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Newsflash: The World (and the U.S.) Aren't Really in Economic Decline!

By Christopher W. Beale, CFP®

"The only function of economic forecasting is to make astrology look respectable ".
This quote is from one of my all-time favorite economists, John Kenneth Galbraith, 1908-2006.

After a quick, 36 hours trip to Kansas City two weeks ago I caught a cold on the return flight. This cold turned into a respiratory/sinus issue with double conjunctivitis. So, to the delight of my office, I did something that I have not done in the last 3 years---I called in sick! Spending time with my two friends, CNBC and CNN, made me want to get back to work as soon as possible. How depressing to listen to their negative take on everything! No wonder why so many people think "we're going to hell in a handbasket". I'd like to take you away from the negative messaging of the addictive 24/7 news cycle to give you my view of what I see for both the short and longer term economic view of the US and the rest of the world.

Let me start with a brief list of economic "realities" that I've heard both at client meetings and from the "expert" talking heads who fill cable TV air time: interest rates are too low making money too cheap, interest rates will be too high, the Chinese economy is slowing, the Chinese economy will take over the United States', too much global unrest including instability in Russia, our dollar is too strong, our political system is a mess, the income disparity is too wide, there's too much debt in the world.

First, let's start with The United States. In 1945, the United States accounted for more than half of the world's total gross domestic product (GDP) or total output of goods and services.

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Who is Teaching Our Kids and Grandkids About Personal Finance?

By Christopher M. Lee, CFP®

In many households, the topic of personal finances is taboo and rarely talked about and can be uncomfortable. Understandably so with such topics as: *How much do you make? How much did/does this house cost?* If we as parents or grandparents are not educating our future generation, then who is? Many of you may think it is being taught in the schools, but it may not be, as I will explain below.

But first, let's talk about the importance of it and what's at stake. When we do not teach children about personal finance – about managing household budgets or making informed decisions about larger investments in education or a home – we are condemning them to learning it largely and perhaps entirely on their own, if at all.

Above all, people need to know that there are a few big moments in their lives where they are going to confront specific decisions with potentially massive consequences, such as taking out a mortgage or student loan. Do you go to school here or there? Do you buy this house or that one? How much debt do you take on, and on what terms? Do you understand the consequences? These crucial decisions have huge ripple effects in your life, lasting for years. These are significant occasions where you can make a terrible decision by focusing on the wrong things or failing to gather enough information.

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This means that half the world's economic output took place inside our borders. Today the United States economy makes up just fewer than 24% of the world's GDP. Without further analysis we could conclude that the United States has been in a terrible decline over the last 70 years. But economic and financial growth is not a zero sum game. The leveling of the global playing field is not from us going down on one side but both sides going up, albeit at different rates. In other words, the US has absolutely enjoyed steady growth, but the rest of the world; including developing economies (somewhat due to a lower starting point) have essentially taken off like a rocket! In a recent client meeting, the client's accountant questioned whether the 30% international stake allocated to the equity portion of our model was too high. Again I don't expect the average accountant to understand why it is essential to have global diversification. Most accountants don't understand that some international markets have faster growth rates and higher dividend yields than our US markets. The US tax code doesn't show how global diversification can reduce risk and increase returns over time.

Other concerns I've heard from some of you during our client meetings is about the United Sates declining to the point that we will soon be irrelevant to the global economy. This reminds me of when I started as a financial advisor over 3 decades ago. The rhetoric today sounds strikingly similar to the 1980s when Japan was going to eat our lunch economically. The common belief was that we would quickly become a second rate economic power full of lazy workers. Although before my time, I would assume the National conversation was very similar after October 4, 1957 when the Soviet Union launched Sputnik and beat the United States in the global space race.

Let's take a look at what's really happening. Every year, the World Economic Forum ranks countries for global competitiveness. They rank factors such as labor market efficiency, the quality of primary education and higher education, infrastructure, strength of institutions, innovations, business sophistication, technological readiness, in the sophistication of financial markets. In the most recent survey, the US ranked third overall just behind Switzerland and Singapore. The superpower that most Americans are worried about, China ranked 28th, one rung above Estonia.

One last doom and gloom issue the "experts" love to discuss is the decline of US manufacturing. One of the untold stories is that the combination of wage increases in China and elsewhere, plus the availability of cheaper energy, has made it more attractive for American companies to bring their manufacturing plants back to US soil. Foreign companies have also relocated their plants here to be more convenient to the huge end market for the manufactured goods. This trend even has a name. It's called "reshoring". Two recent examples that never made it through the filter of the 24/7 news programming because they aren't negative enough: General Electric moving the manufacturing of washing machines and heaters from China to a factory in Kentucky (the **rumor** that the Kentucky factory was closing did make the news); and Apple moved the production of its Macintosh lines from China to the U.S.

The bottom line is that the US economy is growing, tax revenues are increasing, the deficits have shrunk from post-crisis levels, we are politically stable and have had 46 straight months of job growth. The United States didn't become a second or third world economy in the 1950's or the 1980's and I see no threat of this happening today.

What about the rest of the world?

The same two inherent, universal drivers of US economic growth are also drivers of world economic growth. The first is that all people strive for a better life for themselves and their families. The second driver is the new era of global innovation in which we live.

400,000 people **per day** will enter the middle class over the next decade. Nearly one billion people entered the middle class from extreme poverty in the last 17 years. By 2025 (just 10 years from now) 4.2 billion people of the 8 billion people are projected to be living above the poverty line. This will be the first time in human history that over half the world's population will be living above the poverty line! This is beyond the feel good story. As an investor, this story has huge implications. What do you want when you leave extreme poverty?

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"With excellent time management, you get more living out of life, more time for the people and things you enjoy."

-Brian Tracy, Chairman and CEO of Brian Tracy International

"Trust men and they will be true to you; treat them greatly and they will show themselves great."

-Ralph Waldo Emerson, American essayist, lecturer and poet.

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"Few things help an individual more than to place responsibility upon him, and to let him know that you trust him."

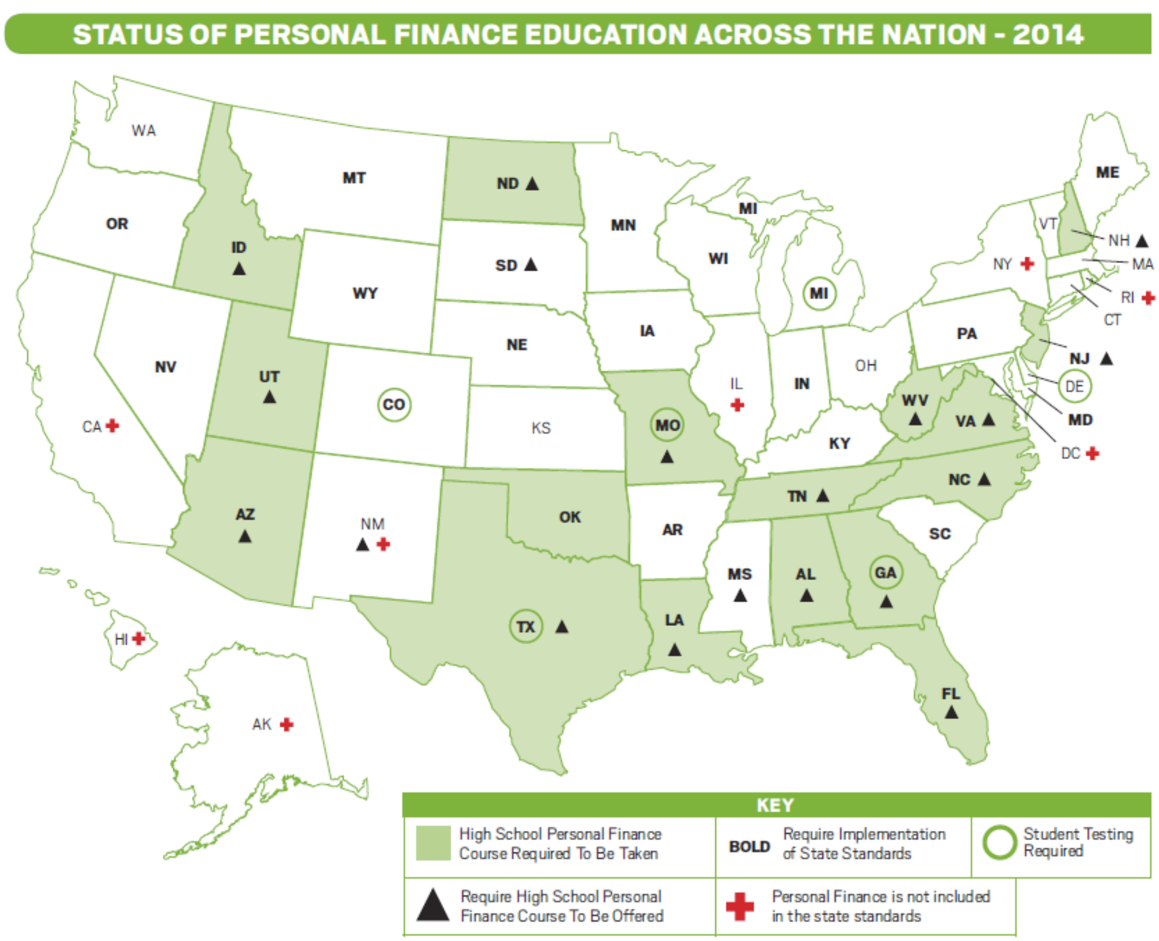
-Booker T. Washington, African-American educator, author, orator and advisor to presidents of the Unites States.

At a minimum, our young people need to understand which decisions are important and not to treat them casually. A key part of sound financial education is learning to distinguish the few large decisions from the many small ones, and to give those decisions a more appropriate amount of consideration.

We saw firsthand what poor financial decisions can lead to in our most recent recession (mortgage crisis) 9 years ago. Consumers made many bad choices because very often they did not know any better and unscrupulous businesses took advantage of those consumers. This neglect of financial education can certainly help ruin the basis that our nation was founded on; a regime of personal responsibility and organized around free markets.

When it comes to building a knowledgeable society, we make sure to teach our young people many things, but then we leave them to learn about personal finances in the so-called "school of hard knocks." This phrase is a facetious one, reflecting that this is no school at all, but a place where people will continue to make the same kinds of mistakes that others have made before them, with the same results and the same regrets.

If we are not teaching our children personal finance in the home, then where are they learning it? Here in Connecticut, it is not a graduation requirement to take a personal finance class, like some other states have incorporated (as seen below):



Source: Survey of the States, February, 2014, Council for Economic Education (CEE)

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This is a question that most of us, thankfully never have asked ourselves, so let me share the research. These people want better health care, better education for themselves and their families, and finally, travel and leisure opportunities. These basic goals will have great economic impact on well positioned companies. 15% of Mexicans earned $15,000 or more in 1995. Today 65% earn at least that much. Disposable income has gone up 149% in the last 17 years in Vietnam. On the way to earning $15,000 annually, we go from walking to purchasing a bike, to a scooter to a car, with the next purchase being a luxury car. Actually one of your first purchases after hitting $10,000 is a refrigerator. Then you purchase more and better food, better beer and better wine. Better is a relative term because you typically buy more animal based food. Again, all these predictable trends have economic opportunities.

What about travel and leisure? Many of the new global middle class will take their first trip on an airplane. US manufacturer, Boeing, predicts the world will need an additional (not replacement but additional) 35,000 jets costing $4.8 trillion over the next 20 years to meet this demand.

Research and development costs in health care totaled more than $145 billion last year alone. Please reread this again. We didn't spend $145 billion for healthcare last year—this was just the research and development costs. $240 billion spent on e-commerce last year would be a big number. But that was not the industry sales last year. One company, Alibaba (the Chinese version of Amazon) had sales $240 billion in sales last year!! The income growth and wealth creation over the next decade will have a transformational impact on the world's economy. In my office I often say "everyone likes progress, but no one likes change". Without change there is no progress. Change is here. And change and progress are disruptive. I think of this every time I try to play one of my 8 tracks or cassettes. Strangely, vinyl records are having a bit of a comeback from hipsters and diehard audiophiles, but downloads are rapidly replacing the CD.

So armed with this knowledge, how do we position your portfolios? I think it is a mistake to just be in the US stock market or US bond market. It would also be a mistake to just be in the international stock or international bond market. This is why our portfolio models are diversified. At New England Capital, we will never share the view of short term traders who measure their time horizon by the second hand of their watch. Let them panic if they want when emotion causes market swings. We will enjoy the long term returns which come from our diversification. I tend to agree with Warren Buffett who said "when we own portions of outstanding businesses with outstanding managements, our favorite holding period is forever".
I hope you share my deeply held long term belief about diversification. Diversification is always my best friend on my worst day.

Finally, don't interpret my rational optimism as a prediction of a future without economic challenges or market declines. Thankfully, there will always be challenges. Challenges force human beings to grow, to strive to be better. Markets and investments will always swing up and down. To which I say "great" because these swings, caused by emotion, create opportunities for the informed investors. There are times to be fearful. The current reality does not support the fear-mongering rhetoric however. The world and US economy may not be to our liking or coincide with all our beliefs, but it simply doesn't portend economic doom. Hopefully the facts in this article have at least made you rethink your desire to take your gun to the cabin in the woods with your gold Krugerrands stuffed under the floorboards and a few years of bottled water and canned goods in the pantry. Now you can turn off the television and breathe easier.

You can't shake hands with a clenched fist."

-Indira Gandhi, Third Prime Minister of India

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Finally, there's an interesting comparison. The King James Bible totals around 700,000 words, whereas the U.S. Federal Tax Code numbers 3.7 million words.

Year after year, more and more states have begun adopting having a personal finance class as a high school graduation requirement (the most recent being Florida) and the total is now up to 17 states.

As some of you know, this topic is near and dear to my heart, so much so that I have volunteered and am currently president of the Connecticut Jump$tart Coalition www.ctjumpstart.org, which is a non-profit organization with individuals and organizations representing business, government and education who have joined together to improve the personal financial literacy of Connecticut's youth.

In a survey conducted in 2012 (through the FINRA Foundation's National Financial Capability study[1]) **89% of American parents surveyed thought that a course in personal finance should be a requirement for high school graduation** AND according to Charles Schwab's 2011 Teens & Money Survey[2] **86% indicate they'd rather learn about money management in a class before making mistakes in the real world**. With that being said, CT Jump$tart has been pushing for CT legislation to require a personal finance course for high school graduation. We envision a world where our young people understand budgets, savings, investments, and credit. Our children need to know why we have bank accounts, why we keep track of our bank balances, why we should all check our credit reports regularly.

We are intent upon teaching them that worms are classified as annelids but we do not teach them why it is important to save for retirement. If we teach them subjects like science, history, and math but do not teach them anything about personal finance, then we need to understand that we are making a conscious choice to release them into a financial world where they have to fend for themselves.

CT Jump$tart believes that the groundwork is being built in CT for a bill that proposes just that thing. In this current legislative session, Senator Ted Kennedy, Jr. (D-Branford) proposed Senate Bill (SB) 319. As of now, the bill does not have a "lot of teeth in it" as its Statement of Purpose is *to ensure that students of public high schools and public institutions of higher education in this state receive instruction in financial literacy.* It is nothing close to a mandate, but none-the-less, it is a start – they are talking about it at the Capitol, which is a good thing!

Currently, the groundwork in Connecticut has already started, as 90% of the public high school systems currently OFFER a personal finance class. The problem is that it is an elective and the classes usually fill up quickly and are limited to 20-30 students. With that being said, 10% of public high school systems don't even off a personal finance class, which is a shame. On the positive side, 8 cities/towns (or 6% of the public high school systems) have already made it a graduation requirement (Cheshire, Groton, Middletown, Montville, New Fairfield, North Stonington, Seymour, and Simsbury). Kudos to them!

Since we are still a way off (at least in CT) to making a mandate for a personal finance class in high school, my next article will discuss ways at home that you can teach personal finance basics to your kids or grandkids – since chances are they are not learning it at school!

[1] Council for Economic Education http://www.councilforeconed.org/resources/local-affiliates/

[2] [Charles Schwab, 2011 Teens & Money Survey, April 2011, http://www.schwabmoneywise.com/public/moneywise/calculators_tools/Families_money_surveys/teens_money_survey?cmsid=P-4579457&lvl1=calculators_tools&lvl2=families_money_surveys]