VIEWPOINT

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A Stephens Inc. Economic and Financial Commentary

by Thomas Goho, Ph.D.

We recently caught up with Dr. Thomas Goho, former Chief Economic Consultant for Stephens Inc. to ask him if his outlook for our economy had changed since the end of 2020. Particularly, in light of the recently enacted stimulus package as well as anticipated income tax increases along with a proposed historical spending proposal from the new Biden administration.

It's Party Time USA: A Post-Covid Celebration.

Even before America has reached herd immunity from vaccinations, there is a euphoria building in America, and government is playing a key role in party planning. Forecasts of real economic growth indicate quarterly growth of over 6% in early 2021. Strong economic growth is providing a boost for employment, with the unemployment rate falling to 6% in March 2021. Unemployment is still high compared to the pre-Covid rate of under 4%, but it is headed in a positive direction.

Back in the 1950s, the Federal Reserve chairman, William McChesney Martin, noted that it was the role of the Federal Reserve to take away the punch bowl just when the party gets going. He meant that the Fed should serve as a constraint on monetary policy when there were signs that excessive growth might create inflationary pressure. The current Fed chairman, Jerome Powell, seems willing to tolerate inflation without any indication that he will remove the punch bowl. The Fed will continue its expansionary policies for some unknowable period.

Janet Yellen, the current Treasury secretary and former chair of the Fed, is a cheerleader for this lack of monetary caution. In addition, as a member of the current administration she was a supporter of the recent $1.9 trillion stimulus package. The punch bowl of stimulus spending now totals over $5 trillion, funded by a huge Federal deficit and financed in part by a massive expansion in the Federal Reserve's balance sheet.

An additional $2 trillion in government spending on infrastructure and a Green initiative, if passed, will likely create more deficit spending and greater monetary expansion by the Federal Reserve. The impact of these proposals can spill over into stock and bond markets. Stocks are at historic highs, and the real yields on bonds are artificially low. For the time being, most investors are a bit tipsy from their capital gains over the past decade.

To pay for these significant spending projects, the administration is proposing a myriad of corporate tax increases totaling about $3.3 trillion over the next decade. These tax increases place an especial focus on multinational companies. These latter corporations are significant components of major U. S. stock indices. The administration is also proposing large tax increases on individuals earning over $400,000 per year, including a less favorable treatment of capital gains for high income investors.

Equity and bond investors need to be alert! Too much economic punch often has consequences: inflation and ultimately higher interest rates. Investors should take note that current measures of inflation indicate that inflation is still quiescent at less than 2% even though interest rates have increased significantly since the government spending frenzy began.

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Thomas Goho, Ph.D. is formerly the Chief Economic Consultant for Stephens Inc. He also served as the Co-Director of Stephens University at Wake Forest University. Tom enjoys a successful career in both education and business. He served as a professor of finance, Wayne Calloway School of Business and Accountancy, Wake Forest University for 30 years. Before retiring in 2007, Tom was the first to hold the Thomas S. Goho Chair of Finance. Tom also served on the Board of Directors of the Wells Fargo Family of Mutual Funds for 20 years, and also was on the Board of Directors of Lifepath Funds of Barclay's Bank. A former Certified Financial Planner, Tom earned his BS and MBA from Pennsylvania State University and his Ph.D. from the University of North Carolina-Chapel Hill.

Too many new tax increases on corporate earnings and high-income households also have consequences: lower after-tax profitability and less profitable household investments. Tax increases on corporations and high-income taxpayers can compound an economic hangover. These "tax and spend" parties seldom end well for investors in the long run. Beware!

Final Thought

Jamie Dimon, CEO of JPMorgan Chase, opined recently that the U.S. economy may be in for a Goldilocks recovery through 2023: moderate growth with low inflation fueled by government spending and strong household savings. Remember that Goldilocks was ultimately terrorized by 3 bears as she fled into the woods. Stayed tuned for an update in July.

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