Rosenberg Research

Economic Research for Informed Investing

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Special Report: Fade the Front Cover

FREE REPORT

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Economic Commentary **March 8, 2021**

IN THIS ISSUE

FADE THE FRONT COVER

- Can you believe we now have three magazine covers talking about the "Roaring Twenties"?? I don't think in my entire career I have seen a fairy tale like this emerge as a given by Wall Street seers and the media
- Why anyone would compare today's landscape to what happened after the Spanish flu (and the devastation from WWI) is anyone's guess except that this is the story most investors yearn to hear
- The economy did collapse back then, but the government did not blow its brains out on fiscal largesse — so we went into the 1920s with tremendous pent-up demand, and balance sheets were in far greater shape
- Not only is the outlook for demographic support, productivity, debts and taxation so vastly different, but so is the starting point on valuations for the stock market

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FADE THE FRONT COVER

> *"When all the experts and forecasts agree — something else is going to happen."*

Bob Farrell

> *"Sell the front-page news and buy the back page news on the way to the front page."*

Don Coxe

Can you believe that we now have three magazine covers talking about the "Roaring Twenties"?? I don't think in my entire career I have seen a fairy tale like this emerge as a given by Wall Street seers and the mainstream media.

CHART 1: The Roaring 20s? Towards a New Era of Innovation

United States

JAN 16TH 2021

The roaring 20s? Towards a new era of innovation

Source: The Economist, Rosenberg Research

CHART 2: The Roaring 2020s

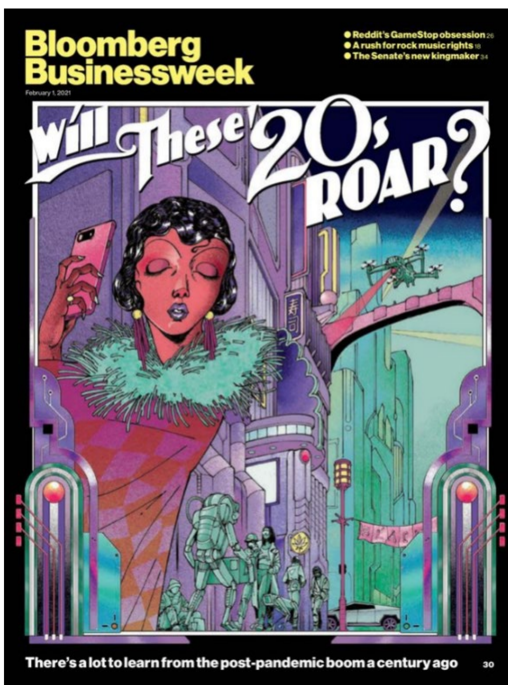
United States

Source: MoneyWeek, Rosenberg Research

Bloomberg Businessweek completes the trilogy of "Roaring Twenties" magazine covers. What could possibly go wrong?

CHART 3: Will These 20s Roar?

United States



Source: Bloomberg Businessweek, Rosenberg Research

Why anyone would compare today's landscape to what happened after the Spanish flu (and the devastation from WWI) is anyone's

guess except for the reality that this is the story that most investors yearn to hear. **But outside of the fact that these two periods shared a health crisis, there are no other comparisons to be made that are relevant.** I would highly recommend that nobody draw inferences from what happened in the 1920s, for the following reasons (there is no global boom coming once we get past this crisis — a lot of time and effort will be spent cleaning up all these debt excesses).

For one, coming out of WWI, which was ending as the Spanish flu was starting, the U.S. had come to account for half of global manufacturing production. That's because the war savaged the entire European economy and gave U.S. industry the opportunity to grab global market share in exports and industrial production.

Second, the U.S. dealt with the Spanish flu totally differently. The economy never went into full lockdown. People just learned to live with the disease, which ultimately vanished on herd immunity. Back then, nobody turned to the government for help; it was all about community and charity. These were the days before welfare and unemployment insurance benefits and company bailouts. Public attitudes toward illness and death were far different and there was no internet or social media to try and influence people's perceptions and stir up emotions.

The economy did collapse back then, but the government did not blow its brains out on fiscal largesse. So, we went into the 1920s with tremendous pent-up demand once the crisis ended, and balance sheets were in far greater shape. Government debt-to-GDP was 10% — not over 100%. And that better public sector balance sheet allowed the federal government to CUT taxes by the mid-1920s — top marginal rates for corporations were initially raised from 10% in 1920 to 13.5% by 1926 but cut to 11% by the end of the decade; for individuals, the rate went from 58% after the war to 24% by 1929. **Does anyone think taxes are going to be coming down in the U.S. any time soon?**

We also have to remember that, in the 1920s, we had a rural economy become more urban. Half the population back then lived in rural areas — compared to one in five today. We saw first-hand in China in the past two decades how urbanizing the population is massively stimulative to the economy. That impetus to growth hardly exists today — if anything, people are leaving the inner city to the sparse areas of the country. And we had a 25% homeownership rate back then versus 64% today — we were on the precipice then of people shifting from being renters to homeowners. That arithmetically is less possible today — but that shift in the "Roaring Twenties" was very much pro-growth.

And also keep in mind that the share of the economy that was "non-essential" (that could be shut down) back then was less than 10% (as

in cyclical services) versus more than 70% today. In the 1920s, we "made" things — manufacturing commanded one-third of the workforce compared to less than 10% now. **The economy was so much more geared towards industries that were "essential" (that could not be closed down) and carried with them powerful multiplier impacts through the rest of the economy.**

There is a common refrain that "demographics is destiny." The difference between then and now is that we had a population profile with so much more vitality in the 1920s. We started that decade with a median age of the population at 29 years — today it is 38 years. The share of the population over the age of 65 was 7% in the 1920s; today that share is on the precipice of hitting 20% for the first time in recorded history. Not to detract from retirees and their dominance, but they are savers, not spenders. When you have half the population under 30 years of age as you did in the 1920s, well, that does blaze the trail for a spending boom.

And guess what? **There was capital deepening back then. Company executives were less focused on financial engineering but on improving the capital stock.** So the 1920s was renowned for a decade that saw 5% annualized growth in manufacturing productivity. We had a central bank then that seems to have understood that we can actually tolerate mild deflation as was usually the case in peacetime periods (as my old chum Gary Shilling always points out). **Only today is inflation seen as a desirable outcome — because today's central bankers are consumed with bailing out debtors and penalizing savers. But inflation erodes real purchasing power — something today's central bankers don't tell you.**

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So we had solid growth in productivity. We had growth in the working-age population of around 2.0% annually in the 1920s. For the next ten years, such growth in the U.S. is destined to come in south of 0.5% per year. There simply is not the "potential" supply-side dynamics today compared to the 1920s. Plus, the mild 1.0% per year decline in consumer prices was tolerated, not resisted, and this massively supported real spending power. So we ended up with real GDP growth per capita of over 3.0% in the 1920s. What is the math that brings us

back to that trend in the coming decade? There is no math, that is the answer.

As for the stock market, indeed, it did rally 250% from the beginning of 1920 to the pre-crash 1929 peak. But the starting point on the CAPE multiple then was below 6x, not at 35x! **Even adjusting for interest rates, the stock market today is two-and-a-half times more expensive than it was when the "Roaring Twenties" began. So not only is the outlook for demographic support, productivity, debts and taxation so vastly different, but so is the starting point on valuations for the stock market.**

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Sample Report

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Sample Report

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