

## **Seven Billion People: How the World Becomes a Smaller Place**

According to estimates supplied by the United Nations, sometime during the day on October 31, 2011 the world will be inhabited by seven billion people for the first time. This is no small achievement. It took the human race an estimated 250,000 years to reach the first billion in population around 1820. This was achieved with the help of the industrial revolution and progress in public health and sanitation. The second billion mark was not achieved until around 1940. The third billion arrived around 1959, with the four billion mark attained in 1974. Five billion people were around in 1987 and six billion in 1999. If current trends remain intact, the world will be called upon to support nine billion people by 2050.

Parallel to this trend, the population of the world is also aging. Due to China's one-child-per-family policy and the propensity of affluent societies to bear fewer children than required to support their population level over time, the number of people over 65 in the world is growing faster than the overall population. The United States was somewhat immune from this trend for years by having a relatively liberal immigration policy. Since 2001 the policy has been restricted and the average age of the US population has been rising at a rate comparable to Europe as a result.

Since both population and demographics drive investment threats and opportunities, the implications of the above are significant. While the number of people living increases, the rate of growth is slowing down, at least in most of the world outside of Sub-Saharan Africa and South Asia. Still, there are issues of food and water availability, population density, increasing infrastructure, and rising living standards.

The trick to capitalizing on these trends from an investment standpoint is to know both the trends and the localities the trends will impact. A rising world population will have less impact on the parts of the world where population is declining, such as Europe or Russia. Industrial raw materials that can move freely should be in demand wherever population increases, whereas land demand may be restricted by nationality. Economic development should have less of an impact in terms of energy and materials as more recently developed countries benefit from the gains made by the developed world. For example, cell phone technology has enabled entire countries to be connected for a fraction of the cost of the earlier generations of landlines.

Economic benefits to world growth will flow to both developed and developing countries, so long as there is free movement of goods, labor and capital. As developing countries will have a younger work force and developed countries a willingness to pay up for labor, an exchange of sorts can be arranged.

The countries that do not have free movement of labor and capital will suffer. For example, Japanese companies are so hobbled in the hiring of foreign health care workers that some are constructing assisted living facilities in the Philippines for Japanese seniors. This is being done as a way of providing for them without importing non-Japanese labor into Japan. Such a mind-set against foreign labor may help to explain the fact that the Japanese economy has been stagnant for the past 20 years as its population shrinks and grows older.

In terms of companies, those attuned to demographics and foreign markets will have an advantage over those who are not. Even domestic companies will feel the effect of higher wages paid elsewhere, taking pricing pressure off domestic goods. In China the lowest wages have increased almost 20 percent this past year due to labor shortages. Add to this the cost of maintaining a long supply chain and “re-shoring,” or bringing back manufacturing to the US, begins to look more attractive. This development has significant inflationary implications that will manifest themselves over time.

Thus higher population in itself is less a factor than how people and countries react to the same. History shows that population growth slows as countries become more affluent and educated. Thus the race is not so much between people and resources as people and economic development. As even the Communist Chinese discovered, the cure for poverty and population growth is the application of capitalism and economic opportunity, even if under another name.

## **The Economy**

After underperforming relative to forecasts in the first half of the year, economic activity is now outperforming reduced expectations in the second half. This reinforces the idea that there will not be a second recession in the near future. The outperformance in the third quarter pulls the economy ahead of its pre-recession levels for the first time in 15 quarters. This is about three times longer than it usually takes for an economy to recover from a recession.

Sectors showing strength include domestic auto production, which has benefitted from Japanese and now Asian calamities, capital goods and exports. Consumer spending outside of housing is displaying great resilience. Government spending is cutting back at the state and local level and may also be cut at the Federal level as well. This last trend bears watching as the greatest threat to the economy going into 2012.

### **Interest Rates**

US Government rates have shown a sharp reversal since October 4. On that date the yield on ten-year Treasury bonds was 1.41 percent. Yesterday the same bond yielded 2.40 percent. An investor unlucky enough to have purchased the bond on October 4 and held it is showing a 13 percent decline in the value of the investment.

This performance reflects the decline of the panic that gripped the markets during the Greek Crisis and threat of US Government shutdown. As investors become less worried about the future, interest rates will drift upwards. This acts at cross-purposes with the goal of the Federal Reserve to keep interest rates low to encourage consumption and investment. The Federal Reserve has really no other means to pump up the economy than to keep money cheap. Low interest rates would be less important if Congress crafted a fiscal policy that provided near-term stimulus to the economy, but that is pretty much wishful thinking at this juncture. If anything, the report of the so-called "Super Committee" will advocate a decline in fiscal stimulus rather than an increase, at least over time. What is hoped is that the fiscal cuts will take place in future years when the economy is better able to sustain them. To reduce fiscal stimulus at this time would be analogous to discharging a patient while still in intensive care.

### **Inflation**

While domestic employment remains slack, the first stirrings of inflation are being felt. The sources are a cheaper dollar, which makes domestic goods in general and especially farm products cheaper to foreign buyers who bid their prices up, and foreign demand which raises the cost of goods in the home countries, making competing US goods more attractive. A factor with food prices is the lack of migrant farm labor due to various anti-immigration initiatives, which is forcing up produce prices as well as canned goods, as crops are not being processed and shipped in a timely manner.

All these factors will be present in 2012. While higher interest rates may strengthen the dollar, it will depend on interest rate trends elsewhere to know how the relationship between the dollar and interest rates holds up.

## **The Stock Market**

With the perceived progress in the European Union over a settlement regarding the debt of Greece and by implication all EU countries, the market mounted a powerful rally yesterday, going into positive territory with conviction for the first time since summer.

The second event to occur for this rally to be enduring is some proposal by the US Congress to reduce the Federal deficit in future years. The report of the so-called "Super Committee" is called for by November 23, the day before Thanksgiving. If no consensus is reached, automatic reductions in both defense and health care will be made.

While there is a great deal of posturing going on by both sides, hopefully there is an appreciation for what is at stake. The original threat to shut down the Federal Government over the debt ceiling is what triggered the stock market slide in August and September. A resolution of the deficit crisis, which will be made on a ten-year projection, will give lawmakers a chance to time the cuts to the perceived future health of the economy. If ever there were a time to let political reality get in the way of principle, it is over this issue. Financial markets cannot handle another impasse.

## **Staff Additions**

We are pleased to announce the addition of two people to the staff of Barnett & Company.

**Deborah Knowles** has joined the firm as the Director of Internal Administration. In this role Deborah will be responsible for accounting, compliance and performance measurement. Deborah has both a CFA and CPA certification.

**Laurie Shipley** has joined Barnett & Company as the firm's retirement plan expert. Laurie will be working on 401(k) and other retirement plan programs for employers. Previously Laurie worked for Comcast as well as several non-profits in Chattanooga. Laurie and her husband are both career Naval Officers.

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October 28, 2011

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