



OAKWORTH  
CAPITAL BANK

## Something to Think About

Since the election, I have had more than one person ask me a variant of: "how are we going to pay for everything Trump says he is going to do?" This is ordinarily more rhetorical than an actual desire to know the answer, which is understandable. There has been no shortage of so-called experts predicting fiscal rack & ruin over the next 4 years. It always seems to go something like this: "Based on what we know of Trump's fiscal and economic plans, our model forecasts an \$X increase in the accumulated debt over Y number of years."

It all sounds very complicated, sophisticated, and intelligent. I mean these are folks with advanced degrees from some of the most prestigious universities in the world. Further, they are on national television, which lends a certain air of gravitas or even validation (for some reason). Surely, they most know better than we; this is what they do for a living for goodness sakes! Well, perhaps, but, then again, perhaps not.

So, whenever I get the question/statement about Trump exploding our debt ceiling (debt ceiling, ha!), I usually counter with one or both of the following, and in no particular order:

- Please remember, the people saying this are predicting the future. More specifically, they are predicting the future with mathematical equations. I don't know about you, but I don't know anyone who can forecast the future with crystal clarity. The best they can posit (okay I don't use the word posit very often) is a probable case scenario based on assumptions THEY make. So, it is prone to some measure of personal bias, intentional or not. And;
- The current Administration's proposed budget for 2017 predicts the accumulated debt will grow in excess of \$9.75 trillion over the next decade, even before anything Trump does. So, the debt is probably going to explode regardless.

Then there is the sneaky truth, which is separate and apart from the above:

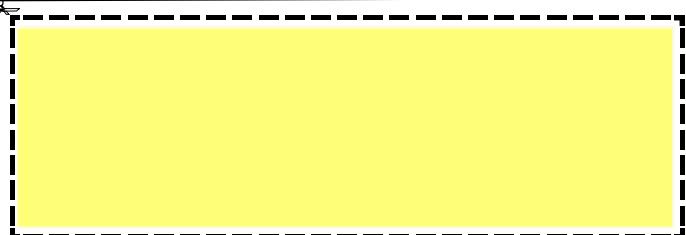
Most, if not the majority, of the people you see on the TV, those guest experts if you will, have a PR firm which helped them get on the set. The PR firm works with the producers of the various program segments, not necessarily the 'on-air talent.' They can get 'you' on the first time, but it is up to 'you' to get invited back, if you will. As such, 'you' can't go on air with commentary which embarrasses the producer, unless you are previously well-known and established (think Jim Rogers). In some ways, these segment producers are on the lower end of the proverbial totem pole, trying to work their way up.

This is the real reason why everyone says basically the same thing **once** the 'line' has been established. A mediocre, even forgettable, guest is better for the producer's career than a bad one (read unknown individual speaking completely off the established script). Essentially, if you aren't in the studio on the desk, you are filling up time...so don't screw it up. If you can prove yourself as 'reliable' for a 3-minute slot, the producer will keep inviting you back. When the producer leaves that particular show or segment (and there is significant turnover), 'you' go back to square one, well, maybe square two.

It is almost like the best kind of handshake. Best handshake? Yeah, the best kind of handshake is

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one you don't really remember. You don't want to 'crush the producer's hand,' nor do you want to be a 'dead fish.' Trust me, I have been there and done that. While not a complete waste of time, you have to devote precious resources, time and money, to be forgettable on the TV.

So, I typically discount pretty much most of what I hear/see on the business channels, having played the game myself in a 'former life.' Right now, the established line seems to be "Trump is going to explode the budget." So, we will get a heaping helping of that from the supposed expert guests.

Now, what if someone got on the set and had the temerity to say the following:

"Over the last 50 years (1956-2015), Federal government receipts as a percent of GDP (Gross Domestic Product) have averaged 17.32%, with a standard deviation of 1.08. This means there is a 68.2% probability they will be between 18.40% and 16.24% any given year. There is a 95% likelihood the range will be 19.48% and 15.16%. Notice I haven't mentioned anything about tax policy, because tax policies has changed any number of times since 1956. Corporate and individual income tax rates haven't been consistent. Neither have payroll taxes, tariffs, deductions, or anything really. Even so, the mean over those 50 years is 17.32%; the median is 17.20%, and the standard deviation is a relatively underwhelming 1.08, although I am certain some mathematicians would argue this is significant."

What if they followed with:

"Further, there is a near positive perfect correlation (.99) between government revenue and nominal GDP growth. Basically, when the economy grows, so do the public coffers. As a result, it would seem the best way to grow tax receipts, and therefore help shrink the budget deficit, is to grow the economy. Therefore, and perhaps counterintuitively, it is in the government's best interests to enact as many business and consumer friendly policies as is possible in order to improve its income statement. So, which would you say, higher or lower taxes, on business and the consumer is more likely to achieve this end?"

In reading what I wrote, I wouldn't imagine this is too far afield for most people. However, Trump is planning a whole bunch of new expenditures, on a whole bunch of things. Heck, he is even talking about growing our nuclear arsenal! While the implications of that are too scary to contemplate, it HAS to be expensive and, therefore, balloon the deficit. Right?

Perhaps, and then again, perhaps not.

There is debt and then there is debt. If, say, a company borrows money at 3%, and uses the capital to grow its business 10%, I think we would all agree this is a good use of leverage. However, if the company borrows at 3%, and its business shrinks or grows by an amount less than 3%, well, perhaps the leverage wasn't all that helpful. It might even hurt the company over the long haul, in fact it will.

During the Bush Administration, Federal debt as a percent of GDP rose from 54.96% (1/31/01) to 77.36% (1/31/09), with over half that difference coming during the financial crisis of 2008. Since 1/31/09, Federal debt as a percent of GDP has increased to 104.81% as of 7/31/2016. As a result, since the end of the Clinton Administration, in so many ways, the US has employed debt/leverage extremely poorly.

If Washington had used leverage properly, debt as a percent of GDP would not have basically doubled in less than 20 years. This ratio basically says we have borrowed more money than we have grown the economy. It is just math. We have borrowed to maintain, increasingly, consumer stasis, as opposed to grow. The increase in debt hasn't been the problem as much as the lack of a commensurate, or better, increase in our collective output! For all intents and purposes, we have eaten the money we have borrowed for the last two decades, and now we are worried about a surge in the accumulated debt?

As such, our accumulated debt is not as important as our accumulated debt relative to GDP. If our economy was \$100 trillion, what difference would \$20 trillion in debt really be? I will save you the trouble: not much. We could almost pay it off with one year's tax receipts if it got to that. However, debt is a problem when it is \$20 trillion and your economy is \$19 trillion, AND, more importantly, your economy isn't likely to grow more than, say 2.0-2.5% for the foreseeable fu-

## *Something to Think About Cont.*

ture. Washington, we have a problem. Do we risk borrowing more to foster growth OR do we risk borrowing the same amount to maintain what we have? Remember, we are probably going to collect 17.3% of GDP, plus or minus 1.08%, regardless of the tax structure....if history serves as a guide, which I am supposed to say it doesn't, even if it sure seems to do so.

That is a great question, a really great one. Do we continue to proverbial kick the can down the road, and worry about it when the time comes? Do we pick the can up and throw it as far as we can? Do we construct a potato cannon and launch the thing?

Unfortunately, this is where we kind of find ourselves...in the middle of the road, having somewhat leisurely kicked the can to this point. In my mind, it is a dirt road in the woods. Others might envision an interstate or a suburban street. I suppose it doesn't make any difference; we have to do something with the dern can.

IF our debt is something we, as a nation, are truly worried about, we have to be willing to unfetter the competitive forces in our economy and grow the thing like crazy. Hey, there is no guarantee of success...far from it, and the economic benefit will be completely uneven, completely. I can't argue passionately otherwise, even if I would suggest a rising tide lifts all boats....while offering some boats are created more equal than others (my apologies to Orwell on that one).

So, in the end, what is the best answer to the question "how are we going to pay for everything Trump says he is going to do?"

Frankly, we are going to initially borrow it, and hope that it engenders greater economic output and an increase in overall societal wealth. Intuitively (to me at least), fewer regulations, a simpler tax code, and a reduction in the corporate income tax rate should help in this regard. IF this doesn't work, and I hate to be cavalier, we are simply going to have to pick up the can in the middle of the road a little sooner than we would have otherwise...but not that much sooner, really, and we were going to have to pick it up regardless.

After all, according to the Administration, our current run rate is an additional \$9.75 trillion over the next 10 years....that is the baseline. To maintain the same Debt to GDP ratio, the US economy will have to grow at around a 4.15% nominal, annualized clip for the next decade. It has been right at 3.00% over the last one. So, something has to give or improve. Because, if we stay the course, and average the same nominal growth we have had over the last 10 years, our Debt to GDP ratio will be around 116% in a decade....that ain't a model; that is multiplication.

Is this scary? Yeah, you bet it is. Will it lead to fiscal rack & ruin? It very well could, as the future is uncertain....despite complicated mathematical models to the contrary. However, we have been on that path for the better part of two decades now, and not doing anything meaningful, substantially different, won't get us off it. I mean you can dislike Donald Trump for a lot of things, and there are a lot, but, at this point, I would hold off judgement on his macroeconomic policies until they play out.

Hey, I freely admit this analysis is way too noncommittal for some and way too laudatory for others. Yeah, it would never get me on the television, and I am okay with that.

## *Disclosure*

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