Academy Rates Forecast – 2023 to 2025

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It is that time of year where analysts are supposed to provide forecasts for next year and beyond. Given the uncertainty of markets, politics, geopolitics, and more, these estimates will change over time in response to new information. Having said that there is value in laying out our base case for what we think will drive rates in the coming months and years as well as highlighting the risk factors.

Having a game plan helps, but it is always important to remember Mike Tyson's famous quote – "Everyone has a plan until they get punched in the face."

Key Drivers - Summary

When examining where rates "should" be in the future, you need to make some assumptions or estimates about key drivers. While there are dozens (if not hundreds) of potential drivers, we will focus on just a few as we believe that these are the most important and we have strong views on them.

We will highlight the risk factors now, present our forecast, and then analyze these factors in more detail.

- **The Wealth Effect**. The wealth effect isn't getting the attention it deserves.
- **Inventory, Demand, and Supply Chains.** This isn't a normal cycle and these factors helped push inflation very high/very quickly, but they could just as easily drag inflation down.
- **Russia, Ukraine, and Energy Prices.** Academy is uniquely positioned on this factor with our Geopolitical Intelligence Group offering keen insights into how this is playing out. The base case is for the status quo to continue.
- **China continues its re-assertion of the communist party and is extending its "client" state relationships.** I do not expect much help from China in the global economy.
- **Jobs.** The job data has been strong and could be one area that continues to show strength, which would be a threat to our rate forecast as we are less sanguine about that market.
- **The Service Sector.** This is another area that has held in there and this might bode well for the future, but there are reasons to believe that this too could "roll over."
- **Inflation.** For all the reasons listed above, I expect deflation to be as much of a topic of conversation next year as inflation.

Longer-term factors. Since this forecast is meant to take us out three years, there are a few longer-term factors that I need to include.

- **Supply Chain Management.** Companies will create simpler and "safer" or more "secure" supply chains.
- **Sustainable AND Traditional Energy Build-out.** Longer-term it will be deflationary, but I expect it to be inflationary for years to come.
- **India.** This is my "outlier" and doesn't get enough attention.

With that backdrop, we will proceed to our forecast.

Rate Forecast

	2-Year		5-Year		10-Year		30-Year	
Current - Nov 26	4.45%		3.86%		3.67%		3.73%	
	Range		Range		Range		Range	
Year End - 2022	4.30%	4.45%	3.75%	3.90%	3.55%	3.70%	3.60%	3.75%
Mid-Year 2023	4.00%	4.20%	3.50%	3.70%	3.40%	3.60%	3.40%	3.60%
Year End 2023	3.90%	4.10%	3.50%	3.70%	3.45%	3.65%	3.50%	3.70%
Year End 2024	3.95%	4.20%	3.75%	4.00%	3.80%	4.50%	3.85%	4.10%
Year End 2024 - India*	5.00%	5.25%	5.00%	5.25%	4.75%	5.00%	4.50%	4.75%
Year End 2025	4.00%	4.25%	4.10%	4.35%	4.15%	4.40%	4.15%	4.40%

The forecast follows a path dictated by the risk factors we listed out. But if you want to "script" how the forecast becomes a reality, it should go along the following lines:

- The Fed has already done too much. The market will start pricing in longer and deeper recession risks. The realization that much of the inflation was "transitory" will kick in. The market will react faster to this than the Fed.
- The Fed will then back off a little to allow the economy to heal itself and grow.
- Then, over time, the inflationary aspects of supply chains and energy build-out will assert themselves, but it will be reasonably well absorbed as the job creation will provide a very solid footing for the U.S. economy.
- The "outlier" is a commodity boom driven by India and that needs to be watched closely over the coming years!

This is a good time to remind everyone of Mike Tyson.

Key Drivers - In Detail

While the summary of risk factors helps you understand how we are creating our forecast, this detailed explanation will help you understand it even better. **More importantly, it will highlight what we will be examining closely to see if we need to adjust our opinions and forecasts!**

- **The Wealth Effect**. The wealth effect isn't getting the attention it deserves.
  - **Housing is down**. For most, home values are higher today than a couple of years ago, but the psychological impact of having home values decline (in response to much higher

mortgage rates) is problematic.

  - **Bonds have been hit hard**. Anyone hoping bonds would zig when stocks zagged is having a tough year. The so-called 60/40 funds (funds that invest in stocks and bonds specifically to capture the typically negative correlation) have had one of their worst years on record.
  - **Stocks have been hit hard**. While the S&P 500 is "only" down 15% this year, the Nasdaq is down 28%, and "disruptive" companies (I will use the ARKK ETF as a proxy) are down 62%. It isn't just the wealth effect of the average investor that is problematic, but it is also the destruction of what was "paper" wealth for many employees of these companies.
  - **Crypto was hit hard**. Many seem to ignore crypto, but in a little over a year, the value of cryptocurrencies has gone from $3 trillion to maybe $0.7 trillion. The entities involved in the space have also seen their valuations plunge.
  - **The Growth Company "Wealth Effect."** If you go back to early 2021, growth was everywhere. Raising equity (publicly or privately) was relatively easy even at large valuations. That money was raised and was spent because showing growth was the key objective. Now, with valuations low (and more of an emphasis on cashflow) these companies which were big engines of growth will be much more careful with their spending.

- **Inventory, Demand, and Supply Chains.** These factors could just as easily drag inflation down.
  - **Demand seemed high, but was it sustainable?** Consumers had wealth (see above), stimulus, and responded to potential supply shortages by buying more last year than they needed and effectively pulled demand forward. There is evidence (in inventory data) that companies didn't see this.
  - **Supply chain overcompensation.** Companies responded to supply chain risks by ordering more. Demand seemed robust and it also seemed "safer" to have more inventory than less. As supply chains are normalizing (lots of evidence that this is occurring, even with China still enforcing a zero-COVID policy), we can see more inventory build-up.
- **Russia, Ukraine, and Energy Prices.** The base case is for the status quo to continue, which will keep upward pressure on energy and commodity prices, but much has been priced in and global supply chains are shifting to adapt to this new universe.
  - **If anything, the "surprise" would be some sort of truce.** The expense of military equipment is weighing on many NATO nations. Ukraine cannot really "win" and Russia cannot afford to lose, so trying to avert further infrastructure damage (and permanently displacing citizens) is a reasonable goal. Sanctions seem to hurt us as much as Russia, which is yet another reason to try to come to the table. One of the outcomes of the sanctions is that moving oil by tanker has become difficult and expensive because shipping routes have lengthened to adjust for "who can buy or sell oil to whom."
- **China continues its re-assertion of the communist party and is extending its "client" state relationships.** I do not expect much help from China in the global economy.

- **Xi is re-asserting the authority of the communist party.** It was always in charge, but even internally the perception of the party's power relative to successful businesspeople (as one example) is being clamped down on.
- **Expecting China to do what we wish they would do has been and will continue to be a flawed strategy.** There remains a "hope" that China really wants to be like us and they will come around to that way of thinking. This is highly unlikely to happen.
- **Shifting economic ties.** China and Russia, in many ways, make better trading partners than the U.S. and Russia (Russia wants high tech from China and has a trade surplus from selling commodities). This relationship exists with many countries, especially the autocratic/resource rich nations of the world. The Belt and Road Initiative has been an extremely effective way (from the Chinese perspective) of solidifying relationships with countries that China wants resources, access, or other things from.
- **Taiwan.** The GIG sees a military invasion as unlikely, but look for political and economic pressure to be ratcheted up, while maintaining an intimidating military presence.

- **Jobs.** The job data has been strong and could be one area that continues to show strength, which would be a threat to our rate forecast as we are less sanguine about that market.
  - **Jobs (always a lagging indicator) will be even more lagging this time.** After a year or more where it was extremely difficult to hire, companies will not fire people any time soon! Firing will be a last resort (even more than usual). You will see cutbacks in services used (legal, consulting, cloud, advertising, etc.) first and there is evidence we are seeing some of that.
  - **What sort of jobs will be lost?** This time around, it seems like many job cuts (at least in the early rounds of layoffs) will be higher paying jobs. This won't be a job market that hits low-income earners hard because it will hit high income jobs more than usual. That will matter as it will take fewer jobs lost to tilt the economy down.
  - **Not all jobs data passes the "smell" test.** The Household Survey shows 2 million fewer jobs created than the Establishment Survey. The JOLTs data has been showing more and more jobs relative to hiring since more job searches went online. There are also some "wonky" but realistic questions about various metrics in the jobs data.
- **The Service Sector.** This is another area that has held in there and this might bode well for the future. However, there is a risk that similar to inventory (where supply chain fears overstated demand), a similar phenomenon could be occurring in the services space. The contention is that after an extended period where travel or seeing your family was difficult, there is a "catch up" effect that may not be as robust once we make it through this year's holiday season.
- **Inflation.** I expect deflation to be as much of a topic of conversation next year as inflation.

Longer-term factors. Since this forecast is meant to take us out three years, there are a few longer-term factors that I need to include.

- **Supply Chain Management.** Companies will create simpler and "safer" or more "secure" supply chains. That will create jobs domestically, in Mexico, and in other areas. That will create

opportunity and will be somewhat inflationary. It will create more "middle" class jobs, not just in manufacturing, but in the logistics around these new supply chains. This will be good for American jobs, but not great for inflation.

- **Sustainable AND Traditional Energy build-out.** We need to build out sustainable energy faster and more aggressively than previously thought. We need to ensure that the backbone of our energy system is big enough (for long enough) to let that transformation occur smoothly. This will eventually be deflationary, but it will be inflationary in the near-term as immense amounts of money will need to be spent on the materials and people needed to create the world for which we are striving.
- **India.** This is my "outlier" and doesn't get enough attention. India is set to surpass China in terms of total population with a much better demographic mix! India is also set to gain China's "losses" on the supply chain side. India was growing rapidly before Covid and seems to be back on that trajectory. There are many obstacles (some of which are their own making), but if there was one outlier that I'd be looking for it would be an "early 2000s like" China commodity boom! Let's not forget, India is buying Russian commodities because cheap resources are critical for India. They work with Venezuela too and seem to be mimicking China's playbook for resource accumulation in many ways. It seems shocking how seldom India comes up in conversations, yet this could be the shock to the global system for which we aren't prepared.

Thanks, and good luck in the coming weeks, months, and years!

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