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MARKET INSIGHTS

From RiverPoint Capital Management

Slow Growth – The New Normal or Just a Lull?

The U.S. economy has entered a new environment, where 2 percent real economic growth, as measured by real GDP, is considered "normal." For reference purposes, our economy has grown by 3.2 percent, on average, per year – including recessions – since the end of World War II. Despite the "new normal" of slower growth, we don't have to accept this fact that the U.S. can't reasonably expect to grow much faster than 2 percent on an annual basis. Our economy has proven to be resilient in the past and gotten out of moments in time where economic growth looked bleak at best. We believe slower growth is not a pre-determined destiny, and that with a few changes we can get back to growth rates seen pre-2000.

Track Record

To start off, let's take a look back in time and examine our country's historical economic growth record. From 1950 through 1999, our economy grew by an average of 3.6 percent per year. This record wasn't particularly spotty, but the growth rate was rather consistent.

Decade	Average Annual GDP Growth Rate
1950's	3.8%
1960's	4.5%
1970's	3.2%
1980's	3.2%
1990's	3.2%
Average Growth Rate	**3.6%**

Source: World Bank

As can be seen, economic growth, on average, was incredibly consistent during the three decades ending in 1999. True, there were good and bad years, but on a longer term, systemic basis, economic growth was rather steady. Then came the year 2001.

Decade	Average Annual GDP Growth Rate
2000's (starting in 2001)	1.6%
2010's (through 2015)	2.1%
Average Growth Rate	1.8%

Source: World Bank

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The average annual growth rate over the last 15 years has been **half that of the longer term 50-year American experience ending in 1999.** What has happened? Why has our growth rate over the last decade and a half been reduced by 50 percent as compared to the long term average? A few economic facts have impacted the growth of GDP in the U.S. since 2000. These facts are:

- **Private Sector Debt Structure:** By most measures, the consumer side of the U.S. economy has been busy paying down debt over the last seven years. This debt grew explosively during the housing boom in the early 2000's. Household debt (including mortgages) has fallen to 78 percent from a peak of 96 percent in 2009. Debt-to-GDP levels are now at the same level we witnessed 15 years ago. As people are paying down debt, consumption growth rates slow, negatively affecting overall GDP growth rates.

- **Demographics:** Our nation is getting older. The average age for U.S. citizens is now 37. Fifteen years ago that average stood at 35. It is reported that 10,000 members of the baby-boom generation turn 65 every day. Each year for the next 15 years, 3.6 million Americans will celebrate their 65th birthday. As people age, they tend to change their spending habits by purchasing fewer large ticket items and spending more on health care and vacations. Additionally, as people age, they already have most of the items they need or want. Their discretionary spending growth rates and productivity growth rates tend to contract, leading to slower overall economic growth.

Our nation is facing debt and demographic challenges; but there have been significant positive changes which have occurred regarding these two factors over the last seven years. So while **our economy still faces growth challenges, those challenges should be less severe than has been the case over the last few years.**

Continuation of Slow Growth is a Choice Not a Pre-Determined Destiny

Much of the slowing in growth can be attributed to misplaced economic policies driven by our leaders in Washington. The U.S. has faced growth challenges before and put in place the correct policies to lift the country out of its malaise…the point being, these are not unprecedented times. With leadership, the U.S. can resume its normal long term growth path into the future.

- **U.S. Pre and Post 1982: Prior to 1982, the United States was an economic giant in decline.** We were intimidated by forces in the Middle East, inflation was running rampant and interest rates were well above 10 percent. After President Reagan was elected, and after Fed Chairman Volker drove down U.S. inflation, unemployment fell, productivity soared, fiscal and trade surpluses occurred. The country became the unchallenged global leading innovator in health care and technological capabilities. **Ronald Reagan kick-started all of this in the early 1980's by deregulating the economy in a number of ways. Like him or not, his policies worked well – and led to 18 years of prosperity.** Ronald Reagan, and other leaders, chose to alter non-productive policies in favor of pro-growth policies.

In the example cited, neither government spending nor central-bank policies could drive all the changes needed. Our central bank members, along with many CEO's of large corporations in the U.S. have been urging policy makers in Washington to put their differences aside and move toward instituting pro-growth policies as well. A plan to drive healthy, sustainable growth must be balanced in nature and include trade and tax initiatives as well as prudent government spending and central bank policies. This is not rocket science.

Looking Ahead

Despite slower growth, the U.S. economy does appear to still be on solid footing. Recent economic data has shown improvements in the housing market, a consumer that continues to spend, employment and wage gains that remain solid, and a service sector in the US that shows no signs of deviating from its firm growth path. We remain focused on these facts that illustrate the US economy is steady, albeit not robust. As we look ahead, we are faced with chatter about a Fed rate hike in June or July, the United Kingdom prepares to vote on whether they will remain a member of the European Union, and a presidential election that takes place this November. While the outcome of these events will not derail steady US growth in our opinion, they will likely contribute to elevated volatility in the stock market and perhaps keep it range bound in this summer period. We believe the fundamental trends set us up nicely for a better fourth quarter once we get these events behind us. Couple this with easier earnings comparisons in the second half and this could be just the items the market needs to move higher through the end of the year.

Given our positive view of this slow and steady U.S. backdrop, we remain near the mid-point of our equity allocation ranges for client portfolios. Looking out a bit at the intermediate and longer term, we do believe a resumption of 3+ percent GDP growth is achievable. For now, we are comfortable in this slower growth chapter with lower inflation while we wait to see how this evolves. We need to remember to be careful what we wish for. Accelerating growth, if it becomes too robust, tends to bring with it fears of inflation and angst that the Fed is behind the curve in holding rising prices at bay…and this can ultimately lead to recession. Steady as she goes for now is just fine. Stay tuned.