Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

MACROCOSM

2023: Our Greatest Hits, Our Gravest Misses

Friday, December 29, 2023

Donald Luskin

No recession, inflation done, the Fed done, stocks at new highs. But bonds… China…

We know you're busy doing nothing this week. So we'll keep this simple and high-level and chart-free.

We made two emphatic calls for the macroeconomy for 2023.

- *There would not be a recession* despite a near-universal consensus that one was inevitable given the lagged effects of the Fed's 2022 scorched-earth hiking regime (see "Recession? No Thanks, We've Already Had One" December 30, 2022). We were right. It was a terrific year, with real GDP likely to report at something like 3%.
- *Inflation would return to normal* despite a near-universal consensus that it would be "sticky" (see "Surprises of 2023 Volume 1: From Inflation to Deflation" January 3, 2023). We were right. We said it would happen in the summer, so we were a quarter early. It happened in September, with core CPI ex-OER printing below the Fed's target now for three months in a row.

We made emphatic calls for the Fed, and US equities.

- *We said the Fed would stop hiking rates* (again, see "Surprises of 2023 Volume 1: From Inflation to Deflation"). We were right, but early by six months. We thought the January FOMC's would be the last hike, and became even more sure when Silicon Valley Bank failed in March. The Fed did stop – or at least *pause* – in June, two FOMC meetings later. Then after one more hike in July, the Fed was in fact done. The December FOMC's pivot (see "On the December FOMC" December 13, 2023) has struck markets as a policy turning point, but the hiking regime has been done now for the better part of half-a-year (see "On the July FOMC: The Most Unkindest Hike of All" July 26, 2023).
- *We said US stocks would make all-time highs* as the Fed makes explicit the end of the tightening cycle, and Chair Jay Powell triumphally takes credit for beating inflation without causing a recession (see "Video: What you're not hearing about the coming deflation" June 23, 2023). We were right – the S&P 500 made new all-time highs on a total return basis two weeks ago, exactly the same day Powell took a victory lap at the December FOMC (again, see "On the December FOMC").

Update to strategic view

US MACRO, FEDERAL RESERVE, US STOCKS, EUROPE STOCKS, ASIA STOCKS, US BONDS, OIL: Our very out-of-consensus call for no recession was perfect. Our call for disinflation was correct, but we were about three months early. Our call for the Fed to stop raising rates was early, too. The first "pause" came two FOMC meetings after we expected the halt. We said US stocks would recover to new all-time highs, and they did on the same day two weeks ago that the Fed finally definitively pivoted. We correctly said that the failure of Silicon Valley Bank would not be systemic, and that it would result in a deceleration of bank credit, but not a freeze. We recognized immediately the historic importance of the arrival of large language models as the portal to AI for the masses, and the bulk of S&P 500 earnings growth has come from stocks related to that. We were correct that US stocks would strongly outperform European stocks, but very wrong that Chinese …

[Continued on next page]

We had a perfect call on the critical shock-event of the year.

- *We said that the failure of Silicon Valley Bank would not be a systemic event for the banking system* (see "It's Over For SVB – And the Fed" March 13, 2023). We were right. We said there would be a deceleration in bank credit creation, but not a credit freeze. Also right: $178 billion in bank loans and leases has been created since SVB failed, the bulk of it for commercial real estate loans from smaller banks.

We had an early call about the boom in artificial intelligence.

- Unlike crypto and other tech fads we have been quick to dismiss, we think the arrival of *large language models as an AI access point for the masses is the real thing* (see: "Video: Surprises of 2023 Volume 3: What you're not hearing about the boom in generative AI" January 17, 2023 and "Video: TrendMacro conversation with Jon Stokes -- Understanding ChatGPT and generative AI" February 21, 2023).
- We were right. Of the $130 billion in forward earnings growth for the S&P 500 this calendar year, $102 came from the Magnificent Seven stocks that are associated in the public mind with AI.
- Incidentally, for all the complaining about the dominance of returns by these arguably bubblicious stocks, as of this writing they explain about 61% of the S&P 500's total return for the year – having contributed 78% of the earnings growth!

We had one big win and one big loss in global equity allocation.

- *We said US equities would strongly outperform European equities* based on our equity risk premium models (see "Surprises of 2023 Volume 4: Global Allocation, and the China Question" January 24, 2023). We were right, by almost two-to-one.
- *We said Chinese equities would be the best-performing globally*, based on an anomalously high equity risk premium and no inflation for its central bank to worry about. We were egregiously wrong. It was a value trap. We never based our call on the idea that the Chinese economy would reaccelerate out of its "Zero Covid" lockdowns, because we never thought those lockdowns really existed (see "The Myth of China's Lockdown" May 26, 2022). But perhaps where we went wrong was underestimating the extent to which the consensus was pricing for that non-existent reacceleration. China was the only major equity market in the world to end up the year with a loss, and it was a big one.

Our call for oil was mixed.

- *We started the year calling for $100 Brent crude and identifying $70 as a floor* (see "Surprises of 2023 Volume 2: Oil Demand, With or Without EVs" January 11, 2023). We got to $96, and the floor held. We ended up lowering our upside price target to $85 (see "Russia's

[Continued from first page]

… stocks would be the world's best performers (they were the worst). Our call for oil has been generally accurate, capturing the year's price-range. Our worst call was long-term Treasuries, because we were too early on the Fed. There will be a positive total return for the year, but there was a brief but agonizing draw-down before the Fed revealed an intention to pivot. We didn't capitulate.

[Strategy dashboard]

Oil Miracle" June 12, 2023), and that has been a little above the $82 average price for the year.

We had a miss in bonds, but we're glad we didn't capitulate.

- *We said long-term Treasuries would out-perform stocks*. Nope. Not even on a risk-adjusted basis (again, see "Surprises of 2023 Volume 4: Global Allocation, and the China Question"). After a disastrous move above 5%, the 10-year Treasury yield far outran our expectations – with the year-to-date draw-down in the Bloomberg Aggregate Long-Term Treasury Index showing a 14% loss on a total return basis!
- Our miss was likely the product of growth even better than our out-of-consensus expectations, and our too-early call for the end of Fed tightening. At the time of the maximum drawdown, the FOMC was still raising the "dot plots" and hadn't yet acknowledged the risks of "tightening financial conditions" (see "On the September FOMC" September 20, 2023). Then they did (see "On the November FOMC" November 1, 2023). Then they lowered the dots (again, see "On the December FOMC").
- It's cold comfort, but we called the top in the 10-year yield at 5% (see "That Quarter, Those Yields, This Correction" October 27, 2023). As of this writing there has been a remarkable recovery, with the Index now flipped to a positive 4.2% total return year-to-date.
- We're glad to have gotten out alive, but the 4.2% total return for long-term Treasuries this year is wholly uncompetitive with the 26%-plus total return for the cap-weighted S&P 500. That said, ladies and gentlemen of the jury, it is the case that on a risk-adjusted basis, 4.2% is historically competitive with the 9.9% total return of the median S&P 500 stock. Just saying.

Bottom line

Our very out-of-consensus call for no recession was perfect. Our call for disinflation was correct, but we were about three months early. Our call for the Fed to stop raising rates was early, too. The first "pause" came two FOMC meetings after we expected the halt. We said US stocks would recover to new all-time highs, and they did on the same day two weeks ago that the Fed finally definitively pivoted. We correctly said that the failure of Silicon Valley Bank would not be systemic, and that it would result in a deceleration of bank credit, but not a freeze. We recognized immediately the historic importance of the arrival of large language models as the portal to AI for the masses, and the bulk of S&P 500 earnings growth has come from stocks related to that. We were correct that US stocks would strongly outperform European stocks, but very wrong that Chinese stocks would be the world's best performers (they were the worst). Our call for oil has been generally accurate, capturing the year's price-range. Our worst call was long-term Treasuries, because we were too early on the Fed. There will be a positive total return for the year, but

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Dallas TX
214 550 2020
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

[About us]

there was a brief but agonizing draw-down before the Fed revealed an intention to pivot. We didn't capitulate.