Is the New Stock Market High Telling Us the Congressional Budget Office's Warning About the Evils of the Trump Tax Law are Simply Wrong? So, it Seems!

by
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The S&P 500 hit a record high recently in part reflecting a pro-growth Trump tax law and a strong American economy. Working Americans have benefitted enormously- more jobs, higher real incomes, and a vast improvement in the financial condition of all state and local and union retirement plans and by extension the wealth of the average American. But this was not supposed to happen. When the Trump tax law was first analyzed by the Congressional Budget Office, the director, Keith Hall concluded: "The prospect of large and growing debt poses substantial risks for the nation and presents policy makers with significant challenges," More recently the Congressional Budget Office updated its analysis and concluded that GDP would now be $7.7 trillion dollars higher than it first projected and 32% of this increase is due to Trump's tax law. Moreover, the cumulative deficit is now $400 billion dollars lower than first projected. The focus on the size of the debt, and its negative implications for economic stability by economists, and by extension the media and politicians, is overstated to the extreme. What is critical to sustainable economic growth and economic stability is the ability of the American economy to create wealth and rising Federal debt does necessarily limit this.

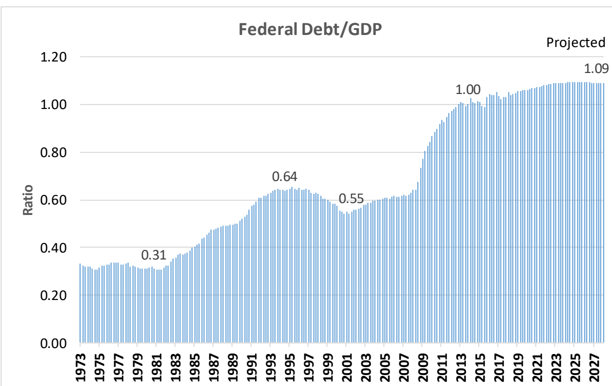
The table below provides evidence why global investors are optimistic about the US economy and why they are willing to continue to invest in America.

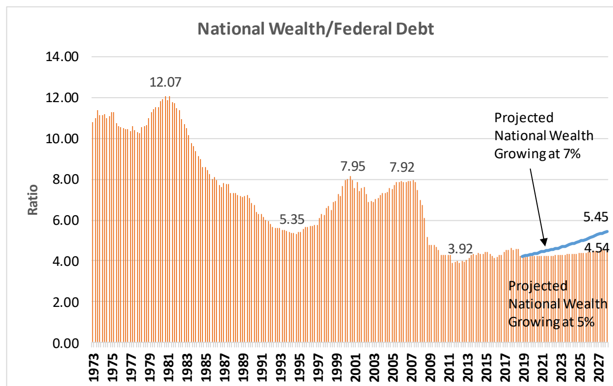
Date Range	Median 5 Year Federal Debt (Millions) (1)	Median 5 Year National Net Wealth (Millions) (2)	Median 5 Year National Net Wealth / Federal Debt	Growth Rate Federal Debt (3)	Growth Rate National Net Wealth (3)	Median Dollar Index Value	Dollar Index Value Range: Min - Max	Synthetic Credit Score
1973-1978	$553,647	$6,004,801	10.85	61%	53%	94.559	89.069 - 107.616	AAA
1978-1983	$907,701	$10,828,939	11.93	69%	73%	89.747	84.133 - 110.974	AAA
1983-1988	$1,823,103	$15,067,791	8.26	100%	39%	111.495	92.135 - 128.437	AAA
1988-1993	$3,233,313	$21,142,557	6.54	70%	30%	91.005	85.408 - 96.225	AA+
1993-1998	$4,973,983	$27,626,233	5.55	31%	54%	88.767	84.049 - 102.108	AA
1998-2003	$5,726,815	$44,302,058	7.74	17%	22%	104.515	98.711 - 112.767	AA+
2003-2008	$7,932,710	$62,471,988	7.88	46%	48%	97.148	87.111 - 107.32	AA+
2008-2013	$13,561,622	$60,426,633	4.46	78%	3%	84.975	80.241 - 96.618	AA
2013-2018	$18,152,056	$80,275,952	4.42	26%	41%	94.623	83.007 - 103.252	AA
2018-2028	$33,851,000 (4)	$152,158,939 (5)	4.54 (6)	61%	55%			AA

(1) Federal Debt Source: Federal Reserve Bank of St. Louis Federal Debt, Total Public Debt
(2) National Net Wealth: US Wealth (Federal Reserve, All Sectors; US Wealth, Level)
(3) Percent Change from starting point of period to ending point of period
(4) 2028 Federal Debt Source: https://www.statista.com/statistics/216985/forecast-of-us-gross-domestic-product/
(5) 2028 National Net Wealth Calculation: (2018 National Net Wealth grown quarterly at 1.25%) - Annual Growth Rate of 5%
(6) The Projected Adjusted Net Wealth / Federal Debt for 2028 Only, Not a Five Year Median

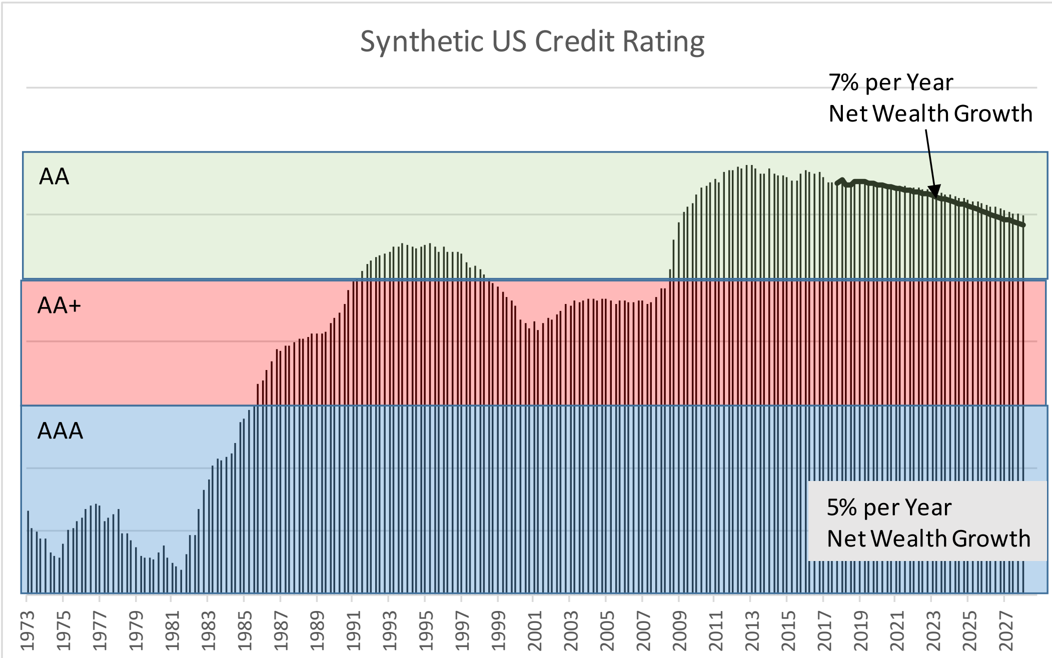
Before I draw any conclusions, let me describe the data in the table. The table shows the level and growth in Federal debt, US national wealth as calculated by the Federal Reserve, the ratio of national wealth to Federal debt, a synthetic credit rating for the US economy (which I describe below) and the dollar value index over five-year periods between 1973 and 2018. Also shown is the Congressional Budget Office's initial 2028 Federal debt projection and my projection of US wealth at 2028. National wealth can be calculated in several ways but the best way to think of it is that it is the net of all assets and liabilities of the US economy or, what is equivalent, it is the total economy's equity position.

The most important takeaways from the table are that national wealth has registered significant growth, but that Federal debt has grown even faster. The second takeaway is that while the ratio of national wealth to Federal debt has declined, it is still greater than four times Federal debt. Third, the value of the dollar has varied a great deal over the business cycle but there is no pronounced downward trend. Fourth, the synthetic US credit rating I calculated using my firm's credit platform declines over time indicating a material deterioration in credit quality. While the credit platform is not designed to specifically calculate national economy credit ratings, it nevertheless captures the fundamental factors that drive credit quality- Federal debt to GDP and national wealth to Federal debt.





To better understand why global investors are sanguine about the US economy and its creditworthiness, I first compare projected Federal debt to the US wealth level in 2028. I assume that US wealth will grow at a baseline rate of 5% per year consistent with growth in the S&P500 but below net wealth's long-term historical growth rate of close to 7%. The result is that national wealth by 2028 will be 4.5 times greater than Federal debt. If wealth grows at its historical rate of 7% annually, then the wealth ratio will be considerable higher-5.5- and the credit rating of the US by 2028 will register considerable improvement. This all happens even though Federal debt is projected to be 9% greater than GDP by 2028.



Although the baseline forecast of 5% growth in national wealth is conservative, I also expect that if there is a surprise, it will be on the up side- perhaps 7% or higher. There are multiple reasons for this, but the two most important are the reduction in financing costs that businesses face-the cost of capital- and the freeing up of additional resources to fund investment activities that the tax law has created.

The cost of capital reduction is directly related to the decline in the corporate tax rate. We know that the decline in the cost of capital stimulates business investment which is a major determinant of economic growth. More importantly, a lower tax rate frees up additional resources to fund R&D, incentivize people to “think outside the box” and take risks that produce the innovations that drive wealth creation. What underlies all economic forecasts is the fundamental, but typically unstated, assumption that government policies and potential government over reach do not materially interfere with the risk-taking appetites of market participants or as Lord Keynes so eloquently put it, the “animal spirits of businessmen”. This does not to mean that public investment, and the debt creation to finance it, is bad. Rather it indicates that for public investment to create value for all Americans, it must leverage the entrepreneurial and risking propensities of those willing to put up private capital. When properly done, private wealth increases by far more than the public debt issued to finance public investment. This means that the credit quality of the US can materially improve despite the fact that the ratio of public debt to GDP rises.

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