CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

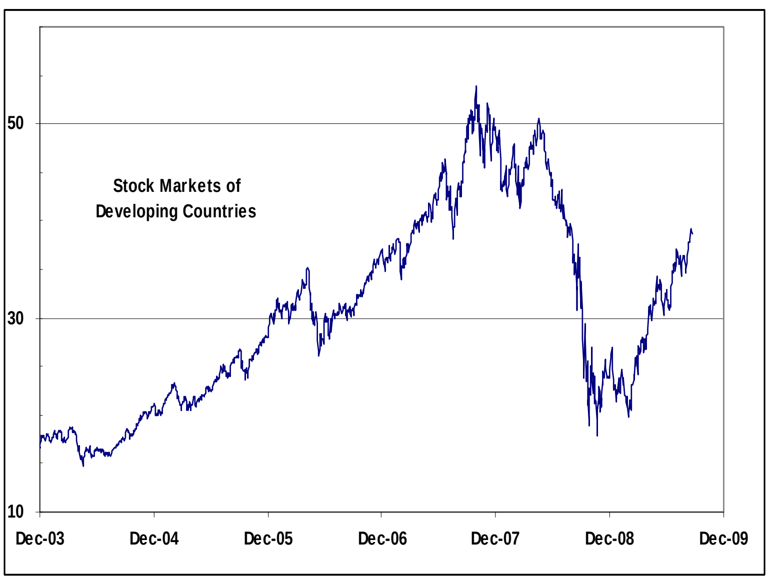
September 22, 2009

The View Ahead

What will unfold in the world's economies and in financial markets over the next five to ten years? Rather than considering the recent past and the prospects for the period just ahead, let us assume that the crisis of the last eighteen months is over and take a look a bit further down the road.

Stock markets of developing countries grew strongly in the early part of this decade. Economic conditions and the flow of investment capital are likely to drive them far higher in the coming decade.

Two significant economic trends have been unfolding in recent decades: the growth of developing economies, especially in Asia, and the relentless expansion of credit in the United States. Economic growth in China, India, Brazil and many other developing countries has been accompanied by what may loosely be called 'globalization', including freer flow of goods and capital around the world and the opening up of financial markets in developing countries. Rapid credit growth in the United States is a phenomenon that began in the 1980s. Since then and until last year, Americans took on more and more debt in relation to America's economic activity. The collapse of home prices since 2006 caused massive defaults on this debt and triggered a move by Americans--individuals and companies--to save rather than to borrow.



There is not room in this letter to discuss these phenomena more fully, but the interplay of more saving and less debt by Americans, with continuing strong growth in developing countries, suggests that financial markets in developing countries will attract far more capital in coming years. As capital finds its way into stock markets in these countries, the prices of investible assets in those countries will rise. In short, it seems likely to me that the growing economies of the developing world will prove to be very successful investments in the next decade.

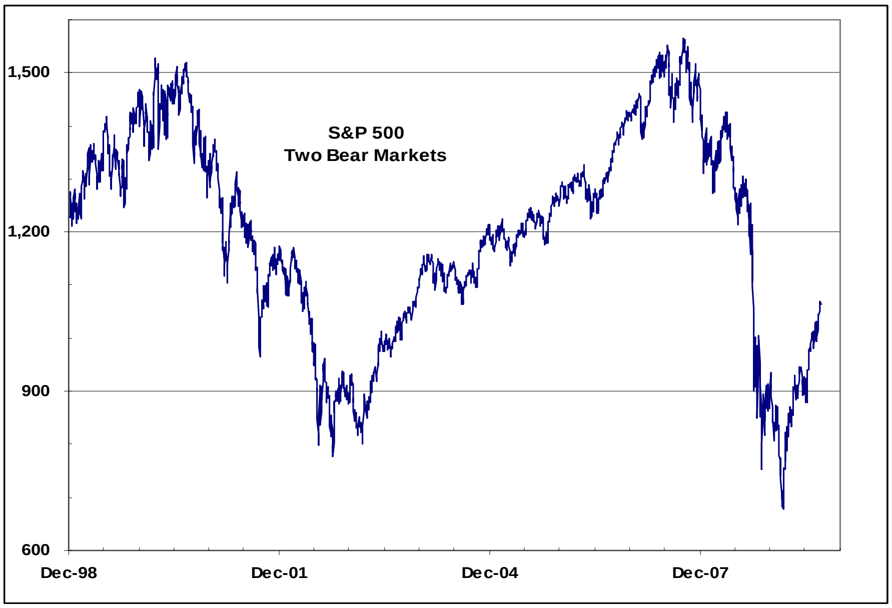
America's economy surely will grow in coming years, as will the US stock market. The same applies to the economies and the financial markets of the western European countries. But it seems a near certainty that America's slice of the world's economic pie will shrink as economies of developing countries grow faster. Core's clients have had meaningful investments in developing countries for several years; my expectation is that we will increase the portion of our clients' capital allocated to emerging markets in the coming months and years.

By

Jack Mayberry

Take China as an example: a significant amount of its growth over the last decade has come from investment in its roads, bridges, railways, airports, factories, and the like. (We used to call this public works, now the favored locution is infrastructure investment.) Export activities have also grown substantially. It is probable that infrastructure investment and exports will continue to be strong, but to these will be added growing spending by Chinese consumers. Growing wealth and spending by consumers in the developing world will probably itself be another force to drive stock markets in these countries higher.

The problems that unfolded in the wrenching crises of the last eighteen months are by no means fully (or satisfactorily) resolved, but the tools employed by central banks and governments tend to produce outcomes we can already observe, that is, rising prices of stocks and other risk assets. As the financial crisis subsides, the markets are hinting, it seems to me, at what lies ahead. Massive credit support and direct infusions of capital by the government into banks and other failing industries, huge government spending to stimulate economic activity, zero percent interest rates on short-term deposits, direct purchases of securities by the Federal Reserve and other central banks all are directed to arrest the deflationary spiral. In effect, the Fed and the government seek to forestall the impulse by the private sector to save: their policies encourage a new round of credit creation.



Central bank and government actions are driving investors away from safe investments--money market funds yield next to nothing--and into risky assets like corporate bonds and stocks. The Fed and other central banks assure us that these policies will continue for a long time. This is a very positive force for investment markets.

Thus, we have in place the ingredients for very large investment gains in the rapidly growing economies of Asia and Latin America. Government policies impel investment toward equities and other risky assets. Economic growth will be strongest in the developing economies; dynamic growth in those countries will be a magnet for investment from the United States and elsewhere. Fine investment returns from our investments abroad seem quite likely.

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A caveat is in order. My notions about economic growth and the movements of investment capital over the next period of years are reasonable, I submit. Experience teaches me that having an informed and rational point of view about the future is useful in investing. But predictions are quite perilous. We are by no means making a set of investments in 2009, then heading off to the beach for the next decade. We remain alert to risks, political and financial; we are prepared to act quickly in response to problems that will certainly arise.

It is certainly appropriate--after this fantastically dramatic banking and financial system crises of the last eighteen months--to look ahead calmly and think about the future. At present, the crises seem to be resolving themselves, although in a muddled and quite imperfect way. And, at present, the future has some bright aspects. I have tried to outline them in this letter; we will work to realize their benefits.

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