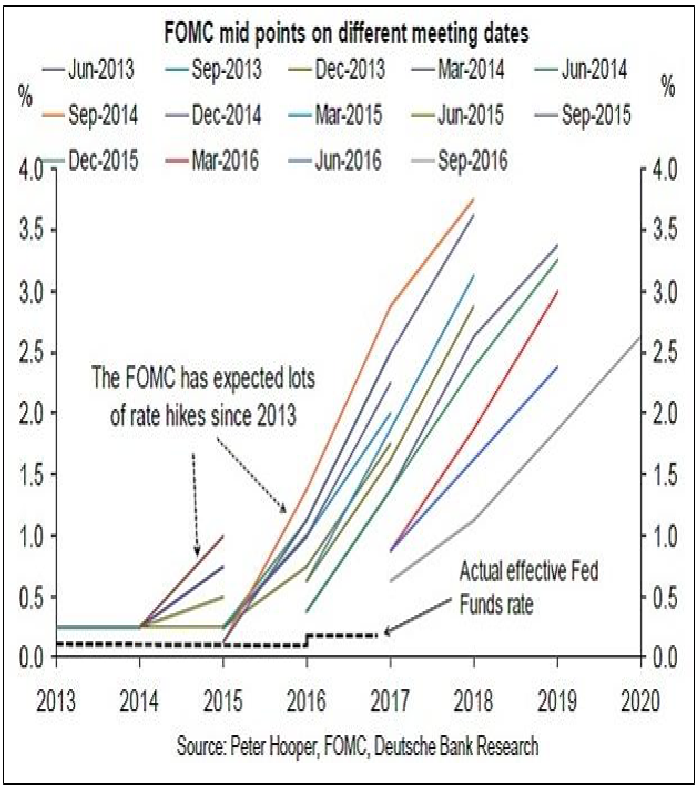
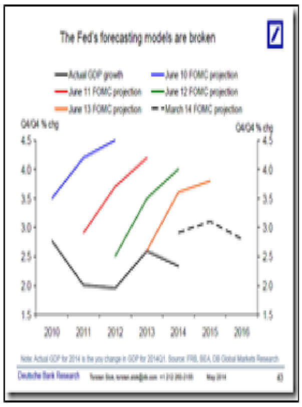
?The hubris in economics came not from a moral failing among economists, but from a false conviction: the belief that theirs was a science. It neither is nor can be one, and has always operated more like a church. You just have to look at its history to realize that.? ?Collaborative Fund The Federal Reserve (Fed) has over 750 Ph.D. economists on staff, many of whom sport degrees from the *finest* universities in the world. Given such a population of *experts*, why does the Fed have such a poor track record forecasting economic activity? Consider the graphs below, which provide recent evidence of the Fed?s futile forecasting efforts, if you find the preceding question slightly condescending or offensive. Please note it is not just the Fed, but poor economic forecasting pervades most economists including those at the IMF and the private sector as also highlighted below.

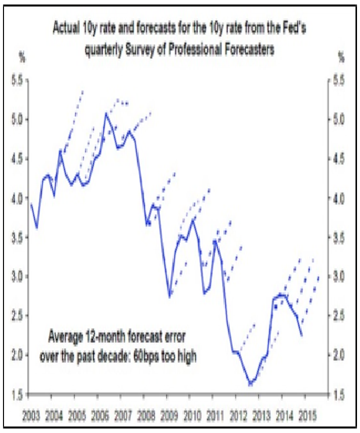
Fed Forecasts Fed Funds Rate

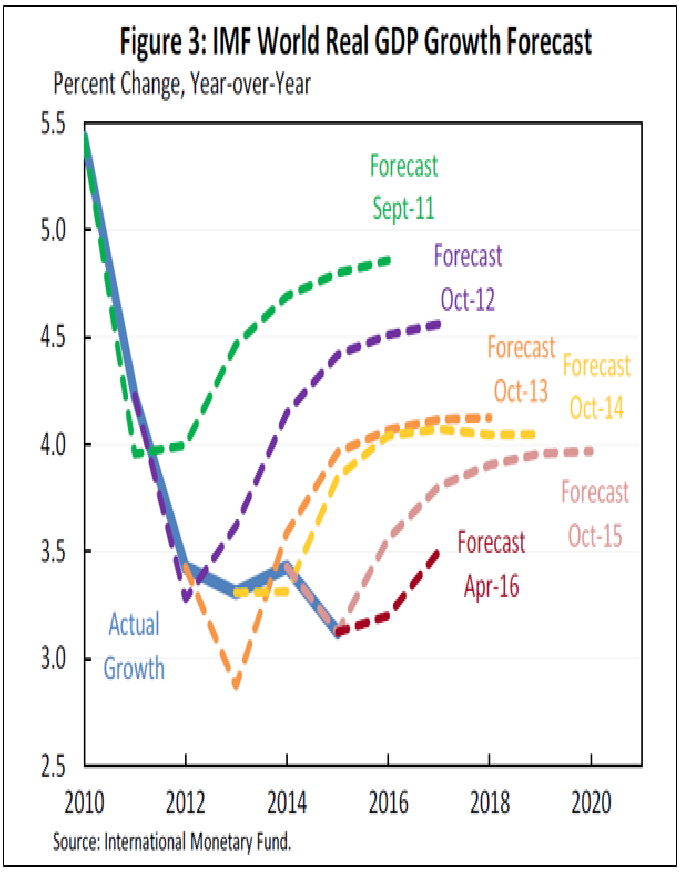


Fed Forecasts GDP



"Professional" Forecasted 10-Year Yields

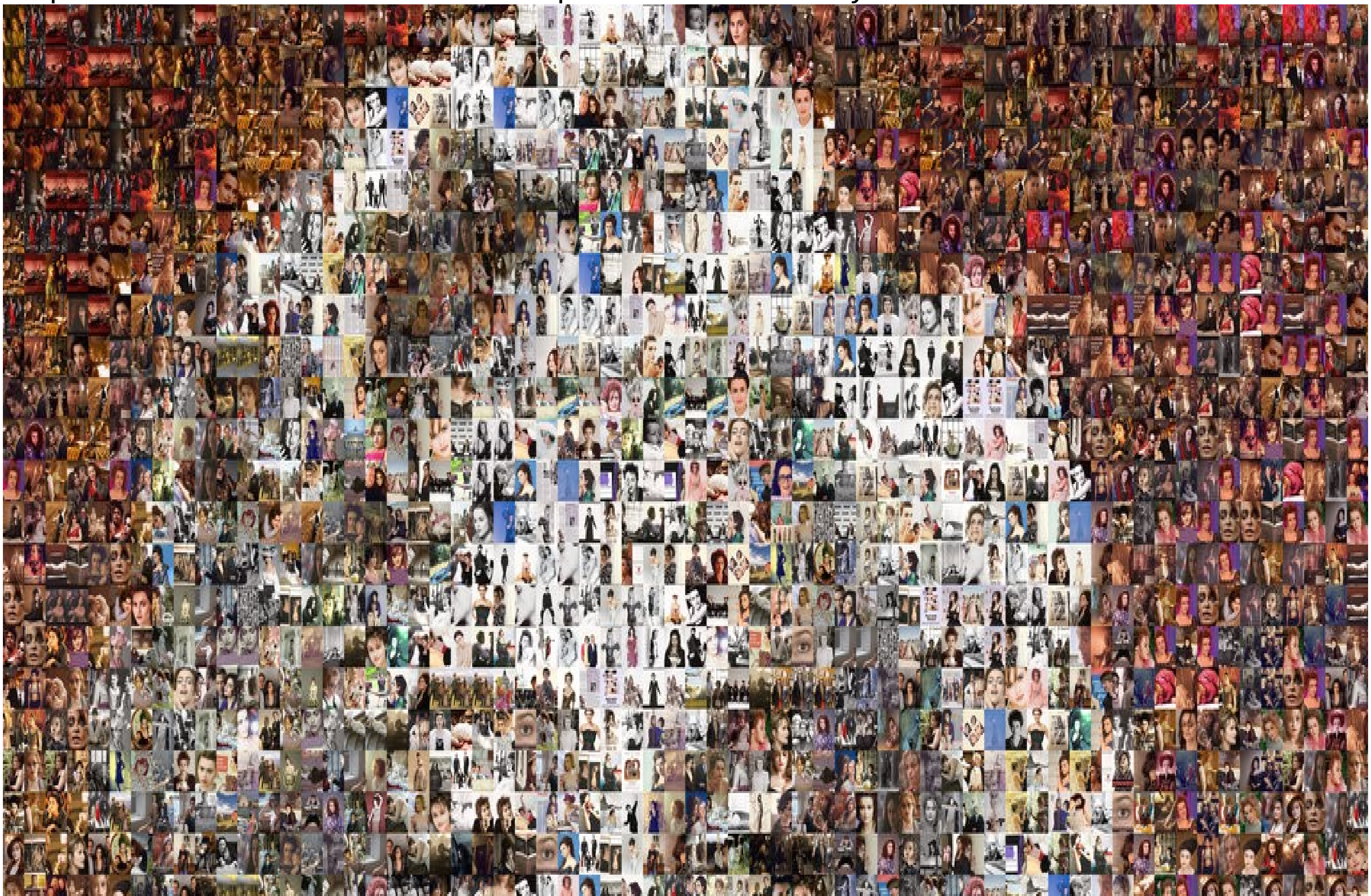




To understand why the Fed, and most economists, fail to accurately forecast economic activity more often than not, one must only contemplate economics at its most basic level. The problems many economists have are found in the faulty theories, technical lexicon, and asinine assumptions embedded in their supposed logic. Simply, they have lost sight of what economics really is. The most basic building blocks of economics are our *individual* supply and demand curves. Armed with an understanding of those basic building blocks, we highlight two errors most economists commit in trying to make economics a definitive science with known answers. **Economics 101** Consider the following perspectives of supply and demand:

- Human beings have desires, and those desires drive decision-making. Given the desires and the means or ability to fulfill those desires, they will do so.• **This results in demand.**
- At the same time, to fulfill one?s desires, human beings will undertake activities that give them the• *means*• to fulfill their desires.• **This results in supply.**

To elaborate, consider your personal economy. You have needs and desires to consume certain goods and services. Some of these are core to your survival, such as food, water, energy and shelter. Beyond necessities are desires which may include a smart phone, filet mignon, Netflix, or a yacht.• All of these items hold some unique value to you. To consume or obtain these goods and services, you need to have something of value to offer in exchange. To accrue value, we work and produce goods and services that others need and desire. The more successful and efficient one is at producing goods in demand, the more value one accumulates and therefore the more needs and desires one can fulfill. This most basic description of our personal supply and demand curves is the core of economics. It is the building block upon which billions of transactions occur every day. **Problem #1 ? Singular Economy** One of the biggest complications with the study of macroeconomics is in its attempt to aggregate individual economies into a singular, larger and, hypothetical economy. In other words, economists assume we all have the same preferences, desires, motivations, and quirks. Further, these collectivized traits are modeled and used to forecast economic activity and prescribe monetary and fiscal policy. **When one aggregates individual and household economies, a picture is created that may appear to be coherent. Many times, however, the 350 million unique pixels, constituting the U.S. population, paint a picture that is not accurately representative of the one economists believe to be the case.** Step back for a moment and admire the picture below of Marilyn Monroe. •



Now move closer to the screen, zoom in, and you will realize the picture is composed of pictures of many other people, none of which are Marilyn Monroe. Most economists do not bother to understand our unique and widely diverse opinions and preferences. Instead, they gravitate to the simplicity of assuming we all share the same ?average? or ?aggregate? needs, desires and means. As such they also assume we react alike to the same positive or negative economic stimulus. Those assumptions operate on the premise that human beings are rational. Were that truly the case, we venture to guess that Richard Thaler would not have recently won the Nobel Prize in economics based on his work in behavioral finance and human beings? proclivity for irrationality. To better understand the consequences of taking a singular, aggregate economy approach, consider how the Fed and most central banks administer monetary policy. When aggregate demand or consumption decline for a period of time, central bankers have a dependable history of lowering interest rates to incentivize consumers to borrow for houses, cars and other goods. Is such an approach logical? What if I am simply cutting back on spending because I recently splurged on a glamourous vacation? What if you stopped eating out twice a week because you are concerned about your diet? How about your neighbor who decides to be more frugal, reduce spending and increase her savings as she nears retirement? Will lower interest rates produce predictable behaviors and actions? Will lower interest benefit some while hurting others? The fact of the matter is that broad prescriptive policies are aimed at the average. The average may represent a decent percentage of the population at times, and such policy may produce expected results. •Other times, the average may represent a much smaller percentage of the total and produce feeble results. Currently, the ?average? find themselves heavily indebted and approaching retirement. Should policy be tailored to their situation? If so, how will such policy affect the individual economies of the millennials that are starting to save, buy houses and have children? The Fed?s policy reaction to the Great Financial Crisis of 2008 was to reduce the Fed Funds rate to near zero and quadruple the size of the money supply via the purchase of U.S. Treasury debt and Mortgage Backed Securities (MBS). Those citizens and organizations that were able to take advantage of low interest rates and increase their financial leverage benefited handsomely. The other 80% or so of the nation, living pay check to pay check and dependent upon paltry savings accounts earning nothing have clearly seen little benefit. One must question whether the post crisis monetary policy considered the unique circumstances of the population at large or those of a select few. Using Keynesian methods and armed with invalid counter-factual rationalizations, post-crisis monetary policy does not appear to have considered the ways in which the crisis itself altered economic circumstances and individual decision-making. Then again, why would it? The constituents and interests of the central bankers are not those of the general public, it is financial institutions to whom they are beholden. The bottom line is, given the vast age, social and geographical diversity of this nation, we should not be shocked that the extraordinary monetary stimulus applied since the 2008 Financial Crisis has largely failed to deliver a durable economic recovery. Monetary policy has always been a blunt instrument but in the post-crisis decade, it has had especially poor efficacy and high margin of error, the consequences of which are still pending. **Problem #2 ? Keynesian Economics** A second problem with modern economics is the exclusive reliance on the Keynesian school of thought. Keynesianism, based on the work of John Maynard Keynes, is the principal economic theory taught in our schools, practiced by economists and used to prescribe monetary policy by the world?s central bankers. It stresses that economic activity is predominately dependent on aggregate *demand* for goods and services. When economic growth does not meet expectations, Keynesian policy responses include greater fiscal spending, lower interest rates or other fiscal and monetary action designed to boost *consumption*. **This one-sided view fails to capture the benefit of creating value through productive activities or, in other words, the *means* which allow us to consume.** To help you appreciate the benefit of creating value, we elicit the National Geographic Channel?s *Life Below Zero*. The documentary tracks the lives of several people that live largely independent, ?off-the-grid?, in the wilds of Alaska. Of particular interest is Glenn Villeneuve, who does not appear to rely on help from the outside world, nor many of the innovations of modern society, including electricity and power tools. Assessing

Glenn?s daily activities, we better illustrate the measurement of a personal economy. While this example does not represent the norm, it does provide a microcosm of a simple economy to allow us to illustrate the fallacy of an economic perspective focused on consumption. A typical day for Glenn involves some of the following activities in which he produces goods: hunting, trapping, fishing, sourcing water, and chopping lumber. Other parts of his day are spent consuming prior production such as eating, drinking, sleeping, and warming up by a fire. The first set of activities involves productive endeavors that add economic value. The second set of activities involves consuming the value he created. Note that there is also an intermediate stage in which the value he created is stored (saved) for future consumption. Throughout the show, Glenn consistently extols efficiency or the benefits of using the least amount of energy and the most amount of ingenuity to add value to his camp. After watching an episode or two, a viewer quickly realizes that without this supply side mindset Glenn would quickly exhaust his resources and become a victim of the harsh Alaskan climate. Most of our days are quite different than Glenn?s, but nevertheless they are filled with similar pursuits. We sit at a desk providing legal services, picking grapes from a vine, building houses and millions of others jobs in which we create value. While most of us do not ?eat what we kill? and consume the value we create directly, we earn the value in the form of currency. As a store of that value, currency then affords us a medium of exchange for something we need or want when it suits us. Just as portrayed in Glenn?s example, the harder we work and the more innovative and productive we are, the more value we create. It is in this straightforward incentive that the prosperity of a populace grows and scarcity is diminished. For related 720Global research on this important concept we recommend reading *The Death of the Virtuous Cycle* and watching our short video *The Animated Virtuous Cycle*. Given the prior discussion we ask you if it makes sense that economic measurement and incentives are so heavily tilted towards the consumption of value. Consider again Glenn?s activities in the eyes of Keynesians. Given the emphasis on consumption, they would count how much he ate, slept and the extent to which he was able to heat his cabin as economic progress. His GDP would not properly capture the value of catching 30 salmon, bagging an 800-pound moose or innovative means of preserving those resources. If a Keynesian wanted to boost Glenns?s economic well-being, why would they focus on his consumption? Give him a rifle, a chainsaw or other productivity-enhancing tools to generate value. In other words, Glenn cannot go in debt to nature to pull his consumption forward in the event of a shortage. For him, a deficit equals starvation. **#1 + #2 = Poor Economic Policy** When one logically thinks through what a personal economy actually entails and considers the faulty reliance on the singular aggregation of our economies and a consumption driven mindset, they can begin to understand why economists consistently struggle to forecast economic activity and prescribe constructive policy. **They have put the economic cart before the horse and are trying to convince the rest of us that it makes sense. Unfortunately, these errors do not only result in bad forecasting but pathetic monetary and fiscal policy which tramples innovation and productivity resulting in stagnant economic growth, wealth inequality and onerous debt burdens.** It should be clear that the straight-forward approach discussed here is not favored by the banks, economists and Wall Street professionals being paid handsomely to dole out Keynesian advice. That said, it is the economic school of thought that best captures the most relevant aspects of the economy. The logical thought process applied here is what is required if we are to ever properly diagnose our problems, employ policies that actually combat the current economic malaise and relieve the burdens and social unrest that are choking off prosperity.