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4 Economic Headwinds To Watch

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We do have some concerns about the economic outlook, and we are not as excited as the equity markets about the tax cuts. We see the following headwinds:

1. **Tax Cuts:** The Reagan tax cuts were done when the Debt to GDP was about 30%. The current cuts in revenues are coming at a time when Debt to GDP is about 105%-110%. Debt levels of this magnitude are a serious drag on economic growth. We believe increased borrowing to pay for the tax cuts will likely inhibit economic growth rather than increase it in the long run. Our high levels of debt and sluggish economy won't be solved by increased borrowing to finance tax cuts.
2. **High Levels of Debt:** Virtually all the developed countries are over-indebted. Studies show Debt to GDP ratios over 90% are a severe drag on economic growth. Monetary and Fiscal policies have been designed to stop the deleveraging process which began during the financial crisis. This means the process of debt liquidation will be drawn out over a much longer period. This will lead to subpar economic growth for many years. Japan is a good example to show borrowing more is not the answer to too much borrowing. They are now suffering from 2 lost decades of economic growth.
3. **Negative Demographics:** The U.S. suffers from negative demographic trends which include an aging population, fewer people in the work force, and declining birth rates. These trends are negative for future economic activity and entitlement programs such as Social Security and Medicare. They have also contributed to the problems of funding pension obligations and other post- employment benefit programs for municipalities. These problems are well documented. There is no evidence these trends are in the process of changing.
4. **Monetary Policy:** The Fed is in the process of increasing the Fed Funds rate. They are talking about raising it 3 more times this year. They are also engaging in Quantitative Tightening (QT) by reducing their balance sheet. Both actions are negative for the economy.

The recent tax cuts have created a sense of euphoria in the equity markets as investors believe the cuts will serve as a driver of economic growth. While we believe they may stimulate growth in the short term, we are concerned about the previously mentioned headwinds for the economy and their drag on economic activity.

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