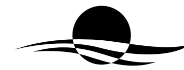
Growth STRATEGIES

Trend Analysis That Builds Business Decisions



LA JOLLA INSTITUTE
Steve PonTell

Dr. Roger Selbert, Editor & Publisher
E-mail: roger@rogerselbert.com

3200 S. Barrington Ave. #4 • Los Angeles, CA 90066
Telephone: (310) 721-6322

IN THIS ISSUE: CHEER UP AMERICA (OR NOT)

1 – THE OPTIMISTS
2 – THE PESSIMISTS
3 – TWENTY BIG TRENDS THAT WILL DOMINATE AMERICA'S FUTURE

1 – THE OPTIMISTS

Year-end seems to be a good time for listing sources of optimism (and sources of pessimism). Among the optimists you can count Zachary Karabell, who writes in The Atlantic that the economy and the country are much better off than you think. His biggest reason for optimism is that billions of people will be entering the global middle class and that a porous global system will continue to yield benefits.

Jan Hatzius of Goldman Sachs is also an optimist, writing that the US economy will be "moving over the hump" the next four years. He expects 2013 will be the last year of sub-trend growth, following which we can expect growth above 3%, based on a re-leveraging private sector and a retrenching public sector.

Peter Navarro, business professor at the University of California, Irvine is also optimistic. He writes in Barron's that we are on the verge of a new American bull market driven by four powerful trends:

1 The profits – and therefore the stock prices – of big US-based multinational companies are becoming decoupled from the US economy. It's the inevitable result of an ever-increasing share of the profits of these largely flagless corporations being earned in production and sales offshore, as they open factories and gain market share in emerging Asian, African, and Latin American markets.

   To put this most simply, the Dow Jones Industrial Average and Standard & Poor's 500 no longer measure US stock markets; they just reflect markets physically located in the US that will rise and fall, based more and more on events outside our borders.

2 After a difficult decade, the vast majority of globalized US companies have adjusted to lower gross-domestic-product growth rates in the US and Europe by "right-sizing" themselves. Add to this a sustained era of low wage growth in the US, cheap wages abroad, and little or no inflation, and you have a recipe for sustained corporate profit growth previously thought impossible. The big corporations will profit, even if the world's two biggest economic engines – the US and Europe – remain stuck in low gear.

3 Underpinning the next global bull market is the Federal Reserve's quantitative easing. It lowers long-term interest rates through massive Fed purchases of long-term government bonds. Because the Fed pays for these new bonds by simply printing money, the result is an ongoing flood of new currency onto world markets; this is positive for equities.

4 The fourth bullish macrotrend is the largely unforeseen energy revolution now underway. Today, the technology-driven development of massive reserves of shale gas and oil sands holds the prospect of what once was unthinkable – North American energy independence. Even cost-effective development of arctic hydrocarbon reserves might become feasible. Simply put, we have the makings of another 30 to 50 years or more of cheap energy and attendant higher growth rates.

SIX MORE BULLISH TRENDS

Last December, Citi's Chief US Equity Strategist Tobias Levkovich wrote "The Raging Bull Thesis" on America, which highlighted six trends:

1 US fiscal problems will move closer to a resolution, and equity risk premiums should come down.

2 The US is becoming more energy independent.

3 The US housing recovery should soon emerge.

4 American manufacturing will enter a new renaissance.

5 Demographics are actually favorable for stocks right now.

6 The US is the leader in technological innovation and will benefit as demand for mobile technology continues to boom.

This year Levkovich notes that a lot of recent data is reinforcing his thesis:

"Recent news accounts of a plausible bottoming in the housing market, rising American oil and gas production and resurgent manufacturing activity especially as facilities relocate to the US are giving a boost to the credibility of [last] December's report. Indeed, even the news of 22% wage inflation last year in China has added to the allure of producing products locally versus doing so in Asia."

2 – THE PESSIMISTS

Jeremy Grantham of investment firm GMO has an excellent track record of predicting economic and stock market trends, and is pessimistic about the American economy's long-term growth prospects. He writes in a recent note to clients that the US GDP growth rate that we have become accustomed to for over 100 years – in excess of 3% a year – is not just hiding behind temporary setbacks; it is gone forever. Grantham forecasts that US economic growth will be less than 1% a year for the next 40 years.

Here are some of the reasons he cites for low future growth:

- Population growth peaked in the 1970s, and man-hours worked will grow at only around 0.2% per year.
- Manufacturing productivity is high, but manufacturing is falling as a share of GDP. Currently it's around 9% of GDP. He expects it to fall to around 5% by 2040.
- Service productivity is low and declining.
- Resource costs are rising, and are likely to accelerate.
- Climate change will become increasingly unfavorable. He sees more floods and more damage to crops.

Tyler Durden of the web site ZeroHedge.com is also sounding the alarm. He writes that rapid, dramatic inflows of cash into savings deposits usually coincide with times of great monetary stress. The three biggest episodes in history to date have been the 2008 Lehman failure, the August 2011 Debt Ceiling Crisis and associated US downgrade, and the May 2009 First Greek failure and bailout.

Those three episodes represent the biggest weekly Savings Deposits inflows number 2 through 4. When was the largest ever inflow into Savings Deposits at Commercial banks, *at $131.9 billion in one week?* Last month (the third week of November 2012).

Why? We don't know, writes Durden, but the people who control $5.6 trillion in US commer-

cial bank savings deposits – certainly not the vast majority of the US population who have virtually no money saved up, but the true 1% – just decided to park the most cash on a week-over-week basis into their savings accounts in history.

ARE WE RELIVING THE 1930S?

Amity Shlaes, a senior fellow in economic history at the Council on Foreign Relations, writes that 2013 looks a lot like 1937, and that's not a good thing. In the year after the re-election of FDR, industrial production dropped by 34.5% and the Dow Jones Industrial Average dropped by half.

It's hard to imagine stock indexes dropping by half today, or unemployment rising past 15%, as they did in the "depression within the Depression." But the parallels are visible enough to be worth tracing. They have to do with the danger of big government, writes Shlaes, and can be captured in a few categories:

- **Pre-election spree that sets records.** In the old days, federal spending amounted to about 19% of gross domestic product. It goes up during crises, then drops back. That has not happened this time: even in 2012, when the crisis was long past, the government is spending the equivalent of 24.3% of the economy. In 1936 a similar barrier was breached: that was the year the federal government first spent more than states and towns combined (a stunning shift for a country based on a federation of strong states).
- **Bath of cold water afterward.** After this year's election, President Obama made it clear that budgeting was his first priority. Roosevelt too opened his second term on a sober budget-cutting note.
- **Fearsome attack on the status quo.** Obama is targeting the rich. So did Roosevelt. When Roosevelt followed through in 1937, both with high taxes and his effort to pack the Supreme Court with more progressives, markets shivered.
- **Fallout from first-term legislation.** Obama signed his health-care act in 2010, postponing much of its enforcement until 2013, after the election. Now that the effects of the act are so proximate, markets are wondering whether they or investors can handle the changes demanded. Roosevelt's equivalents were threefold: Social Security, the Wagner Act and the Banking Act of 1935, all laws passed well before the election whose full effects weren't felt until the following year, when they increased uncertainty and lowered business confidence.

Won't an announcement by Obama to cut government size and spending in his second term reassure the markets? No, explains Shlaes, the markets don't believe any reduction would be permanent. Giants are giants. Expansionists tend to revert to expanding government, as FDR did, most drastically, in World War II. The mandate matters more than the austerity chatter. And giant government spooks markets.

Reuven Brenner of McGill University has another concern about repeating the mistakes of the 1930s. He writes in The American:

> Many people draw parallels between today and the 1930s, labeling this the Great Recession. They note the high unemployment rate, referring not to the mismeasured, official statistic, but to the number more than double that rate, which also accounts for those who dropped out from the labor force and are no longer counted as "unemployed." Others worry about the deflationary risk, the dollar devaluation, and the status of the US dollar as reserve currency. Still others worry that the "vital few" – those with high scientific aptitudes and entrepreneurial drive – no longer come

to or stay in the United States, but stay in or go back to the many countries whose Iron Curtains have been punctured since 1989.

Yet the most worrying parallel with the 1930s is one that is not discussed. Then, as today, societies were uncertain about the model of society they should strive for and about how to repair domestic and international monetary systems after wildly varying expansions of credit during and after World War I in the different countries. In addressing these two questions, societies ended up betting on the wrong ideas, which had long-term, disastrous consequences. We may be committing similar mistakes now…

For Western countries with still-deep capital markets, stabilizing exchange rates does not seem a priority at present, as the hundreds of trillions of derivatives mitigate the rates' destabilizing impact. But for the rest of the world, as their capital markets are in their infancy, the instability prevents them from developing.

Unless this trend is reversed – and international cooperation to stabilize exchange rates takes priority – the image of a model of society worthy of emulation will get further blurred. The thinner capital markets, the less they are democratized. As cash flows through governments' bureaucracies – by default the prevailing financial intermediary – this leads to or perpetuates inevitable centralization. Without dispersion of powers – which only deeper, independent sources of capital can create – votes and beautifully written constitutions have little if any meaning. Bureaucracies end up matching talent and capital, and power stays concentrated, votes notwithstanding.

Centralization of powers and the thinning of capital markets are the most dangerous parallels to the 1930s. What model of society will people bet on as these trends continue, and Europe and the United States get into mazes of error? The 1920s and 1930s offer warnings.

3 – TWENTY BIG TRENDS THAT WILL DOMINATE AMERICA'S FUTURE

According to Eric Platt, Matthew Boesler and Max Nisen, writing on Business Insider, these are the 20 big trends that will dominate America's future:

1 The End of The Big Box Retailer
2 America is Aging
3 The Mobile Revolution
4 Weakening Infrastructure
5 The Epic Rise of Student Loan Debt
6 The US Energy Boom
7 Car Culture on the Decline
8 The Partisan Divide Grows
9 A New Healthcare Mandate
10 The Pension Crisis
11 High Frequency Trading Domination
12 The Housing Market Recovers
13 The US Manufacturer Roars Back
14 A Much Less Profitable Banking Sector
15 Agriculture and Climate Change
16 The End of the Post Office
17 American Cities are Economic Juggernauts
18 Immigrants Driving Product Innovation
19 Military Spending Under Pressure
20 The Pharma Patent Cliff