

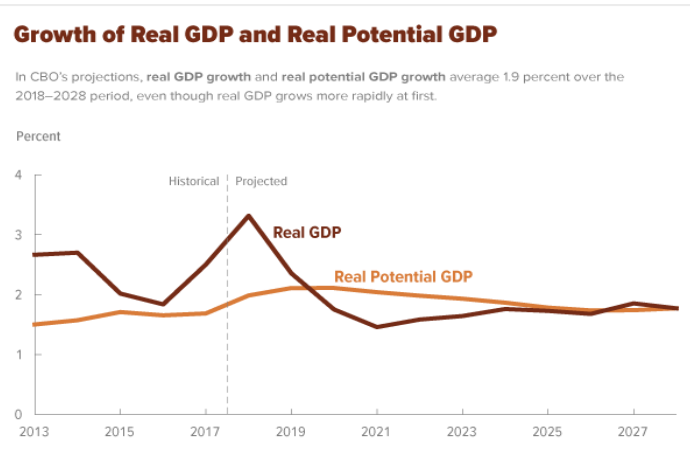
May 2018

*Major tax and spending legislation has been passed in the last six months. This month, we will discuss the initial review of the legislations from the Congressional Budget Office (CBO), plus earnings data from Standard & Poor's.*

There are two takeaways from this Paradigm. First, most forecasts admit that forecasting more than 18 months out is murkier than usual. Even the CBO took several extra months to review the data before presenting its update. Second, now is a good time to guard against what is called the overconfidence bias. This means that due to the higher than usual uncertainty your long-term strategy should not be overly biased based on your personal views of the recent tax and legislation changes.

Most forecasts believe that through 2019 economic growth, corporate earnings growth, and interest rates will be higher than previously thought, and that the unemployment will be lower than previously thought.

The following graph from the CBO highlights the near-term boost to economic growth. This is mainly due to tax cuts, both for corporations and individuals. However, oth-



er legislation will increase near-term federal spending. This boost in growth is why unemployment is expected to remain low. However, the CBO believes increased growth, coupled with a tight labor market could increase inflationary pressures, and, thus, interest rates. It now believes that the 10-year treasury bond's yield will average just over 4% in 2020 and then decline slightly.

Mainly due to the lowering of the corporate tax rate, earnings for companies will grow faster than previously thought. Back in August, earnings for companies in the S&P 500 were projected to grow 8% in 2018. 2018's earnings growth is now expected to be 18%. The strong stock market at the end of the 2017 partially reflected the growing belief of this higher earnings growth.

Currently, 2019's earnings for the S&P 500 are estimated to be up 10%, well above our long-term growth rate of 5%. Historical patterns of future estimate revisions, usually down, should be weighed alongside the current projection. Also, this is a good example for our second takeaway: Do not let a long-term strategy be based on overconfidence of what might or might not happen in the next few years. In this case, earnings and, thus, return expectations could prove to be too high.

The murkiness post-2019 revolves around forecasts of economic growth. The CBO graph implies that the boost is temporary. It believes that higher interest rates and prices along with lower growth in federal spending, will dampen future growth. Other projections believe that the incentives to invest and work will last well beyond 2019, leading to higher growth over the next decade than the CBO forecasts.

None of the preceding has dealt with renegotiating trade pacts, the potential impact from tariffs or trade wars, and the potential for negotiations regarding Iran or North Korea. As it relates to trade matters, the timing, magnitude and long-term impact are difficult, at best, to assess at this time. This is another reason to guard against the overconfidence bias.

It will be interesting to follow how the graph produced here changes over the next few years. Is the boost temporary, do the recent tax and legislative changes unlock growth, and do new factors like trade become bigger pieces of the equations?

*Major tax and legislative changes have occurred, and the medium-term outcomes appear less certain than normal. However, a solid long-term strategy can be executed to keep your financial future on course.*

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