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MACROCOSM

Our Predictions in This Most Unpredictable Year

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Donald Luskin

Three big hits. One big miss. Three prescient conversations. One scandalous idea.

The prediction business is hard, and when you get it right, hopefully you can be forgiven for some self-congratulation. *We got it mostly very right in 2024, on issues where everyone else got it mostly wrong (so it was possible to profit from being both right and out-of-consensus). And, yes, there were some fails, too*.

Our signature call for 2024 – we got it right, and it was a gift that kept on giving all year – was to continue after two-and-a-half years, ever since the yield curve inverted in April 2022, to stand against the relentless consensus that the economy was about to lapse into recession.

- The case for recession was based, fundamentally, on fear of the lagged effects of the Fed's violent tightening program in 2022 and 2023. We have said all along that it was, in fact, not a tightening program at all, but a normalization program. Whether by design or accident, it aligned policy in a post-pandemic boom with a higher neutral interest rate than was appropriate in the post-GFC era of secular stagnation (see, among others, "Video: What you're not hearing about why it doesn't matter when the Fed cuts rates" February 26, 2024).
- The recession case was buttressed by any number of technical arguments, initially the persistent inversion of the yield curve – and then later its uninversion became an argument for recession, too. We have said all along that such macroeconomic rules of thumb are approximate at best, but basically useless in this unique post-pandemic era after a once-in-history outright depression that was completely reversed within just three quarters (see, among others, "Four Fun Facts about the Uninverted Yield Curve" September 27, 2024).
- We have had to stand against any number of geopolitical catastrophe narratives. We don't pretend to have any special knowledge about it and play Henry Kissinger on TV, but we did a good job of using simple game theory principles to argue that the various conflicts overhanging the world wouldn't expand to systemic proportions (see, among others, "Our Hot Take on Iran's Attack on Israel" April 14, 2024).
- We have also had to stand against any number of recession narratives about the labor market. When the Sahm Rule was triggered, we said to ignore it, and pointed out that its track record

Update to strategic view

US MACRO, US STOCKS, US BONDS, US POLITICS: We were correct to continue stand, after more than two and a half years, against an overwhelming consensus calling for recession – it never happened, and it made possible a second year in a row of strong gains in stocks, and rising bond yields, both of which we correctly predicted. Our key election call all year was don't worry about it – whatever else happened, Republicans would control the Senate and block anti-growth policy initiatives in 2025. We predicted Trump would win the popular vote, but the election was less close than we expected. We sponsored client conversations with thought-leaders who would later be appointed to key Trump administration roles. We perfectly called both the top and the bottom of the near-10% correction from June to August in the wake of Biden's evident senility. Our call for outright deflation was wrong, which made us also wrong on the timing of Fed rate cuts. We are especially proud of our controversial analysis that illegal immigration, whatever its evils, is driving job creation and economic growth.

is not indeed perfect, as claimed. The Rule reversed itself the very next month, which has happened only once before in history (see, among others, "Two Faddish Indicators and Their Flaws" September 9, 2024).

- *As a consequence of our correct expectations for uninterrupted expansion, our call at the beginning of the year for a second-in-a-row great year for stocks proved pitch-perfect – as did our call for 10-year Treasuries to trade no lower than 3.5%, but then back up and treat 4% as a floor* (see "2024: Deflation, Election, and No Recession" January 3, 2024).
- Even with our no-recession call pointing to higher stock prices, we've had to stand fast against the apparent overvaluation of equities on a forward P/E basis, and against the narrowing of the equity risk premium to zero (and on several days this year, below zero). In some kind of ideal world we could have a booming economy and the unfolding of artificial intelligence as a mainstream technology and somehow have cheap stocks, too. But as Milton Friedman might have said, that would be like wishing for a cat that barks. So we've relied all year not just on a no-recession call, but from *our conviction from the beginning that that AI is real – not a fad* (see, earliest, "Video: Surprises of 2023 Volume 3: What you're not hearing about the boom in generative AI" January 17, 2023). We have been tireless advocates, increasingly adopting it in our own work. So we have noted that the zero ERP is, in fact, very similar to its average value from 1982 to 1999, the best 17-year period in the history of the stock market, and the last time that a world-changing technology (the processor on a chip) hit the mainstream.

With the presidential election now settled, it's almost hard to remember how much anxiety there was all year about how it would turn out.

- Our gravest concern at the outset of 2024 – not our *prediction*, our *concern* – was that Joseph Biden would win, and take another run at Build Back Better or some similar program of massive tax hikes on firms and individuals – but with the retirement of Joe Manchin (D-WV) and Kyrsten Sinema (R-AZ) from the Senate leaving no one to stop it. Indeed Biden, then Kamala Harris, campaigned with promises to do exactly this.
- *However, our key election call – a correct call, made with high conviction, a call that allowed us to completely tune out our gravest concern – was that Republicans would take control of the Senate, no matter who was elected president or controlled the House of Representatives. No second run at Build Back Better, or any other major anti-growth legislation, would be possible*. After that, the rest of the election – including the presidency – could be seen as something of a mere detail in terms of investment risk for 2024.
- *In terms of market impact, our critical call was to perfectly predict the 9.71% correction that followed in the wake of Biden's catastrophic debate performance in late June* (see "Our Hot Take on Last Night's Presidential Debate" June 28, 2024). And we called

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it's bottom in early August on the very day (see "It's a Recession! Well, Maybe It's Just a Correction" August 5, 2024).

- Where we got the election wrong was in thinking, right up to the last moment, that it would be close. With this in mind, we alerted clients early in the year to the very real possibility of a potentially disruptive third party run by a centrist "Unity Ticket" sponsored by the No Labels bipartisanship advocacy organization (with whose leadership we held a Zoom question-and-answer session for clients). After spending nearly $100 million on ballot access, and fighting Democratic lawfare at every step, the effort had to stand down when Joe Manchin and other leading potential candidates for declined to participate (see "On March Jobs, and No Go for No Labels" April 5, 2024).
- Just before, *we said correctly that Donald J. Trump would win (indeed, that he would win the popular vote*, which no one else expected -- see "Our Fearless Forecast" November 5, 2024) – *but it was a less close election than either of the prior two* (see "Our Hot Take on the Election" November 6, 2024). That will have consequences in terms of Trump being able to behave as a man with a mandate (see "Trumponomics II, The Sequel" July 17, 2024) – but more on that in reports next year, as the details unfold.
- We are especially gratified to have been the host for client question-and-answer Zoom calls with three thought-leaders who have been nominated to influential posts in the Trump administration – Robert F. Kennedy, Jr. (Health and Human Services), Vivek Ramaswamy (Department of Government Efficiency) and Marty Makary (Food and Drug Administration) (see "Video: TrendMacro conversation with Robert F. Kennedy, Jr.", "Video: TrendMacro conversation with Vivek Ramaswamy" and "Video: TrendMacro conversation with Marty Makary on 'Blind Spots' in health and medicine").
- Almost as an aside, we'd like to point out how difficult it was for us to predict Trump would win when our quantitative election prediction model was saying that Biden would (see "For What It's Worth... TrendMacro's 2024 Presidential Election Model" December 11, 2023). That model has been a trusty old friend for many years, as has the yield curve and the Index of Leading Indicators and the Sahm Rule for other economists. But we couldn't very well tell our colleagues in the profession to jettison their time-tested tools in this most unusual climate and not be willing to do so ourselves. So we did, and it was the right thing to do. (see "Trump's TrendMacro Cabinet" November 25, 2024)

One that we really missed was our high-conviction call for deflation – for the Consumer Price Index and other inflation indicators to print at outright negative values on a year-over-year basis.

- With the money-supply contracting for the first time in the modern history of the data, our monetarist model – which had brilliantly predicted the top in inflation in 2022, just when everyone else was sure it would be anything but "transitory" – made deflation seem like a sure thing.

- Indeed, it has materialized in the goods sector of inflation, a strong plurality of the consumption basket. But services inflation, even excluding shelter services, has run higher and longer, keeping the overall indices from doing anything more dramatic than pretty much "sticking the landing" near the Fed's target.
- *So our call for deflation was simply wrong. We reversed it in April and recalibrated our monetarist model* (see "Video: What you're not hearing about the shrinking money supply and the prospect of deflation" April 24, 2024).
- As a consequence of this bad call, we were also wrong in predicting when the Fed would start cutting policy rates. At the beginning of the year, we were essentially in step with the markets, which expected the first cut at the March FOMC. It did not, in fact, come until September – by which time we, and the markets, had very much changed our tune.
- This bad call had also led us to expect a deeper correction in equities than we experienced this year. We thought deflation – though not objectively a bad thing after the bout of extreme inflation we had in 2022 – would nevertheless drive something of a panic. *Never so happy to be wrong*.

We note one final element of our work in 2024. It wasn't a prediction we made at the outset of the year, but rather an insight we have had along the way: that *the crisis of illegal immigration into the US, for all its evils, is in fact contributing strongly to job creation and economic growth* (see "Video: What you're not hearing about the effects of immigration on the post-pandemic boom" April 9, 2024).

- In client conversations, this view has turned out to be quite controversial. Many argue that any economic advantages are more than offset by the long-term corrosive effects of a lawless system, while some argue that our analysis of the advantages fails to take into account offsetting costs of the many externalities of immigration. We respect these divergent views. And we are proud to have brought this controversial insight into the mainstream of political and economic discourse (see in the *Wall Street Journal,* "Open Borders Produced the Biden Economic Boom" May 24, 2024). We think border reform is likely the leading edge of Trump's self-perceived mandate, and we worry that in an attempt to redress the evils, he might also choke off the growth. We expect we'll be talking a lot about that in 2025.

See you on the flip side…

And thanks to all of you, our beloved and esteemed clients and friends, for being with us on another year's journey. Is investing the greatest game ever conceived by the mind of man – or what?

Bottom line

We were correct to continue stand, after more than two and a half years, against an overwhelming consensus calling for recession – it never happened, and it made possible a second year in a row of strong gains in stocks, and rising bond yields, both of which we correctly predicted. Our key election call all year was don't worry about it – whatever else happened, Republicans would control the Senate and block anti-growth policy initiatives in 2025. We predicted Trump would win the popular vote, but the election was less close than we expected. We sponsored client conversations with thought-leaders who would later be appointed to key Trump administration roles. We perfectly called both the top and the bottom of the near-10% correction from June to August in the wake of Biden's evident senility. Our call for outright deflation was wrong, which made us also wrong on the timing of Fed rate cuts. We are especially proud of our controversial analysis that illegal immigration, whatever its evils, is driving job creation and economic growth.