PRUDENT GROWTH INSIGHTS

Apr 03, 2017 Trump Economics: Perception versus Reality.

President Trump's proposals for improving the US economy have been credited with igniting the current stock market rally. Today we assess whether this enthusiasm is based in reality especially in light of a high-risk, high-valuation US stock market (refer to our Jan 13 note at www.ramclients.com for RAM's projection of low 12-year annual returns for the US stock market.)

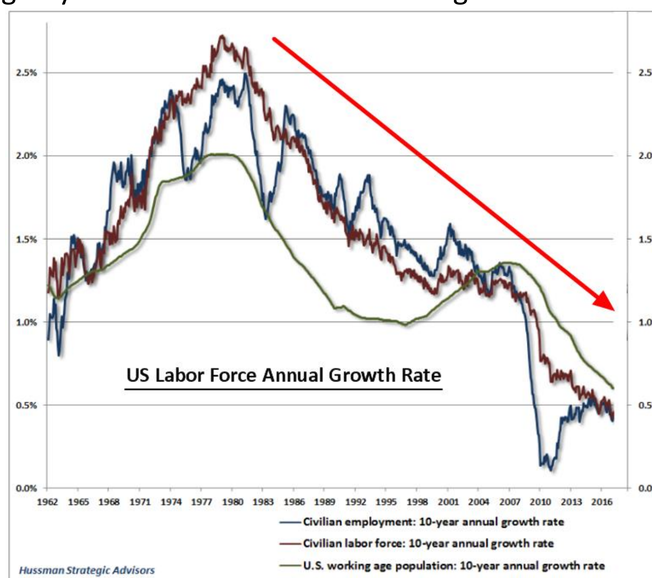
The standard measurement for economic growth, and thus stock market potential, is Gross Domestic Product (GDP). Trump's strategy is to grow the GDP through an economic stimulus policy financed by government spending cuts and tax policy.

The stimulus variables targeted are infrastructure spending, income tax cuts, a redirection of trade away from imports and toward job-creating exports, and a reduction in immigration. To fund this stimulus plan Trump intents to tax foreign imports and reduce Federal deficits by cutting entitlement and regulation expenses.

We have set the non-partisan political debate aside and have looked only at the prospects for success of this approach. Success in our opinion would be increasing the annual GDP growth rate from today's 2% to 4%. Our analysis that follows leaves us skeptical and reinforces our concern for the US stock market especially now that the success of Trump's approach is priced in the market.

Annual GDP growth is the sum of the *labor-force growth rate* and the *output growth per worker*.

Let's look first at *labor-force growth rate*. The chart below shows US population growth peaked in 1980. When combined with the secular trend of baby boomers retiring en masse and the discouragement of immigration, it is highly unlikely that the current annual population growth of 0.5% will increase meaningfully in order to contribute to the goal of 4.0% annual GDP growth.



The second variable for GDP growth, *output growth per worker*, is a function of domestic investment. Technology is the quickest depreciating investment and has become a greater proportion of all domestic investments, as a result annual output growth per worker has been in decline over the past 60 years from 2.8% to now only 1.0%. A possible source of improved productivity could have come from a labor force experiencing high unemployment. It follows that putting them back to work would be a productivity booster. Unfortunately for the Trump presidency it is starting from a very low 4.5% unemployment rate. As a result there appears to be little to boost worker productivity. In fact, a one trillion-dollar infrastructure spend plus a boost in domestic manufacturing at the expense of foreign manufacturers during a period of low available workers is more likely a scenario for increased inflation than improved worker productivity.

The bottom line is we believe the 10-year US government bond trading at a 2.5% yield has it right. The current average trailing US GDP growth rate of 2% is unlikely to improve and bail out the overvalued stock market especially given these prevailing population and productivity constraints.