First Trust
Monday Morning OUTLOOK

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Senior Economist*
Andrew Opdyke, CFA – *Senior Economist*
Bryce Gill – *Economist*
Nate Gerze, CFA – *Economic Analyst*

630-517-7756 • www.ftportfolios.com

January 6, 2025

2025: A Year of Promise and Paybacks

The College Football playoffs included 12 teams this year and all five automatic berth teams (because they won their conference championships) are now out, including the top two ranked teams, Oregon and Georgia. It wasn't supposed to turn out this way, and the debate about why has only just started.

And if you think forecasting college football is hard, try the economy, stock market, and elections. Not one Wall Street firm came close to predicting the level of the S&P 500 on 12/31/24. They were all too low. The sharp slowdown in growth, or even recession, that we forecast did not come true.

Inflation stopped improving too, and even the Fed had to shift its forecast for rate cuts for 2025, reducing them from a total of one percentage point to half of that. And don't forget that most presidential election forecasts missed the shift in nearly all demographic groups even in blue states toward Donald Trump.

All of this makes forecasting 2025 another significant challenge. The US has run nearly $2 trillion budget deficits in each of the past two years, half of all job growth in the past two years has been in government and healthcare jobs, growth in the money supply is trending higher.

At the same time, the new Trump Administration wants to cut spending by up to $2 trillion (over how many years we have no idea), push for an extension of the 2017 tax cuts, and possibly cut other tax rates as well. In addition, tariffs are in the picture, as is a significant slowdown in immigration, with deportations of some immigrants who are already here.

This follows some of the most dramatic policies in US history. We've always thought that COVID lockdowns were a huge negative for growth, then and in the future. Yes, we know GDP fell sharply early on, but then massive government spending (and handouts) along with the largest surge in the US money supply in the history of the country pushed GDP back up to its previous level (even with many states locked down). The stimulus masked the pain, like morphine.

We have always believed the morphine just delayed the pain and a recession was inevitable once it wore off. But the US is hooked on morphine, with irresponsibly high deficits creating government jobs and short-term spending stimulus. If Trump and DOGE cut the deficit, the morphine will wear off. With significantly less stimulus a recession is highly likely. Not a deep recession, but one that causes real GDP to decline 0.5% to 1%, and corporate profits to disappoint for the first time in years.

There are caveats to this forecast. The debt ceiling is now back in place…this means the Treasury will finally dip into its checking account at the Fed. This account holds over $750 billion, and when the Treasury spends that money, it will boost M2 growth. So, while the federal government spends less, the M2 measure of money will rise no matter what the Fed does.

This is one reason why we don't expect inflation to fall much more. We expect CPI will be up in the 2.5 – 3.0% range this year. And what this means is that the 10-year Treasury yield, which may find a bid as growth slows, will have a hard time falling below 4%.

And when we put that into our Capitalized Profits Model, it says that stocks are overvalued by about 20% right now. Will stocks fall that much? Probably not because the market seems euphoric over the impact of AI, new satellite networks, and even Ozempic. But another year of 20%+ gains in stocks does not seem to be in the cards. We expect the S&P 500 to end 2025 between 5000-5400…let's say 5200.

At the same time…China is in trouble economically, while also making trouble geo-politically. One thing we believe is that if the US gets its fiscal house in order, and at the same time projects power and not appeasement, the world will become a safer place. In the Middle East, the October 7th massacre, which was absolutely horrific, was a turning point for Iran. While peace might not break out, there is less chance of a wider war. Trumps victory is also affecting politics in many other countries, just look at Canada, France, Germany and the UK.

So, while there are many positive things happening, this new world order is still uncertain. Less regulation is great for growth, but reduced deficits are a short-term headwind. In the long run, just like under Reagan, smaller, less intrusive government policies are a massive positive. But, remember, the PE ratio of the S&P 500 was 8.0 in 1981. Today, it is 28.2. In other words, unless Trump policies lift productivity, growth, and profits immediately, while reducing inflation, the stock market does not have nearly the same upside that it did in the early 1980s.

We still believe the US must pay a price for the bad policies of the past five years. And we think 2025 is the year it pays.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-6 / 9:00 am	Factory Orders – Nov	-0.3%	**-0.7%**	-0.4%	+0.2%
1-7 / 7:30 am	Int'l Trade Balance – Nov	-$78.2 Bil	**-$77.6 Bil**		-$73.8 Bil
9:00 am	ISM Non Mfg Index – Dec	53.5	**53.2**		52.1
1-8 / 2:00 pm	Consumer Credit – Nov	$10.5 Bil	**$10.5**		$19.2 Bil
1-9 / 7:30 am	Initial Claims – Jan 4	215K	**217K**		211K
1-10 / 7:30 am	Non-Farm Payrolls – Dec	160K	**140K**		227K
7:30 am	Private Payrolls – Dec	133K	**110K**		194K
7:30 am	Manufacturing Payrolls – Dec	5K	**-10K**		22K
7:30 am	Unemployment Rate – Dec	4.2%	**4.2%**		4.2%
7:30 am	Average Hourly Earnings – Dec	+0.3%	**+0.3%**		+0.4%
7:30 am	Average Weekly Hours – Dec	34.3	**34.2**		34.3