PRIVATE ASSET MANAGEMENT, INC.
WEALTH STRATEGY ADVISORS
PARADIGM

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This is the first of a four-part series. This Paradigm reminds investors of three long-term trends that we believe should be incorporated into your long-term game plan. The next three Paradigms will delve deeper into each trend. By the end, we hope you have a better understanding of how each trend and their interplay may affect your unique situation.

The investment world is full of predictions. Most short-term economic predictions have proven to be largely inaccurate and unhelpful. However, long-term trends can usually be identified with more accuracy. We have identified three long-term trends we believe investors would be well advised to account for in their planning.

First, there is reason to believe returns in the U.S. will be lower due to slower growth and current valuation levels. The real growth rate for GDP in the U.S was a healthy 3.4% per year from 1980 to 2000. This was due to more women entering the workforce along with the baby boomer generation becoming established in their careers. From 2000 to 2015, the real growth rate for GDP in the U.S. declined to 1.8% per year. This period included the Great Recession. Also, beginning in 2014, the baby boomer generation began to retire, slowing the growth of the labor force. Most economists believe that future growth will be closer to the latter period than the former. This is likely to lead to lower earnings growth from companies. Also, current valuation levels for stocks are above their long-term average and current yields for bonds are below historical levels. Both mean that future returns could be dampened if there is any reversion to the mean for P/E ratios and bond yields. Lower returns could cause investors to save more, wait longer to achieve financial goals, or spend less in retirement.

Second, we believe higher taxes are a long-term trend that investors will have to navigate. The Congressional Budget Office (CBO) projects a growing deficit due to entitlement spending and increased interest expense. This spending deficit is at a reasonable level right now, however the CBO predicts the current deficit will almost double by 2023 and continue to grow in future years. This is unsustainable. One obvious solution is to raise taxes. Of course higher taxes reduce how much one has to spend. Healthcare reform could help because a sizeable part of entitlement spending is on healthcare: think Medicare and Medicaid.

Third, inflation may return to higher levels than in the past decade. The period from 2007 through 2016 experienced inflation of less than 2% per year. However, for the twenty-year period from 1987 through 2006 inflation was just over 3% per year. Higher inflation over longer periods of time can severely erode your purchasing power. One argument for continued low inflation is a decline in the workforce participation rate as noted above. With fewer workers there is likely less demand for goods and services which should moderate price increases. Arguments for increased inflation point to the virtual full-employment status in the U.S. This could cause wages to begin to increase faster than in the past, pushing inflation higher. Another factor is the complex process of reducing the Federal Reserve's balance sheet that ballooned during the Great Recession to spur growth. The consequences to inflation are unknown at this time, though there is a risk of a shock to the upside for interest rates. Given that the Federal Reserve may start decreasing its balance sheet later this year, next month's Paradigm will focus on inflation.

While these three trends may seem pessimistic, we are optimistic. Navigating change has always been crucial to your long-term success. The three-step process of planning, monitoring your plan, and reviewing it regularly will continue to be of utmost importance to achieving your goals. Also, you can start now if adjustments to your game plan are required. As always, we are here to help you assess and navigate your unique situation.

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