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GOOD-BYE
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In July 1973, my wife and I left our recently sold home in Westwood, California to drive across country to a new position at Georgia State University in Atlanta. (Three years later, our Westwood home sold for five times the price we accepted for it.) GSU wanted me to head a "forecasting activity". In August, with the help of the Atlanta Chamber of Commerce, I presented my first national forecast in Georgia to a packed house. I noticed three individuals arriving late and standing at the back as I started my presentation.

When I presented my second national forecast in November, the house no longer was packed. (I never again had standing room only. Was it the forecast, which indicated that a recession was brewing, or was it the fee I began charging?) Those three individuals, again arriving late, continued to stand in the back. After the conference, they approached me and asked if I would consider providing consulting services for a new brokerage firm they wanted to start.

When I arrived at GSU, I had decided that my "forecasting activity" would be financed by its own activities. In addition to conference and publication fees, I sought corporate sponsors. Later, I also worked on grants. (When I retired from GSU in 2000, my Center's account approached a million dollars, which was available to my successor.) Because I was seeking corporate sponsors, I outlined a proposal that included a sponsorship and separate fees for providing consulting services to these individuals' clients (mostly in the form of written material). Thus began my activity with M. Irby and company and its research director, Dick McStay.

Dick and his partners may not have recognized that my recession forecast meant that their timing was poor. The company lasted less than a year and then ceased operations. A year later, in 1975, Dick contacted me to see if I would provide the same agreement with a company he had joined in Memphis. Fortunately, my forecasts were showing a solid recovery and I still wanted corporate sponsors, so I accepted. One reason Dick wanted to make this arrangement was because he felt economic research was needed, but the company had a capital base of $3.5 million. Hiring a staff economist was out of the question. That is how I began working as a consulting economist for Morgan Keegan.

Though Morgan Keegan grew until hiring a staff economist was no longer an issue, they never did so. Of course, they hired researchers who developed client based services that attracted and sustained client relationships. When Allen Morgan decided that Morgan Keegan should have a New York Stock Exchange presence, he asked me to become an "outside" board member. My employer was GSU, but I was providing consulting services to Morgan Keegan. The other "outside" director was the company's lead attorney. At the time, that was acceptable.

In those days, the four lead members of Morgan Keegan did not receive compensation for their leadership positions. (They were effectively subsidizing the growth of the organization.) As a board member, my fee was what I received for a day of consulting, also a far cry from current practices. Eventually, compensation included some stock options, but I did not become rich as a Morgan Keegan board member. I was head of the audit committee as Morgan Keegan built its computer support system. We had a major battle with our lead programmer, who wanted to have access to all accounts at Morgan Keegan. I understood his concern for programming efficiency, but there are separations of duties that must also be followed. They were interesting times.

During that time, Goldman Sachs decided that public finance offerings in the South were mostly too small for their consideration. As they left, Morgan Keegan took their place in many offerings. While the company grew, it began to hit capitalization constraints on some of the bigger projects that our developing relationships otherwise would have brought to the company. That was

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one of two reasons why I joined other members of the board in deciding to sell the company to Regions Bank. (The other was the large Regions dividend, which virtually disappeared during the financial crisis of 2008.) With Region's capitalization, Morgan Keegan was able to seek those large financing projects.

After the sale, I no longer was a board member, but I continued as Morgan Keegan's consulting economist as Regions largely permitted Morgan Keegan to remain an independent operation. Of course, several years ago, Regions sold Morgan Keegan to Raymond James before Regions exited TARP. Though Raymond James has an economic staff, they apparently were willing to let me remain as a consulting economist for the fixed income group. As a professional courtesy, I never read nor remarked upon Scott Brown's work. I do not want to respond to an inquiry about his work. (After I left GSU, I went to a forecast conference presented by my successor, Rajeev Dhawan. During the question period, people wanted to know my opinion about his forecast. I waited another fifteen years before returning once a year to his conferences.)

I am writing this to outline my relationship with Morgan Keegan and Raymond James. I never was an employee, but was very involved with the company. I certainly enjoyed the people with whom I worked at the company and the ability to express my thoughts and develop some ideas as I wrote for its clients. A year ago, I decided to end my relationship with the company, but my wife was still teaching. She has since retired. There is a time when one needs to change one's direction in life. I am sure I will always be an economist and I will always remember my friendship with the late Dick McStay and his family. However, it is now my time to seek that new direction. Goodbye.

However, I will leave you with one last forecast. Perhaps it is fitting that I began this journey with a recession forecast and will end it with the possibility of another recession forecast.

Those who regularly read my material know that I believe in economic dynamics. The ideal economic state is one that is sustained over time. Although most of our economic policies are trying to get more growth, they should be directed at raising sustainable growth e.g. creating more talent rather than merely providing more jobs. Our economy can be compared to a stationery space orbit. It looks stationery, but it is traveling more than a thousand miles per hour to maintain its position relative to earth.

Imbalances cause deviations from that sustainable speed. In economics, those imbalances are behavioral and policy driven. They also are external and internal to our economy. Behavioral could be "irrational" exuberance or financial imbalances. In outlining a forecast, I must first establish what the sustainable growth path is. If we approach it too rapidly, we will overshoot and probably need to slow dramatically. If we approach too slowly, we will never reach it. Frankly, the latter is preferable to the former, but both are policy errors (the latter means under utilizing our talents, though it might extend the time of our expansion.)

Although exports are 14% of our economy, they provide wobbles in our path that usually does little to alter its performance. However, a policy, such as reduced globalization, could have a serious impact upon our economy. I do not believe that is the objective of this administration's tariff wars, but it is the outcome if capitulation is not achieved. I believe we have a serious misunderstanding of the battle with China. We see it as an economic issue that can be resolved by understanding costs and benefits. They see it as an issue of sovereignty which requires diplomatic as well as economic pressure. As I am not a political scientist, I will not opine on diplomacy, but nationalism certainly is not the right policy.

We can argue how much globalization has added to sustainable growth, but the removal of a billion people from poverty because of it suggests that its impact is not trivial. My guess is that these tariff wars will cut as much as a percent from current growth.

Though financial problems always crop up in some sectors, I see little major imbalances at this time. Furthermore, the household savings rate is in the vicinity of sustaining current living standards in retirement.

I see no evidence of widespread inventory excesses. Oil is an exception and the Texas growth engine may sputter because of the declining price of oil, but much of that will be offset by higher purchasing power elsewhere. After all, much of the burden from falling oil prices still is felt abroad. On the other hand, inventory no longer is below desired levels for current economic growth. I had seen the need to rebuild inventory as a stimulus, but no more.

Housing affordability is declining, but financing availability is growing. I think affordability is beginning to trump availability, but most real estate developers insist that slower housing activity is more the absence of contractors and affordable lots than buyers. The slowing sales of previously owned homes seems to refute that, but I will continue to accept that premise until housing price gains fall below inflation.

Let us assume a few tenths off expenditures because of housing in the next year or so, but no other serious impediments to growth in the private internal sector. I already have slashed a percent from growth because of the impact from the external sector.

That now puts us in the policy arena. The Federal Reserve is removing stimulus, both by raising short term rates and reducing the size of their bond holdings. Real rates remain near zero, which is not a steady state result. While the removal of stimulus certainly is applying brakes, it is on a speeding car. By itself, these policies should only remove excess spending, not create recessionary pressures. Nevertheless, it slows current growth.

Then there is budgetary policy. The combined impact of tax cuts and a two fiscal year budget agreement to suspend spending restraints has shifted budgets from slowing economic growth (about 0.2 percentage points per year in the Obama administration) to stimulus (possibly more than 0.5 percentage points this year, but fading by more than that as restraints may again be imposed after next September). That is a swing of possibly more than 0.7 percentage points.

I will concede that lighter regulations have added to production (though not necessarily to economic well-being). Yet, the new Congress may prevent further erosion of regulatory activities.

Adding all the changes leads to growth of less than 1% by the second half of 2020. If businesses fail to slow production as fast as sales slow, as they are prone to do, a recession beginning in the latter part of 2020 may develop.

Of course, the elephant in the room is not the Fed, but the tariff wars. Remove those and I will remove the recession risk for 2020. Production still might be slow to respond to slower growth from the other factors, but that would push any recession into 2021 and the downturn would be a more typical inventory removal process.

Anyway, my last forecast is not quite a recession forecast, but it is close. Employment growth will be minimal in the second half of 2020 and could be worse unless something changes in the above analysis.

CREDIT MARKETS

Treasury receipts continued to rise in the second month of the new fiscal year. However, withheld receipts fell 5%. The gains occurred because of reduced corporate refunds, not necessarily a good indication of economic activity. While I see receipts continuing to grow only 1% over last year through January, gains should improve once the comparison with the lower receipts following tax code changes occurs. Then I expect receipts to improve to 5% gains, in line with the growth of nominal GDP. As the economy slows in 2020, receipts also should slow to gains of less than 4%.

In the past fiscal year, outlays increased 4.1%. Higher interest payments, increased entitlements (2.8% cost of living for social security recipients and almost 2% more recipients), double that for medical costs and then add initiatives for defense and special programs (recovery from disasters) and the outlays could grow twice that in FY2019. Outlays then should slow to less than the growth of receipts in FY2020. This means an increase in government borrowing by $220 billion in this fiscal year before showing little change the next fiscal year.

State and local governments are slowly increasing their spending. I would not expect any reductions in spending growth until the latter part of 2020 when revenues should slow. I am pegging the growth of net borrowing by state and local governments at $170 billion in 2019 followed by a similar gain in 2020. This suggests that all governments will need to borrow nearly $400 billion more in 2019 before slowing increases to half that pace in 2020.

The household sector is growing its housing investments at a slowing rate. Probably less than $50 billion of additional funding will go to housing investment in 2019 with very little more occurring in 2020. Savings should be stabilizing in 2019 and might grow modestly in 2020. As a result, I have the household sector needing a small amount of net savings in 2019 and possibly adding a small amount to the savings pool in 2020.

The big swing will come in the corporate sector. It has used up the additional cash it received from the tax reductions by investment in inventory and a bit of capital (the buybacks and higher dividends are transfers to the household sector). I see the corporate sector as a net borrower of relatively small funds in 2019 followed by more than a $100 billion additional need for funds in 2020.

As there are no net suppliers of funds domestically, international flows must settle our accounts. In 2018 that was not a problem as a stronger dollar and rising interest rates attracted international funds. Also, tax reductions and inventory liquidations allowed the corporate sector to release funds for domestic uses. I expect U.S. assets to remain attractive but at reduced intensity in 2019. This suggests that our long-term interest rates will begin rising, but only modestly, while the dollar should be falling but also modestly. Early in 2020 the dollar should fall further, but our long-term rates may also fall as investors expect the Federal Reserve to shift policy to avoid a significant downturn.

The results of these credit flows are reflected in the interest rate table.

The Federal Reserve has predicted that it will raise rates three times in 2019. Given my economic forecast, that would not be good policy. Following the rate increase in December, the Fed probably will wait until midyear before raising rates further and may stop at only one more rate increase if the outlook is changing as I outlined. I would then expect some rate relief in 2020.

EQUITY MARKETS

As far as the equity investor is concerned, there is no Santa Claus this year. A bear market has descended, which means declining lows until the bottom is reached. Normally, a bottom does not come until values are sharply below fair value, about 10% lower than such a measure. The good news, if there is any, is that the decline is relatively fast. The period of decline is usually less than a year, and may be less than six months. Of course, recovery depends upon what policies are in place to counter the weakness.

The past four weeks have been a nightmare for investors. The S&P lost nearly 7%. Nasdaq and the Dow did better but still declined about 6.5%. The Russell 2000 fell almost 10% in a month. Such declines not only create alarm, but the pattern also suggests that further weakness may be ahead.

Small value was the biggest loser with a decline of 10% for the month. The least bad was large growth, which still declined more than 5%. Value did worse than growth while large did better than small. While growth suggests that some opportunity seekers have not thrown in the towel, the poor performance of small stocks suggests that not many investors are willing to seek opportunities. Instead, they are holding onto the past leaders rather than seeking new opportunities. That is not a pattern that suggests a rebound is near.

My son suggested that this decline looked like 2006. While I tried to suggest that values were not that excessive except in some growth stocks (which remain the better performers in this decline) and that faulty “financial insurance devices” were not as apparent now as then (do algorithm investments qualify as value distorters?), he persisted and wanted to know what the appropriate investment opportunities were then. I mentioned that bonds proved to be the appropriate investment then, but the Fed was moving rates higher now. If only I had listened to my voice and bought bonds following that Thanksgiving discussion.

Long treasuries are up nearly 4% in the past four weeks. Long corporates lagged but still gained more than 2%. Mortgage backed bonds jumped over 1.6% while tax exempts did nearly as well. TIPs lagged with only a 0.3% gain as inflation hedges seemed less appropriate than other bond investments. At one point, the 2-10 spread had narrowed to 11 basis points before widening to 17 as bond investors lowered their expectations of Fed rate hikes. There was some widening of the spreads between corporates and treasuries and between the higher and lower investment quality corporates. Also, junk bond prices dropped sharply. One could worry about recession fears in these changing spreads. However, that case is far from proved by these spread actions. Unless the Fed is thinking of cutting rates, which would require a recession, I see little further improvement in bond prices, though earning the coupon may be better than what the equity markets currently provide.

Sometimes global equity markets appeared to be dragging down U.S. values, but the four-week performance shows no major global market falling as much as the S&P. India and Hong Kong gained during the latest month (though the increases were small). The dollar weakened late in the month, but did not erase all its strength early in December. Europe was weak with the continent trailing England despite the latter’s Brexit worries. However, Europe was not as weak as the U.S. Emerging markets lost ground, partially because of Latin American weakness, but they did much better than the U.S. It was not world growth but U.S. policy fears that caused the equity selling globally.

Not surprisingly, the collapse of oil prices caused that sector to plunge double digits for the month. With oil still falling and U.S. crude inventories still rising, no relief is likely yet in that sector.

Just missing double digit declines were basic materials and financial services. In bear markets, financials are instructive. They tend to lead down but also lead up. So far, they are on the down elevator. A strong dollar does not help basic materials and worries of global growth also are problems. The global growth concerns may be overstated, so the sector could rebound if the dollar declines.

Consumer sectors performed in line with the market. Discretion declined less than staples, but both were near market performance. I would expect discretion to rebound before staples once the market bottoms. While I am concerned about the growth of spending capacity, real weekly earnings are still growing well over 2%. That is not a boom, but neither is it a recession.

The strong bond market aided the performance of the interest sensitive real estate and utilities. Utilities almost gained for the month while the 3% decline in real estate was much better than other sectors. I am worried about excess apartment construction, but rents continue to rise. However, retail space is excessive.

Healthcare was a market performer, though most of its decline occurred in the past week after adverse reports undermined the stock value of Johnson & Johnson. ETF declines may have pulled down other stocks in the sector because of J & J. That might create opportunities in the sector.

Industrials struggled more than most, suggesting that some concerns about economic growth exist. Those fears may be excessive but not that far off the mark. I recommend caution in the sector.

Telecoms and technology were mostly market performers. The big sell-off in semiconductors may be over. However, disruptions from streaming and the strength of content over distribution continue to plague the telecoms. I simply do not have the expertise to choose winners in that sector.

I see no evidence that the selling is abating. This appears to be a bear that will have modest opportunity seeking rallies, but the lows continue to be lower. As my forecasted values suggest, another 5-7% decline in values is not unreasonable at this time.

Percentage Annual Rates of Change

Current forecasts for several key economic variables are shown below (they reflect the chain weighted measures of GDP):

	2017	2018				2019				2020		Ann.	Ann.	Ann.	Ann.
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	HI	HII	2017	2018	2019	2020
Real GDP	2.3	2.2	4.2	3.5	3.0	2.4	3.0	2.8	2.6	2.0	0.8	2.2	3.1	2.7	1.3
GDP Deflator	2.5	2.0	3.0	1.4	1.9	2.1	2.4	2.2	2.4	2.4	2.6	1.9	2.1	2.2	2.4
Nominal GDP	5.1	4.3	7.6	4.9	5.0	4.6	5.5	5.1	5.1	4.5	3.5	4.2	5.3	5.0	3.8
CPI-U (qaar)	3.3	3.4	1.6	2.0	1.7	1.8	2.5	2.2	2.4	2.5	2.5	2.1	2.0	2.0	2.4
CPI-CORE (qaar)	2.2	2.9	1.8	2.0	1.9	2.2	2.3	2.3	2.4	2.5	2.6	1.8	2.1	2.1	2.5
91-Day Bills	1.2	1.6	1.8	2.1	2.4	2.6	2.7	2.9	3.0	2.9	2.9	0.9	2.0	2.8	2.9
Prime Rate	4.3	4.5	4.8	5.0	5.3	5.5	5.6	5.8	5.8	5.8	5.8	4.1	4.9	5.7	5.8
Federal Funds	1.2	1.5	1.7	1.9	2.2	2.5	2.5	2.7	2.8	2.8	2.8	1.0	1.8	2.6	2.8
2-Yr Note	1.7	2.2	2.5	2.7	2.7	3.0	3.0	3.3	3.3	3.3	3.2	1.4	2.5	3.1	3.2
5-Yr Note	2.1	2.5	2.8	2.8	2.8	3.0	3.0	3.3	3.3	3.3	3.3	1.9	2.7	3.1	3.3
10-Yr Note	2.4	2.8	2.9	2.9	3.0	3.2	3.3	3.3	3.3	3.3	3.2	2.3	2.9	3.3	3.3
LT-Average	2.8	3.0	3.1	3.1	3.3	3.5	3.5	3.6	3.6	3.6	3.6	2.9	3.1	3.6	3.6
ML Aaa	2.9	3.3	3.5	3.5	3.7	3.9	3.9	4.0	4.1	4.1	4.2	3.0	3.5	4.0	4.1
ML Bbb	3.6	3.9	4.3	4.4	4.8	5.0	5.0	5.2	5.2	5.2	5.4	3.6	4.3	5.1	5.3
Corp. Profits ($ bil)	1751	1899	1962	1976	2003	2032	2074	2119	2163	2201	2205	1831	1960	2097	2203
Adj. Op Profits (")	1817	1965	2008	2074	2119	2144	2183	2220	2272	2308	2300	1749	2042	2205	2304
S & P 500	2603	2734	2703	2851	2636	2493	2546	2667	2728	2805	2816	2449	2731	2609	2811
S & P 500 Equil.**	2529	2661	2651	2772	2719	2722	2772	2791	2856	2901	2863	2397	2700	2785	2872
Value Gap (%)	+3	+3	+2	+3	-3	-8	-8	-4	-4	-3	-2	+2	+1	-6	-2
Dow Jones	23713	25127	24556	25613	24378	22897	24361	25548	26117	26899	26984	21750	24919	24731	26942
Nasdaq	6758	7254	7356	7877	7055	6593	6802	7158	7395	7601	7647	6231	7385	6987	7624
Trade Wt. Dollar	120.1	117.7	120.8	125.1	128.3	128.0	127.7	127.6	127.0	126.0	124.3	122.1	123.0	127.6	126.1

Qaar = quarterly average at annual rates.

**This is an equilibrium value based upon discounted cash flows related to current earnings, discounted by Bbb rates and adjusted for additional share supply for existing companies. I continually recalibrate the estimates based upon trend peaks in stock market values.