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BACK TO THE FUTURE IN 2015

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KEY TAKEAWAYS

This week we examine how the U.S. economy in 1985 compares with 2015, focusing on factors such as the pace of the current economic expansion, the political balance in Washington, consumer sentiment, and the role of the Fed's monetary policy.

Happy New Year. The Hollywood blockbuster *Back to the Future* was released 30 years ago, in 1985, and is garnering some headlines lately as its sequel, *Back to the Future II*, was mainly set in 2015. The original film, set in 1985, sees the main characters use a time traveling DeLorean—that's a car for those of you born after 1975—to travel back to 1955, and at the end of the film, briefly, to this year, 2015. The quick visit to 2015 at the end of the first film set the stage for the sequel, *Back to the Future II*, which was released in 1989. Although some of what was depicted as 2015 in *Back to the Future II*—hoverboards, flying cars, sneakers with automatic shoelaces, fax machines everywhere, time travel, and the Cubs winning the World Series—has yet to happen (sorry Cubs fans), some things about life in 2015 did come true. Flat-panel TVs, hands-free gaming, cameras everywhere, video chatting, and yes, even drones, all appear as staples of everyday life in 2015.

Back to the Future II doesn't tell us much about the economy in 2015, however, although most of the economic activity in the film seems to revolve around selling 1980s nostalgia and casino gambling. But how might 2015's economy compare with 1985's, which is often thought of as part of the roaring 1980s and, in some respects, a golden age for the U.S. economy?

1 WILL IT BE BACK TO THE FUTURE IN 2015?

	1985	2015*
Real GDP Growth	+4.2%	3.0%+
Key Sectors of GDP	Consumer	<ul style="list-style-type: none"> ▪ Business Spending ▪ Housing ▪ Consumer
Federal Reserve	Tightening, then easing	Tightening by year-end
Consumer Price Index	+3.5 to +4.0%	Decelerates to near zero in H1; accelerates along with wages in H2
Job Creation	+175,000 per month	+225,000 to +250,000 per month
Federal Deficit (% of GDP)	5%	2.6%*
President	Republican	Democratic
House	Democratic	Republican
Senate	Republican	Republican
Consumer Sentiment	93	Ended 2014 at 93.4

*CBO forecast

Because of its narrow focus, investing in a single sector, such as energy or manufacturing, will be subject to greater volatility than investing more broadly across many sectors and companies.

Source: LPL Financial Research, Haver Analytics, Congressional Budget Office (CBO) 01/05/15

BACK TO THE PAST: THE U.S. ECONOMY IN 1985

Although 1985 was only the second full year of economic expansion after the back-to-back recessions of the early 1980s (1980 and 1981–82) ended in November 1982, that year saw 4.2% economic growth as measured by real gross domestic product (GDP), well above the economy's long-term average (1960–2014) growth rate of 3.1%. The economy created an average of 175,000 private sector jobs per month, and consumer spending contributed nearly three quarters of the economic growth. The Federal Reserve (Fed), which both raised and lowered rates in 1984, raised rates in early 1985, but then cut rates in the second half of the year, while inflation as measured by the Consumer Price Index (CPI) ranged between 3.5 and 4.0% for much of the year. After falling 15% in 1984, oil prices were essentially unchanged in 1985, before plunging in 1986. (Please see the *Weekly Economic Commentary*, "Before and After: Monitoring the Effects of Falling Oil Prices," December 22, 2014.)

In 1985, exports accounted for just over 6% of GDP, and the dollar — after running up more than 50% since the end of the 1981–82 recession — peaked in early 1985 and ended the year little changed from its value at the end of 1984. The federal budget deficit, which ballooned to 6% of GDP in the aftermath of the severe 1981–82 recession, improved to 5% of GDP in 1985, on its way to an eight-year low of 2.7% in 1989. As 1985 began, Republican President Ronald Reagan — after winning re-election in a landslide in November 1984 — was facing a Democratic House of Representatives and a Republican Senate. Consumer sentiment, as measured by the University of Michigan's Consumer Sentiment Index, averaged 93 in 1985, the highest in more than a decade, aside from 1984. In retrospect, 1985 marked the third year of the economic expansion that began in November 1982 and would last for nearly eight years, ending in July 1990.

WHAT WE EXPECT IN 2015

As noted in our *Outlook 2015: In Transit* publication, we expect that 2015 will mark the sixth year of the economic expansion that began in June 2009, and that the odds of recession in the next year remain low, suggesting that the current economic expansion may match, or even surpass the 92-month expansion that began in 1982. We expect real GDP growth to run at just over the long-term growth rate of 3.0%, led by business spending, housing, and the consumer. We expect the Fed to begin raising rates later this year, and that the economy will consistently create between 225,000 and 250,000 jobs per month. Inflation may be pulled down by falling oil prices in early 2015; but later in the year, as wages begin to accelerate, inflation may turn higher.

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In 2014, exports accounted for 14% of U.S. GDP, nearly double 1985's level, making the U.S. economy more vulnerable to global growth in 2015 than it was in 1985. The U.S. dollar, which is up 15% since the end of the 2007–09 Great Recession, may continue to move higher in 2015 as the U.S. economy continues to improve and the Fed tightens monetary policy, even as economies and central banks of many major U.S. trading partners stagnate and cut rates or enact more stimulus [Figure 2]. The nonpartisan Congressional Budget Office expects that the U.S. federal budget deficit will shrink to 2.6% of GDP in fiscal 2015, from 2.9% in fiscal 2014, and the recent high of 9.8% of GDP in 2009. As we note in our *Outlook 2015* publication, as President Obama starts his final two years in office, he'll have to work with a Republican-controlled Congress, opening the possibility of productive compromise that might create some movement out of the gridlock that has plagued

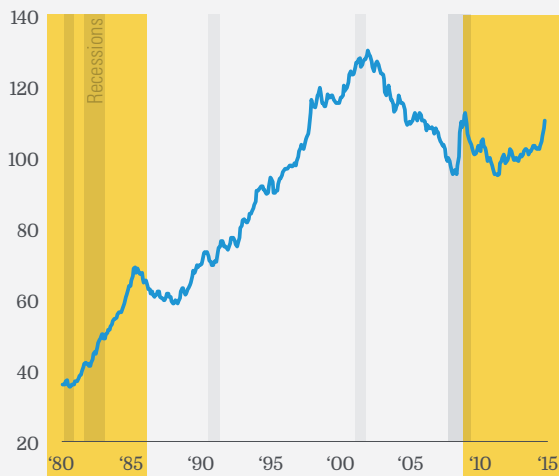
Washington in recent years. Consumer sentiment ended 2014 at the same level it averaged in 1985 (93.6), hitting a new seven-year high [Figure 3]. Also noted in the *Outlook*, we expect the economy to continue to expand in 2015. By the end of the year, the expansion that began in June 2009 will be the

fourth-longest post-WWII expansion, just behind the 1982–1990 expansion—which included *Back to the Future's* 1985—that lasted 92 months. As for the flying cars, time travel, and the Cubs, we'll leave that to Hollywood.

Have a great year! ■

2 LIKE 1985, THE DOLLAR HAS MOVED HIGHER OVER THE PAST SEVERAL YEARS SINCE THE END OF THE PRIOR RECESSION

- Nominal Broad Trade-Weighted Exchange Value of US\$
Jan '97 = 100

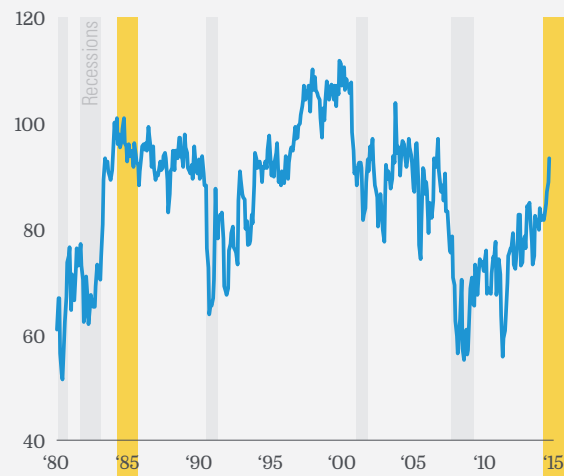


Source: LPL Financial Research, Federal Reserve Board, Haver Analytics 01/05/15

Past performance is not indicative of future results. Indexes are unmanaged and cannot be invested into directly.

3 CONSUMER SENTIMENT ENDED 2014 WHERE IT AVERAGED IN 1985

- University of Michigan Consumer Sentiment
Not Seasonally Adjusted, Q1 '66 = 100



Source: LPL Financial Research, University of Michigan, Haver Analytics 01/05/15

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

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