global economy. **"Rocket Man"** is guaranteed to provoke the wrath of Trump against the backdrop of his destabilizing sanctions. It's just a matter of time. **Demographic** trends such as the retirement of the US baby boomers will erode global economic growth and investment returns for many decades to come. On the demand-side of the equation, spending clearly trends lower as consumers approach their retirement years. While on the supply-side, the labor pool shrinks impacting the cost of wages and profits. The world is getting older with grave global implications in the long-term especially in Japan, China, Russia and Euroland and to a lesser extent the US and Canada**. Climate change** is a today problem not a tomorrow one. There were 15 natural disasters in 2019. The General Accounting Office has determined weather and climate disasters cost $91 billion in 2018 in the US alone. New South Wales Australia, Siberia and the Amazon are all on fire, destroying our forests that we rely upon to cleanse the air. Greenland is shrinking while the permafrost and Arctic ice is melting. The planet is heating up and the oceans are rising with no end in sight. The ramifications on humanity and economic cost are so persuasive and severe that if this is not addressed now the world may not be able to do it in the future. Many scientists already claim we are approaching the point of no return.

There is no doubt we can expect the transmission of fake news primarily from Russia, the masters of election interference. It becomes extremely problematic when the fake news is promoted domestically by our President and the media to further divide our country. We cannot allow ourselves to misinterpret the difference between socialism and left-wing political agendas. Socialism is an economic and political system under which both the means of production (assets) are owned and the economy is controlled by the government. In this society individual freedoms are restricted and their economy leads to poverty. While capitalism is an economic system under which the means of production (assets) are owned by citizens and the economy is based on a free-market system of supply and demand. This society promotes income and wealth inequality, innovation, prosperity/downturns and individual freedoms. The US is a welfare capitalist system and Medicare is the best example of this fact. The left-wing agenda consists of free health care, education and more. We all know nothing is for free. That is why countries like Denmark and Norway who provide enormous benefits have the highest tax rates. To understand modern day socialism, you're talking about oppressive regimes like Cuba and Venezuela, not the USA.

Political Analysis

Since day one, President Trump has done everything in his power to secure re-election. This constitutes a normal practice. However, what makes this different this time around is his actions were not for the benefit of the country but rather for himself. Specifically, the 2017 tax reform was hastily passed by a Republican controlled government. This was designed to artificially boost the economy through substantial corporate and personal tax relief and reduction in income tax withholding. This was the first time in US history a massive stimulus package has ever been employed while our economy is operating above full employment. This type of fiscal policy is always reserved for periods of economic downturns. By the time the treasury department wrote the international rules, the corporate lobbyists secured major loopholes diluting the revenue side of the equation. At the end of the day, the government coffers will suffer, inflation will rise in the long-term and our children will have to pay back $1.5 trillion plus interest**. In sum, this was a governmental dividend to the wealthy, enabled corporate America to buy back their stock rather than investing in the economy and constitutes nothing other than malfeasance.**

Trump will do whatever it takes to be re-elected even if it means a military conflict/war. The Bank Credit Analyst's (BCA) December issue concluded "If President Trump's approval rating stabilizes below 42%, he could give up on the economy and instead bet on a rally around the flag as his best strategy for re-election". As such, it appears the attack on Iranians second in command, General Qasem Soleimani has more to do with his failing poll ratings rather than a justifiable foreign policy decision. The global ramifications are endless, mindless and counterproductive. The Iranian people were protesting in the streets against their own government and now they are united in protesting against the US.

President Trump is the greatest domestic and global political risk in 2020. His impeachment and our election season created an enormous uncertainty bringing about a major contraction in capital investment and impairing economic growth. So there is no misunderstanding, the government has no choice but to raise taxes no matter who comes to power. Their failure to do so would be the greatest miscarriage of justice to the American dream and our living standards and ultimately would lead to a recession/depression.

The government always works best when no one party is in control. Assuming Trump is not removed from office and loses the election to a Democrat, we should probably expect some vindictive action before Inauguration Day. On the downside, if Democrats also take the Senate, we will probably witness a left-wing protocol which is clearly bad for the country. The absolute worst scenario is his re-election. This will unleash his "America First" agenda impairing free trade and foreign policy, and with it, global contraction and chaos. If the Supreme Court rules Obama's Care unconstitutional, Trump could lose many swing states and with it the election. It is extremely probable the election results in many states may become so close that it requires recounts and may take the Supreme Court to determine the presidency once again. This would undermine the legitimacy of whom ever became president and further divide the country. Either way, President Trump will benefit from the economy and a conflicted Democratic party that appears fragile at best. People tend to vote with their wallets and generally give the sitting president credit for their improved finances. We are headed for the most important and intimidating election in our history.

State of the US Economy

The seeds that generated our longest economic expansion in our nation's history was planted during the Obama administration. President Obama inherited the worst recession since the Great Depression after the financial collapse in October of 2008. The Republican congressional minority was against the governmental bailouts of our banks and auto industry claiming fiscal irresponsibility. As a result of the Obama bailouts and the Fed, led by Ben Bernanke, along with his quantitative easing (QE), we were able to avoid another Great Depression and set the stage for our current economic expansion. For many years, I was forecasting a financial collapse to incur in 2009 based upon the 80-year economic cycle theory with 1929 as the base year. It should be noted our government actual lost $9 billion on the $79 billion auto bailouts. Trump's taking credit for and claiming that "our economy is the greatest in the history of our country" is nothing other than a political embellishment or fake news. A close analysis of the economic data reveals abundant facts to the contrary. Trump promised growth (GDP) of 4% or more while selling the Republican's fiscally irresponsible tax cut to our country. When all is tallied, GDP will fall below expectations probably reaching no more than 2.2% versus 2.9% in the prior year. Although the International Monetary Fund (IMF) projects 2020 US GDP at 2.1%, I believe we will be lucky to attain 1.8%. Inflation is expected to close the year at 1.5% and should remain at bay and below the Fed's target rate of 2% given the existing global deflationary fears. The headwinds to growth are the disappointing corporate earnings, a possible liquidity trap, the strong dollar and the geopolitical uncertainty related to the Iranian conflict, China tariff war and President Trump himself. On the downside, our deflationary demographic trends associated with the retirement of 108 million baby boomers will guarantee us that the subpar growth trend will persist for decades to come. The US economy has produced sustainable below trend growth against the backdrop of a domestic environment consisting of accommodative monetary policy, benign inflation, full employment and abundant liquidity while approaching the end of our longest economic expansion in history**. The US has outperformed the economies of the world and tends to surprise on the upside**. Now let's discuss the economic fundamentals effecting our domestic economy as follows:

- **The Government Sector:** In defiance of the Republican doctrine of fiscal prudence, the national debt has grown by $3.5 trillion while Trump has been in office and the economy is running at full employment. $1.5 trillion occurred in 2019 bringing the unsustainable spiraling debt to $23 trillion. One of Trump's campaign promises was to cut the federal deficit in half and pay off the national debt. This is our greatest threat to our future growth, prosperity and living standards. The addiction to debt has infected the entire world. Since the great recession global Central banks including the US printed $26 trillion of new money. Contrary to global belief, you can't borrow your way to prosperity.
- **The Federal Reserve:** Monetary policy became quite accommodative with three rate cuts totaling 75 basis points. These were done to reverse the inverted yield curve and counterbalance the dollar rally. One of the primary functions of the Fed is to smooth out the economic cycle through its monetary policies. As a result of the great recession Ben Bernanke employed quantitative easing (QE), a program designed to create money by purchasing long-term government bonds. This new money was intended to capitalize the banking system and provide more business loans that would expand the economy. However, this money never hit the banks but rather went directly into financial assets, causing these asset values to rise and their yields to fall. This is what creates financial asset bubbles. Harry Dent Jr's argument is "since 20% of the population, most of whom are college educated, owns 88% of financial assets, they are spending more. Their higher incomes cause them to drive 50% of consumer spending, not 20%. So we're growing at 2% on this wealth effect, rather than the normal 4% had the remaining 80% of the population contributed 50% to consumer spending if they had the cash flow to do so". Since consumer spending represents 70% of our economy it may make better sense to stimulate the economy by giving consumers a direct governmental dividend to fuel growth. This is presidential Democratic candidate Andrew Yang's theory along with many other countries already employing this concept. **Although remote, it appears we may be approaching a liquidity crisis.** In September the Fed

purchased $60 billion of one- month T-Bills and injected it into the overnight bank lending market known as Repo since their rate jumped to 10%. Further on the downside, the Fed has been doing this every month since, totaling $380 billion. This certainly appears to be a new round of QE. This also implies the Fed cannot liquidate their bonds without causing a liquidity squeeze. So there is no misunderstanding, one of the key ingredients to a bull market is liquidity. It is more probable than remote the Fed will reduce the rate by 25 basis points within the first quarter and possibly again in the second. The Fed and all other Central banks have made it clear that they will remain in an obliging position and only reverse themselves once inflation surpasses their targets.

- **The Corporate Sector:** Corporate profits were clearly disappointing. Even though profit margins historically come under pressure in the late stages of an economic expansion, the additional cost associated with the tight labor markets have been offset by productivity gains. The primary culprit has been the China tariff war that has put the manufacturing sector into a recession. Trump's GOP tax cuts were intended to encourage businesses to expand. However, corporate America elected to use their tax savings for stock buybacks and pay dividends. On the positive side, when all is tallied, Christmas retail sales increased 3.8% for the first time surpassing the $1 trillion mark while online sales are expected to hit $765 billion rising 12%. However, bankruptcies are now trending higher of which two thirds were in the retail sector. **Gymboree** bounced into liquidation and was sold to GAP, **Payless Shoes** lost their soles and closed 2300 stores, **J. Crew** an upscale retailer literally sank, **Fred's** is dead due to an overdose of debt and closed 700 pharmacies, **Forever 21** believes in reincarnation and filed a Chapter 11, **J.C. Penney** could not be sold for a dime and has not filed yet while **Right-Aid** is looking for a band aid in hopes of avoiding a filing. This bankruptcy trend will continue as brick and mortar retailers fall victim to their Internet competitors.
- **The Consumer Sector:** Our tight labor markets have produced a 3% wage growth for the first time in more than a decade. President Trump gets credit for this. Consumer's financial positions have improved against the backdrop of rising asset values, substantial reduction in debt and debt servicing costs. Their confidence spiked since Trump's election and remains strong. Consumer spending continues to rise and represents the salvation for the economy given the contraction in corporate capital investment. Any major reversal of consumer confidence will trigger retrenchment in their spending and with it a recession.
- **The Unemployment Rate:** We are operating at full employment with a 3.6% unemployment rate that is less than 3.9% last year. The unemployment rate has been consistently falling since 2011 as a result of the Obama policies instituted during the great recession. On the downside, job creation in 2019 had been shrinking and this trend will continue. For example, Obama created 7.3 million jobs in his last 33 months in office as compared to Trumps 5 million in his first 33 months. Now that we are in the late stages of the longest economic expansion in our history, we should expect the unemployment rate to rise rather than fall, say to 4% in 2020. The government needs to reconsider its position and expand legal immigration since there are a substantial amount of business owners that cannot fill low paying jobs.

- **The Housing Sector:** New construction has surprised on the upside but remains well below our demographic needs. This has placed upward pressure on home values and rents while decimating affordability. The general rule is housing costs should not exceed 30% of income. However, one in six households earning less than $30,000, the majority of which are renters are paying 50% of their disposable income towards housing. The affordability issue will worsen and become a disruptive factor to economic progress without local, state and federal intervention.

In sum, the US economy's performance has fallen short of all reasonable predictions with GDP coming in at 2.2%. On the bright side, both consumer confidence and spending accelerated against the backdrop of enhanced balance sheets, debt reduction, job creation and wage growth. While on the dark side, unsustainable national debt, budget deficits, trade wars and political uncertainty all contributed to a retrenchment in business capital investment. Finally, the overvalued US stock markets that was caused by the Fed, closed 2019 and produced irrational returns. As we start 2020, our domestic economy faces many headwinds such as a potential military conflict with Iran, the persistent and unsettling China trade war and political uncertainties any of which could push our slow growth economy into recession. There is no current economic data that suggests a looming recession, as such this expansion can continue over the next 18 to 24 months postponing a recession to late 2021 or early 2022. In the future, we will have no choice but to come to terms with our untenable national debt, unfunded liabilities and the adverse demographic impact of our aging population. Our Fed, just like the other global Central banks will merely kick the can down the road and print more money. We all recognize you can't borrow your way to prosperity. For individuals this leads to bankruptcy and for governments this leads to bursting asset bubbles, recessions and depressions. Absent any geopolitical and/or natural disasters, our GDP may recede to 1.8%. **The direction of both the domestic and global economies rests upon China's hard or soft landing and potential conflict with Iran. The US economy has always remained resilient on a historic basis and is more likely to forge ahead and surprise on the upside.**

State of the Global Economy

When all is tallied, the world's growth is expected to be an anemic 2.9% against the backdrop of the global slowdown that started with China's deleveraging about 18 months ago. This is the lowest rate since the great recession. The world economy has suffered from the trade war that has caused a severe contraction in international trade, rising national debt, diminishing business investment and tenacious political uncertainty. Demographic changes associated with the aging populations in both the advanced and some emerging countries including China is destined to create a major affliction on future growth. Include climate change with all these factors together and the global economies face the risk of long-term stagnation along with a drastic loss in living standards.

On the upside, China has been the major contributor to global growth, but on the downside the greatest polluter. Their authorities remain committed in their transformation from an export to a consumption based economy. Their spectacular growth over more than the past decade has created extensive debt and excess capacity. Their deleveraging severed their GDP to 6% when historically they were accustomed to double digits. However, this action pulled the entire world into its existing slowdown. Against the backdrop of the trade war, it is more probable China will employ the appropriate mix of monetary and fiscal stimulus to fight its recession. **The odds favor China will be successful in turning around its economy and avoid a hard landing.**

In sum, notwithstanding the outlook remains entrenched with escalating risks and uncertainties, global economic activity will have a sustainable advance producing below trend growth of 2.5%. All the Central banks throughout the world are committed to extremely accommodative monetary policies with inflation on the back burner. It appears they are also willing to set aside their austerity measures for stimulating fiscal policies. Assuming both China and the US negotiate a free-trade deal, China has a soft landing and there is no war with Iran, it becomes likely the global economy may turnaround by midyear. **On a long-term perspective, if governments fail to work together and establish fair trade agreements, international rules of taxation and pro-growth policies to expand investment then the world is destined to economic stagnation.**

2020 Economic Forecast

The Bull Market surged in the fourth quarter generating spectacular gains and all indexes closed the year surpassing their historic highs. What made this truly remarkable is it occurred despite political uncertainty, trade wars, recessionary fears and disappointing corporate earnings. The **Dow** again surpassed its 25,000 milestone mark and closed the year at 28,538 producing a surprising return of 24%. The **S&P 500** miraculously closed the year at 3,231 with a yield of 29%. Finally, the tech heavy **NASDAQ** was the top performer closing the year at 9,030 demonstrating a surrealistic return of 37%. On the other hand, Forbes points out these spectacular returns are both overstated and misleading due to the December 2018 market selloff which erased the entire gains for that year. Forbes has calculated the rate of return to include the fourth quarter of 2018 and related dividends to arrive at 8.8%, 10.8% and 10.3% for the Dow, S&P 500 and NASDAQ respectively. Although Trump claims that he has the best stock market ever, the Dow was up 46% at this point in Obama's administration versus 25% for his as of August 30, 2019. Obama gets the award of the best market performance during a presidency. However, he started after the markets crashed during the great recession. The prerequisite for a continuing bull market rests in earnings expectations, equity valuations and abundant liquidity. In this current environment, earnings have been a disappointment and equities are overvalued given the S&P is trading about 18 times earnings. **So how are these valuations possible?** Well, I agree with Harry Dent Jr. who says we should thank the Fed for their liquidity injection that created $5.7 trillion of QE. This enabled corporate America to conduct massive stock buybacks funded with excess cash flow and cheap money. The result triggered a substantial increase in earnings per share and therefore overvalued equities. He also maintains that corporate America are the only substantial net buyers since the 2009 bottom versus institutional or retail/consumer investors. On a historic standpoint, equity markets tend to do very well when the economic cycle is in its late stages and investors are generally rewarded. The odds favor China choosing to reflate its economy and negotiate a trade agreement with the US. This will bode well for a global rebound in economic activity. The Central banks, domestic and foreign are all dedicated to extremely pro-growth monetary and fiscal policies. These institutions are inclined to do whatever it takes to promote economic growth including QE. This is what the BCA refers to as the “End Game” which is the final hooray for potential “double digit” gains in the equity markets. After the next bubble bursts and recession, we will be in the **Boring Twenties.** An extended period in a world of low returns. However, there remains another wild card I refer to as “Trumpmatized Uncertainty". This is where Trump’s actions and equity markets collide. If he chooses war with Iran and/or expands his America First protectionism, all the cards will be off the table and the global economy will go into a tailspin. Understand the Trump trade wars are not only with the China but also include the EU, France, Argentina and Brazil and we don't know who will be next. **Given the mature stage of the economic cycle which may last into 2021, investors may very well be rewarded by remaining in the market.**

As 2020 unfolds, global economic activity is destined to rise against the backdrop of a partial trade agreement enabling a turnaround in China, central banks stimulus and governmental fiscal policies. The progression of these events will induce investors to take on greater investment risk in a world crowded with uncertainty and chaos. Equities will clearly outperform all other asset classes. Diversification is a key element of a well-balanced portfolio. It appears Euroland and to a lesser extent Japan will be the regions that outperforms the world given their low valuations and upside for currency gains. It's too soon to consider China since they have suffered the most severe economic contraction in almost a quarter of a century. Although the US market is overvalued, and the dollar is expected to fall, it still remains a safe place to invest. In terms of sectors, consider the biggest laggards of 2019 consisting of energy, industrials and materials. In addition, think about financials and defense. Technology appears to be at an overvalued extreme. As such, contemplate to a lesser extent large-cap technology. On the other side of the coin, avoid consumer staples, telecom and healthcare. Investor objectives should be based upon cash flow choosing large caps that have demonstrated a consistent record of increasing dividends. These companies need to be able to ride out any market down-turns. **In sum, we are approaching the end game of the bull market that may last into 2021 and investors need to support capital preservation rather than asset appreciation. They should also institute stop losses to protect themselves on the downside. After the asset bubbles burst, and they will, we will have entered the period of the Boring Twenties where low rates of returns throughout the world may last for decades to come.**

Absent any geopolitical and/or natural disasters, the forecast assumes trade resolutions enabling China a soft landing and an expansion in global activity along with easy money and favorable liquidity conditions throughout the world. The Dow will trade between a range of 28,000 and 32,000 closing the year at 31,250. The S&P 500 and NASDAQ may close the year at 3,600 and 10,000 respectively. This trading year will be one of elevated turbulence and volatility but generally will climb in an uneven pattern to all-time highs. Markets will ascend on good news and fall on bad news such as military conflicts.

On the downside, if Trump's "America First" protectionism evolves causing global economic activity to contract further, the US winds up with an electoral and/or impeachment constitutional crisis and an Iranian crisis triggers a global oil shortage than all bets are off the table. The bull market will come to an abrupt ending, bubbles will burst and we will gravitate into a recession.

- **Bonds:** Yields are destined to rise moderately, but don't expect 10-year Treasury rates to surpass 2.25%. Avoid investment grade corporate debt given their deteriorating fundamentals. Investment grade fixed income and high yield bonds will perform the best in this environment.
- **Currencies:** The US dollar bull market has run out. Both the Euro and the Yen will trade higher against the US dollar. The Fed's injection of liquidity into our banking system for the purpose of shoring up the Repo market will contribute to the dollar's decline. On the upside, this bodes well for our export sector and related corporate profits.
- **Oil:** Brent oil closed the year at $63 per barrel. Oil will benefit from both supply- side restraint and demand-side expansion as the global economy picks up momentum. Oil should trend $58-$70 a barrel. However, the unpredictable factor remains to be the Iranian conflict. On a positive note, the US became a net exporter of crude and petroleum refined products in November 2019 finally attaining energy independence.
- **Gold/Silver:** It is a bit absurd for gold and the US dollar to rally simultaneously. Gold is a currency that cannot be debased and rises during inflationary periods, chaos and conflict. Gold closed at $1,520 per ounce producing a shining return of 18%. While Hi-Ho silver, was riding along the Lone Rangers trail of spectacular returns closing the year at $17.83 and triggering an almost 16% return. Against the backdrop of a falling dollar, higher inflationary expectations and mounting world disorders, gold and silver could close the year at $1,800 and $20 per ounce and trend higher in years to come. At this stage gold should be at least 10% of a diversified portfolio.
- **Real Estate**: Rising demand for affordable housing has clearly outpaced the supply-side of the equation. As a result, valuations continue to trend higher outperforming wage growth and dissipating affordability. Against the backdrop of improving economic fundamentals in a low interest rate environment, non-retail commercial real estate will continue to attract capital and perform well on a cash flow perspective rather than based upon valuations.

Given the improving economic fundamentals, the odds support enhanced global economic progress that may possibly continue for the next two years. The domestic and global growth rates will drift lower and possibly avoid a recession until late 2021 to early 2022. We are approaching the end game of the bull market and heading into the Boring Twenties that represents perhaps decades in a world of low returns. These are truly extremely challenging times full of risks and uncertainties that can make it quite difficult to navigate turbulent markets. As such, investors should consider managed accounts.

Disclaimer

The economic forecast and generalizations constitute my views and should not be regarded as personalized investment advice. No assurances are made that I will continue to hold these views that may change at any time based on new information, analysis or reconsideration. In addition, no assurance is made regarding the accuracy of any forecast made herein. For individual applications, several variables may apply which require review of your actual circumstances when determining whether the generalization rules would be appropriate. I disclaim that any and all the advice and recommendations contained herein are applicable to any user. Therefore, any advice without my review on an individual basis is taken at your own risk. Any financial assessment and analysis or specific investment or recommendation provided herein must be presented to and discussed with your own personal financial advisor/broker.