



Wisconsin Foundation
& Alumni Association
UNIVERSITY OF WISCONSIN-MADISON

MIKE KNETTER

Economic Trends: American Capitalism

MEETS
America First



Agenda

- 01** Recent Economic Performance
- 02** Review of Current Drivers of Economic Behavior and Performance
- 03** Some Thoughts on America First Policy Mix
- 04** Near and Long-term Outlook

Predictions for 2025

- The labor market will tighten; unemployment will flirt with 3.5% and employment growth will slow.
- GDP growth will be modest, in the 2.5% range.
- Inflation will remain elevated due to policy impacts on labor and goods, ending 2025 around 3%.
- The Fed will pause interest rate cuts and our fiscal imbalance will become a growing concern in markets. S&P will increase 5% for the year.

Outcomes for 2025

- The labor market softened at year end; unemployment finished at 4.4% and employment growth did slow
- GDP growth was modest, 2.3% y/y for Q3
- Inflation does remain elevated at 2.7%.
- The Fed is now pausing interest rate cuts
- S&P increased 16% nominally for the year
- The big surprise was the power of AI

Current Conditions

- Main indicators are good **(6/10)** at a macro level :
 - Unemployment low, but rising, and employment growth slowing (AI and border)
 - Real GDP growth resilient, aided by productivity gains
 - Inflation is elevated but stable just under 3%
 - Equity markets and household net worth at, or near, all time highs
 - Dollar has weakened over the past year, but not alarmingly
- There is **solid momentum** in the economy heading into 2026
- The relatively benign current condition suggested in **aggregate data masks two powerful forces** shaping the economy in very different ways

Unemployment very low but rising...

USURTOT Index (U-3 US Unemployment Rate Total in Labor Force Seasonally Adjusted)

Bloomberg



USURTOT Index (U-3 US Unemployment Rate Total in Labor Force Seasonally Adjusted) Real MK Template Daily 31DEC1959-14JAN2026

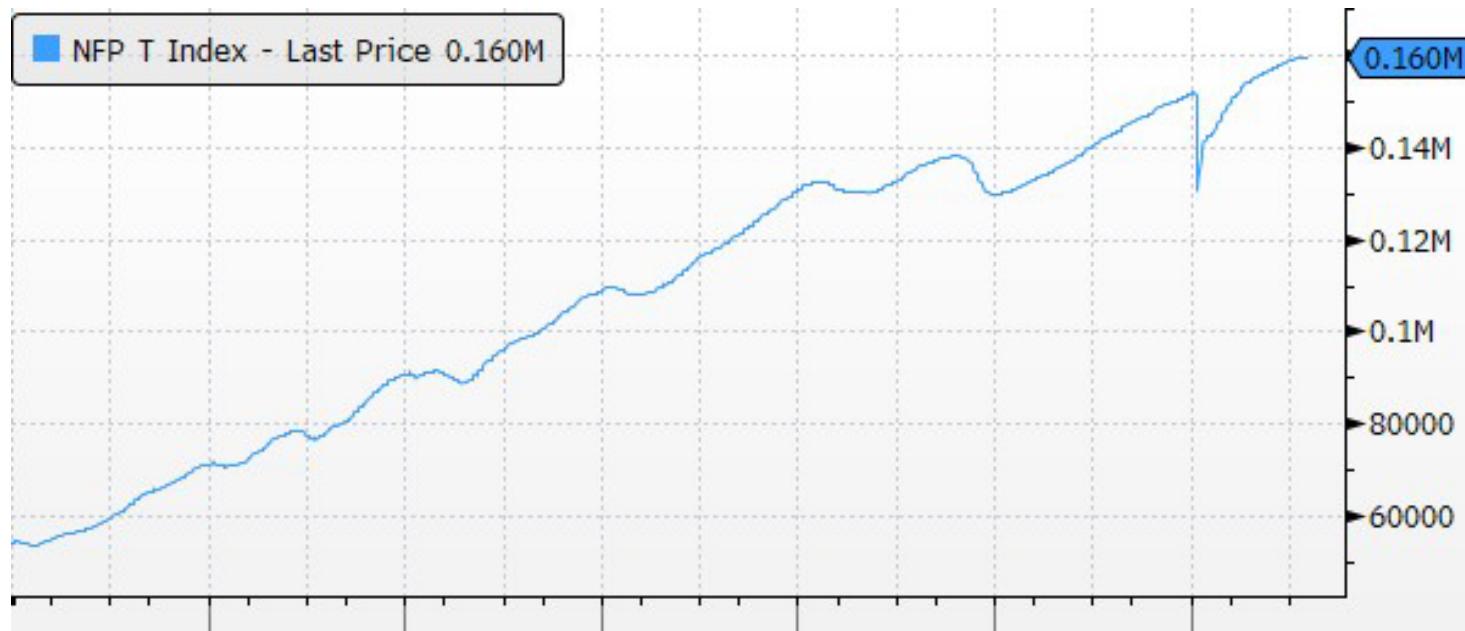
Copyright © 2026 Bloomberg Finance L.P.

14-Jan-2026 13:55:42

Payroll Employment high but slowing

NFP T Index (US Employees on Nonfarm Payrolls Total SA)

Bloomberg



1960-1969

1970-1979

1980-1989

1990-1999

2000-2009

2010-2019

NFP T Index (US Employees on Nonfarm Payrolls Total SA) Real MK Template Daily 31DEC1959-14JAN2026

Copyright © 2026 Bloomberg Finance L.P.

14-Jan-2026 13:56:17

Real GDP Growth: Back to Trend

GDP CYOY Index (GDP US Chained 2012 Dollars YoY SA)

Bloomberg



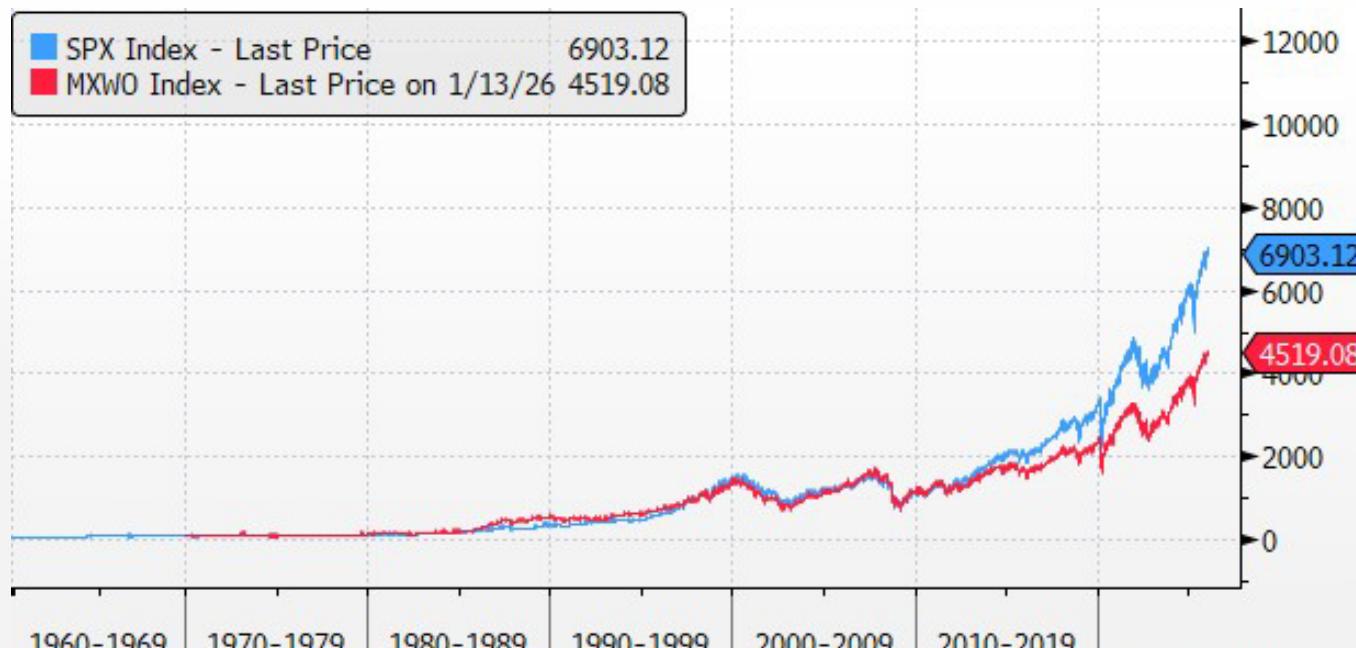
GDP CYOY Index (GDP US Chained Dollars YoY SA) Real MK Template Daily 31DEC1959-14JAN2026

Copyright © 2026 Bloomberg Finance L.P.
14-Jan-2026 13:56:42

U.S. Equities Outperform Since 2010

SP Index (S&P 500 Index) MXWO Index (MSCI World Index)

BLOOMBERG



Household Net Worth: All-Time High

NWORVALU Index (FOF Federal Reserve US Households & NPO Net Worth Nominal)

BLOOMBERG



NWORVALU Index (FOF Federal Reserve US Households & NPO Net Worth Nominal \$ Value) Real MK Template Daily 31DEC1959-14JAN2026
Copyright © 2026 Bloomberg Finance L.P. 14-Jan-2026 13:57:41

Inflation: Falling and now Stalling

CPI YOY Index (US CPI Urban Consumers YoY NSA)

CPI XYOY Index (US CPI Urban Consumers Less Food & Energy YoY NSA)

Bloomberg

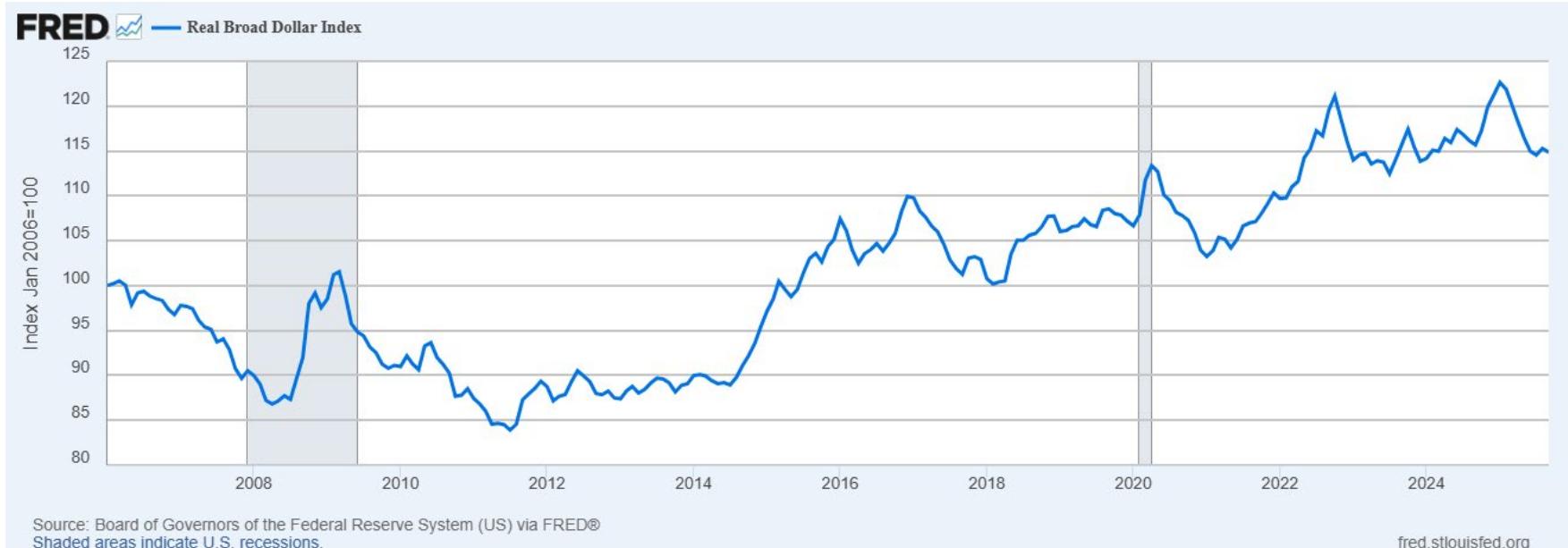


CPI YOY Index (US CPI Urban Consumers YoY NSA) Real MK Template Daily 31DEC1959-14JAN2026
Copyright © 2026 Bloomberg Finance L.P.

14-Jan-2026 13:54:59

Real Trade Weighted US Dollar Index

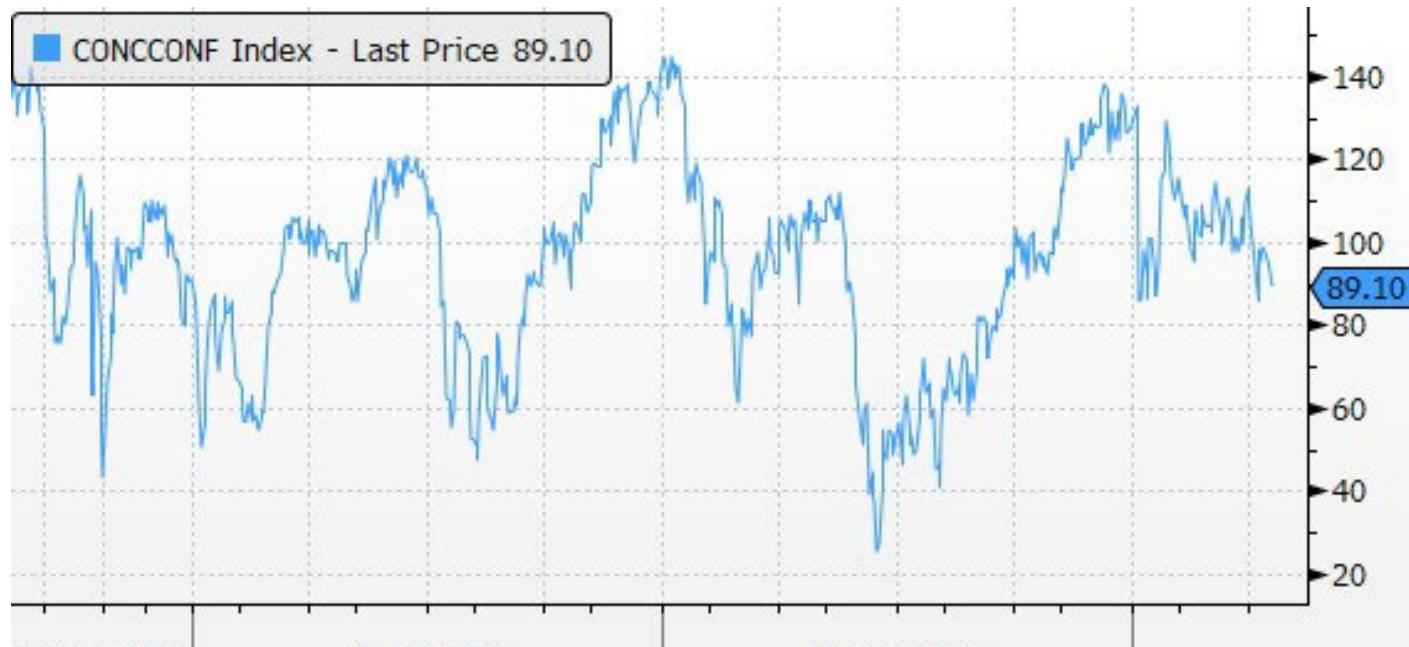
FRED



Consumer Confidence is Declining

CONCCONF Index (Conference Board Consumer Confidence SA 1985 = 100)

Bloomberg



1967-1979 1980-1999 2000-2019

CONCCONF Index (Conference Board Consumer Confidence SA 1985=100) Real MK Template Daily 31DEC1959-14JAN2026

Copyright © 2026 Bloomberg Finance L.P.

14-Jan-2026 13:59:28



Drivers of Current Conditions

- The economy is in a major transition driven by public policy changes and a technological revolution
- The momentum of the AI/tech boom created by American capitalism is powering the economy into 2026
- The current Administration has implemented several major policy shifts (henceforth America First or “AF” policies), mainly through executive actions, which will erode the foundations of American Capitalism over time
- The power of the tech revolution will mask the adverse impacts of America First (even Soviet 5-year plans worked for a while...)



AI Dominance

- According to Cembalest (*Eye on the Market, JPM*), “The Blob”, a group of 41 AI-related (*direct, utilities, capital*) companies have accounted for...

75% OF S&P 500 RETURNS

80% OF EARNINGS GROWTH

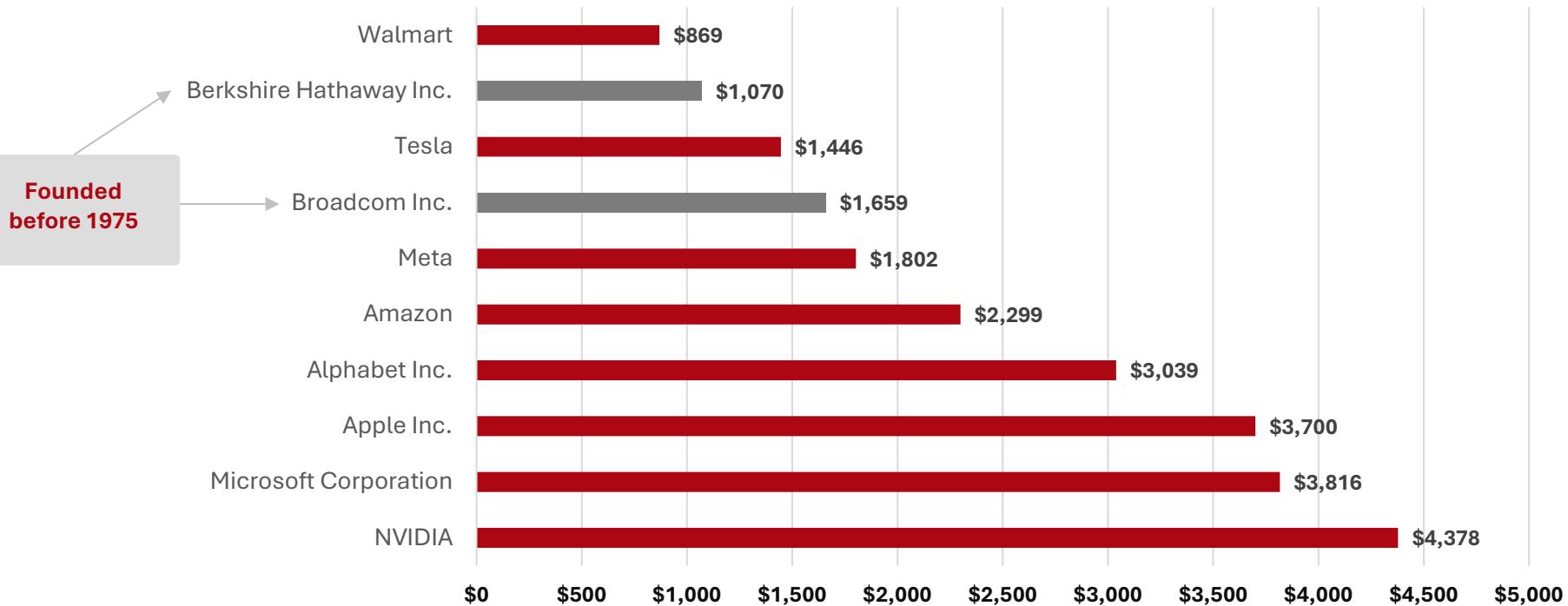
90% OF CAPEX GROWTH

...SINCE THE NOV 2022 LAUNCH OF CHATGPT

- AI is the latest manifestation of the most *dynamic* economy on Earth
- The turnover in top companies is one way to assess the dynamism

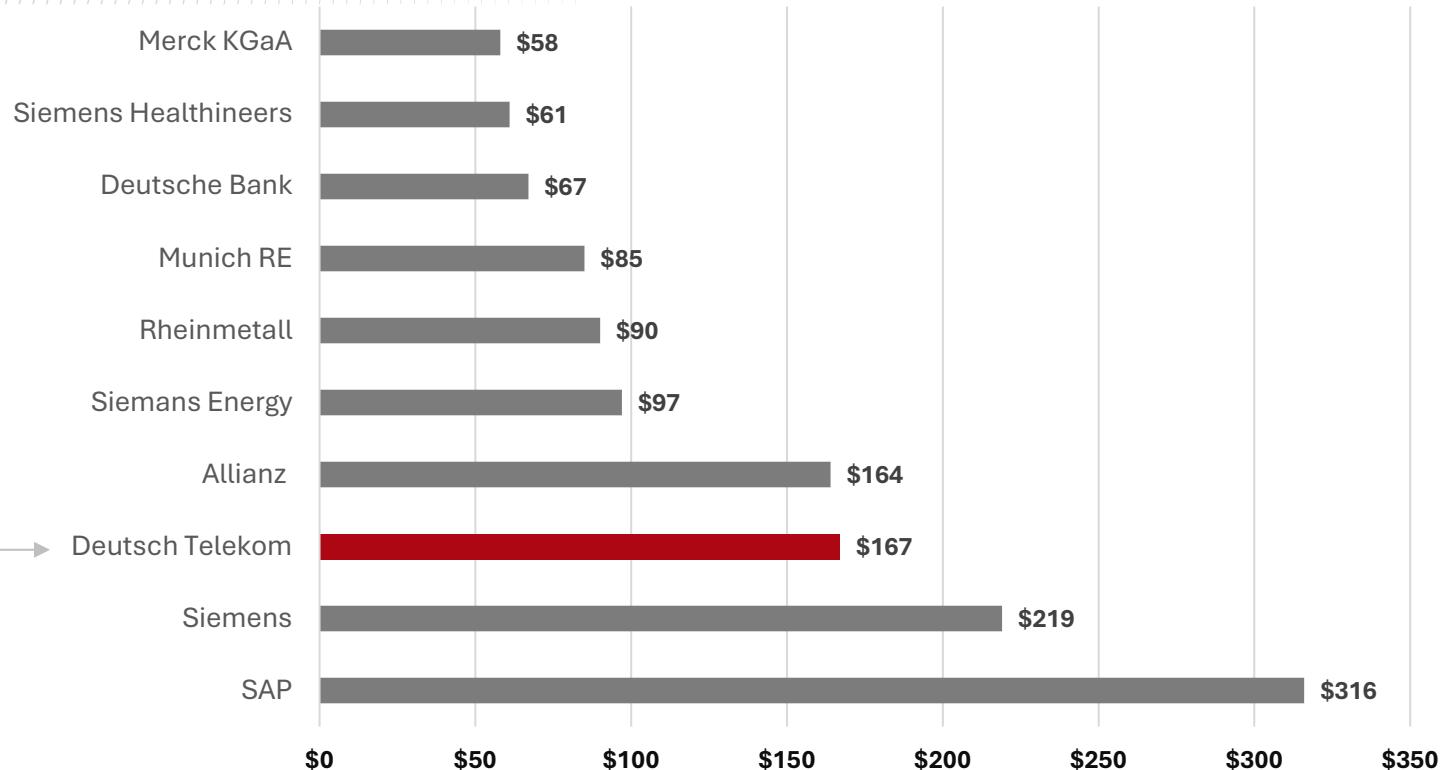


10 Largest U.S. Companies by Market Cap



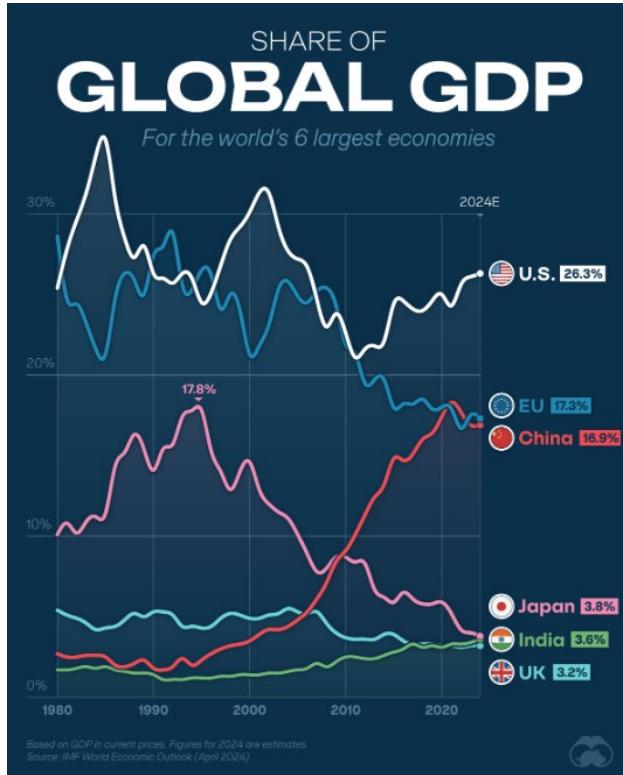


10 Largest German Companies by Market Cap





Market Capitalism v Industrial Policy



- Germany and Japan were anointed the rising star economies in the 70s and 80s as their autos, steel, electronics grew relative to U.S. counterparts
- Reagan resisted protection, letting competition run its course, while Germany and Japan protected their status quo
- What happened?
 - **Germany and Japan more reliant on manufacturing, but the Chinese, Koreans, etc. are now displacing them**
 - **Capital flowed to build the US tech sector, which includes the highest margin industries on the planet**
 - **When was the last time anyone worried about Germany eclipsing the U.S. economy?**

Foundations of U.S. Economic Dynamism

- Thesis: Decentralized, democratic capitalism delivered the resource allocation and incentives that have made the U.S. economy exceptional
- The distinctive features of the U.S. economic model include:
 - **competition (consumer interest above producer) and rule of law**
 - **open to trade and immigration**
 - **dominance in higher education**
 - **stable monetary system (Fed independence)**
 - **sound corporate governance (investors call the shots)**
 - **broad, deep, unfettered capital markets (invisible hand)**
 - **entrepreneurial culture and management talent**
- National industrial policies have proven no match for U.S. innovation
- Now when tech dominance is more important than ever, a policy shift

American Capitalism meets America First

➤ KEY PILLARS OF AMERICA FIRST:

FISCAL

(DOGE, BBB, shutdown)

MONETARY

(challenging independence as
Fed navigates tradeoffs)

TRADE

(jettison multilateral agreements
for bilateral fights and deals)

LABOR

(immigration and migration
down sharply)

HIGHER EDUCATION

(attack on wokeism and
research funding)

INDUSTRIAL POLICY

(direct government investments
and jawboning)

DEREGULATION OR REDUCED ENFORCEMENT ON DOMESTIC FIRMS AND MARKETS

(labor, finance, competition, energy, environmental)

➤

WHAT PROBLEM IS AF SOLVING AND WHAT ARE THE ECONOMIC CONSEQUENCES?



Economic Consequences of America First

- Whatever the intentions, AF policies will have an impact on economy

**Tax cuts and deregulation
boost economic activity**

**Trade frictions reduce
specialization and division of
labor, drag on growth**

**Barriers to immigration
reduce labor force quantity
and quality**

**Erosion of Fed independence increases
inflation, weakens the dollar**

**Attacks on research and foreign students
reduce human capital and innovation**

- Impacts are hard to disentangle from the powerful effects of AI revolution
- In the long run, AF policies will erode the foundations of American Capitalism
- Let's dive into trade, education, immigration....

The Original Case for Openness to Trade

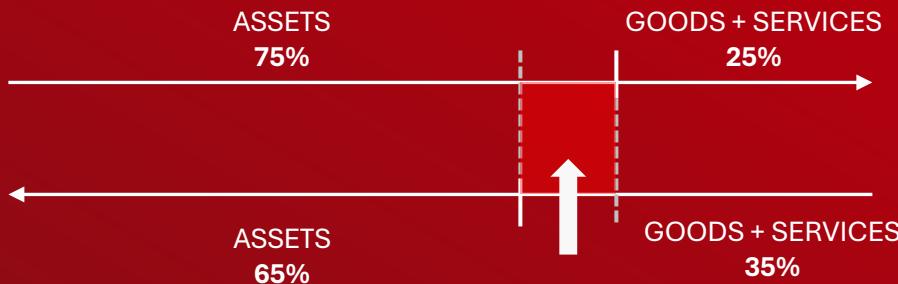
- International exchange is voluntary and only happens if both parties feel better off for making the trade.
- Every exchange has a buyer and a seller, so for every nation **aggregate international exchange is, by definition, balanced!**
- If every exchange benefits the U.S. party that was part of it, trade seems to be an overwhelmingly good thing for the U.S. economy.
- Why did sentiment turn against free trade?
 - Chronic goods and services deficits easy to demonize
 - Trade has winners and losers and we never really helped the losers
 - The pattern of specialization that has emerged may pose national security concerns



Trade 101: Trade Deficits are a Red Herring



REST OF
WORLD



Exchanging assets for
goods + services
(the trade deficit)

Trade, Investment, and Wealth Creation

- Trade deficits are “paid for” as they are incurred by the US assets (stocks, bonds, property, etc.) acquired by foreigners.
- The cumulative trade deficits since 2000 total about \$12.5 trillion.
- Foreign entities own about \$31 trillion in U.S. securities compared to about \$16 trillion in foreign securities owned by U.S. entities.
- Meanwhile, U.S. household net worth grew from \$35 trillion in 2000 to about \$176 trillion in 2025, over \$5 trillion per year.
- Trade deficits are a natural phenomenon arising from market forces in a wealthy country with large fiscal deficits (driving our expenditure above production), great investment opportunities, high demand for consumption, and the world’s reserve currency.



American Higher Education Leadership

SHANGHAI RANKING		
1	Harvard University	🇺🇸
2	Stanford University	🇺🇸
3	Massachusetts Institute of Technology (MIT)	🇺🇸
4	University of Cambridge	🇬🇧
5	University of California, Berkeley	🇺🇸
6	Princeton University	🇺🇸
7	University of Oxford	🇬🇧
8	Columbia University	🇺🇸
9	California Institute of Technology	🇺🇸
10	University of Chicago	🇺🇸

THE Times Higher Education					
Rank	Name Country/Region	No. of FTE Students	No. of students per staff	International Students	Female:Male Ratio
1	University of Oxford 📍 United Kingdom	21,750	10.9	42%	49 : 51
2	Stanford University 📍 United States	14,517	6.4	23%	47 : 53
3	Massachusetts Institute of Technology 📍 United States	11,085	8.0	33%	41 : 59
4	Harvard University 📍 United States	20,050	9.0	25%	51 : 49
5	University of Cambridge 📍 United Kingdom	20,565	11.5	38%	48 : 52
6	Princeton University 📍 United States	7,753	7.3	23%	47 : 53
7	California Institute of Technology 📍 United States	2,240	6.1	33%	37 : 63
8	Imperial College London 📍 United Kingdom	20,275	11.8	61%	42 : 58
9	University of California, Berkeley 📍 United States	39,991	17.9	22%	52 : 48
10	Yale University 📍 United States	11,924	5.2	21%	51 : 49

The Role of Higher Ed in Tech Leadership

- American higher education has a world leadership position rivaled only by our leadership in technology. We are the largest net exporter of higher ed services.
- It builds human capital in our population.
- It attracts the best and brightest from the world and many of them stay here. Those who return home become influential and tend to like USA.
- Founders of largest companies almost all came out of our top universities, often immigrants or 1st generation Americans.
- The synergies between research universities and tech is evident in tech company locations.
- American leadership in the foundations of the knowledge economy are critical to global technological, economic, political, and military leadership.

Immigration and Economic Performance

- U.S. population growth **has slowed dramatically** in the last 20 years.
- American fertility rates **have dropped to 1.6** (below the 2.1 needed to sustain population)
- Immigration **can reduce the gap**, but it is now in decline as well
- **Dependency ratio is projected to increase** by about 20% over the next 30 years which will put stress on entitlement and other government programs
- Immigrants that come through American higher education system **have had huge impacts on innovation and technological leadership**
- Most immigrants at the entry level of the labor market seem to **have high incentive and motivation to climb the economic ladder**
- Creating and enforcing an immigration policy that promotes U.S. economic interests **seems vital to the national interest** in a competitive world

Near Term Outlook

- My base case for the U.S. economy includes
 - Sluggish employment, labor force growth
 - Modest uptick in unemployment to near 5%
 - Modest real GDP growth (2.5%) with more productivity
 - Inflation stuck near 3%
 - S&P 500 up 8%, broadening as AI adoption boosts margins
- Over time, the AF policies will erode the foundations of American exceptionalism and lead to slower steady state growth, higher inflation, and a weaker dollar.

Near Term Concerns

- Several imbalances could disrupt the status quo
 - Extreme dependence on AI theme increases risk of bubble, volatility
 - Impact of AI deployment on labor market
 - Growing fiscal imbalance
 - Inequality in income, wealth, and opportunity fueling populism and nationalism

- The imbalance in attribution also worrisome
 - We blame foreign trade, the Fed, or higher ed for all ills
 - We ignore inequality and fiscal imbalance which will only worsen under current technological and policy trends



Summing it Up

- The U.S. economy is a dynamic super tanker, **currently propelled by AI revolution**
- Major shifts in policy, aimed at non-economic concerns likely to **increase stagflation risk**
- The long-term outlook is worse **if the foundations of dynamism remain under attack**
- Cembalest JP Morgan 2025 Outlook “The Alchemists” is looking spot on...if you break too many things at once, bad things can happen
 - Trade, the Fed, higher education, multilateralism
- Russell Roberts’ wisdom for policy makers to “Don’t just do something, stand there!” is worth considering