First Quarter 2025 Analysis

2024 witnessed very strong equity markets while bonds provided poor returns once again, especially those with longer duration. While equities have experienced strong performance for a couple of years, bonds have likely had their worst bear market in modern history over the past 5 years.

We have witnessed around 40 years of what has been called monetary dominance where monetary policy was very effective in steering the economy. We have seen the Federal Reserve intervene to stem the adverse effects of market turmoil. We are likely to observe a new paradigm, what Lyn Alden and other macro strategists refer to as fiscal dominance. This refers to the condition where the fiscal debt and deficits are large enough that they reduce the options of the central bank, and monetary policy takes a back seat to fiscal policy. Fiscal policy becomes the major determinant of economic activity. Periods of fiscal dominance are evidenced by countries running large structural fiscal deficits that will be accommodated by monetary authorities. This has not been the case since perhaps the 1930s. 2024 will see the country running fiscal deficits of 6-7% of GDP.

Fiscal dominance and fiscal policy will be the dominant themes for 2025. Debt and deficits are grossly unstable, and markets are becoming increasingly concerned about the fiscal outlook. Our federal government has run fiscal deficits every year since 1969, except for a brief period during the Clinton presidency. It took our country 221 years to accumulate the first $12 trillion in debt but only 4 years, 2020-2024 to add another $12 trillion.

Elon Musk and Vivek Ramaswamy, with the support of the incoming administration, will be the most recent attempt to end this fiscal profligacy through a reduction in governmental waste and improvements in efficiency. This might be the only realistic opportunity to change the paradigm of our debt and deficits growing faster than our economy. Our debt to GDP ratio has risen from 79% in 2019 to 97% today and the Congressional Budget Office, CBO, projects the ratio will continue to grow, reaching 166% by 2054 if current law remains the case. Interest payments on our debt amount to about $3,000 per citizen per year.

Previous efforts at arresting governmental imprudence have all failed. In 1975 Sen. William Fullbright launched the Golden Fleece Awards to illustrate absurd government spending. A decade later President Reagan commissioned the Grace Report which identified over $400 billion in potential savings, most of which was ignored. In 1993 President Clinton's 'Reinvent Government' made modest strides. Most recently, President Obama ignored his own bipartisan Simpson-Bowles Commission in 2010 to arrest uncontrolled spending and deficits.

Even though the Federal Reserve has recently cut the federal funds rate twice, market interest rates have risen as the markets believe the Fed is wrong, again. It is imperative that our political class address these fiscal imbalances. If no progress is made on this, my present optimism would have to be modified.

The U.S. remains the epicenter of risk taking, entrepreneurship and innovation. Consider Europe for a moment. Recently the Wall St. Journal reported that over the past 50 years, Europe has created 14 companies worth more than $10 billion, with about $400 billion in market value. By comparison, the U.S. has created nearly 250 such companies, worth approximately $30 trillion. The U.S. entrepreneurial interest stems from vibrant venture capital markets, risk taking culture, and entrepreneurial spirit which has created ubiquitous companies such as Microsoft, Amazon, Google, Apple, and hundreds of others. Much attention is devoted to the wealth created for such visionaries as Bill Gates, Jeff Bezos, Sergey Brin and Larry Page, and Steve Jobs. However, scant attention is paid to how much wealth such founders have created for others. As an example, Jeff Bezos owns approximately 9% of Amazon, which has a market capitalization of $2.4 trillion. So, Bezos has created 91% of Amazon's market capitalization wealth for others. This premise holds across the entire market landscape. Apple is worth more than the 30 largest German companies combined.

The incoming administration advocates policies for pro-business deregulation, energy independence, increased economic growth and a return of business confidence. Even though equites are at historically high valuations by many measures and bullish sentiment has increased sharply recently, roughly $7 trillion remains in money market funds. Periodic corrections will naturally occur but if pro-growth policies are enacted and progress is made on our debt and deficit, I believe a constructive environment lies ahead.

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[First Quarter 2025 Analysis Disclosures]