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CLIENT BULLETIN

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- ***Labor Woes***

In the simplest of models, the economic output of a country is the product of labor and the productivity of that labor. With the average hours worked per person (a measure of productivity) now having achieved a steady rate, the U.S. needs labor force growth. This is a problem for the American economy right now. Over the past five years, the U.S. labor force, defined as those over age 16 who are working or actively looking for a job, has risen by only 2.3 million people despite an increase of 10.1 million in the age 16+ population over the same time period. (U.S. Census Bureau)

- ***Why?***

Conventional wisdom is that millions of Americans have given up looking for a job because there are no jobs out there. The numbers, however, flatly contradict this theory. When surveyed, the number of individuals stating they have given up their job search has declined from 2009 to 2014. The problem seems to be mostly one of demographics. At age 65 Americans become eligible for Medicare and social security eligibility begins shortly thereafter. The number of people dropping out of the labor force has always jumped at age 65. Thanks to the surge in births in the U.S. following the end of World War II, the number of people who will turn 65 over the next 15 years is swelling. This declining labor force participation could be a headwind for U.S. economic growth in the long run.

- ***Future Path***

None of this is pre-ordained. Smarter policies on immigration could boost the number of skilled workers entering the U.S.; smarter policies on entitlements could give more people the incentive to work rather than retire prematurely; and a permanent lowering of the corporate tax rate could repatriate billions of corporate dollars which in many cases could be used to boost capital spending and worker productivity. Congress needs to get to work.

- ***Emerging Markets***

If Washington can't get some of these long-term agenda items done and the U.S. does see slower economic growth, then investing overseas, especially in emerging markets, will become even more important. Emerging markets have displayed stronger trend growth in both labor and capital than the U.S. and that advantage should continue over the next decade – more than 90% of the world's population under age 30 lives in emerging markets. (Source: Mckinsey & Company)

- ***Time for a Change?***

Apparently Americans don't have a lot of confidence that politicians can get jobs like these done. Congress currently has a lowest-ever 15% approval rating. Change may be coming however - there are 535 members of Congress (100 senators and 435 elected officials in the House of Representatives) and 468 of them (87%) are up for re-election on November 4th. (Source: Gallup).

- ***Trade Winds Blowing***

Have you ever heard (or said) "we don't make anything in this country anymore" or "everything is made in China these days?" The reason may be that the United States has run a trade deficit (i.e. we buy more goods and services from other countries than they buy from us) since the mid-1970's. This large and persistent trade deficit acts as a drag on our overall GDP because sales of exports are added to GDP while purchases of imports are subtracted.

- ***Goods vs. Services***

The trade deficit is the sum of two very disparate numbers - we have a large trade **deficit** on the ***goods*** side ($740 billion in 2013) and a **surplus** on the ***services*** side ($231 billion in 2013). Importing more goods and exporting more services isn't necessarily a bad thing. The jobs created in the services export sector (professional and technical services, education, motion pictures, travel, data processing etc.) have a median hourly wage that is more than 20% above the median hourly wage in the manufacturing sector. 8.4 million jobs have been added in the service sector since 2010 while just 1.5 million have been created in the manufacturing sector. And while much is made of the maligned "hamburger flipper" service job, most U.S. service-related jobs require advanced degrees and skills. (Source: U.S Department of Commerce)

- ***Continuing Trend***

This improvement in our trade balance has two powerful forces behind it that will most likely continue moving the U.S. toward, dare I say it, a trade surplus. The first is the fracking revolution. As U.S. energy producers have been ramping up production, petroleum imports have been falling steadily since the end of 2010. Additionally, competitive energy costs make the U.S. an increasingly compelling place to do business for multinational corporations. The key advantage to operating in the U.S. comes from being physically close to a cheap energy supply so the decision of a major industrial company to build a plant in the U.S. compels its suppliers to do likewise.

- ***Emerging Markets Again***

The second force behind an improving U.S. trade balance is the aforementioned emerging markets. Historically the global economic benefit of emerging countries has been the cheap labor they provide. Now, however, there is increasing evidence that a second stage of economic development is taking place in many emerging countries – the growth of a consumer class. Just eight years ago, total emerging world consumption was less than ½ the size of U.S. consumption. As of the end of 2013, emerging world consumption totals 90% of U.S. consumption. As expected from these figures, the U.S. trade ratio with emerging countries has improved sharply as emerging markets overtake the U.S. as the global consumer leader.