MARKET OBSERVATIONS
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SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Competitors

From the late 1980s to the early 2000s, globalization was a dominant economic theme. Net benefits were envisioned for all participating economies. While competition was expected, collaboration was anticipated. In recent years, globalization has fallen from favor as benefits and costs have been assessed and the net result has been unfavorable for many. To be sure, millions of individuals around the world have been lifted from poverty, especially in emerging market economies. But the largest economies now view each other more as competitors than collaborators. A review of some key measures can provide perspective for portfolio weightings among major markets in the period ahead.

PERSPECTIVE

Annual real (net of inflation) economic growth rates for the four largest economies are shown in Chart I. The time frame captures pre-Great Recession conditions through most recent, same-period data for all economies. China clearly has been a net beneficiary of globalization, but with high yearly variability. For the total period, China's real growth compounded annually at +10.8%. While rebounding sharply from the pandemic, China's economy has stalled most recently. At the same time, Japan enjoyed high real growth in the 1980s and the early 1990s but has struggled since. Japan's real growth was quite anemic at +0.6% for the whole period of Chart I. Europe's +2.5% whole-period growth exceeded the +2.0% rate for the USA but with more years of decline.

Growth is important for the viability of an economy over time, but so too is the rate of inflation. A low, stable rate of inflation underwrites decisions that support higher real growth. Chart II shows annual rates of inflation for the four largest economies. For the whole period, rates of inflation for the USA, China and Europe were comparable – +2.5%, +2.4% and +2.3% respectively. Japan struggled to ward off deflation. While the whole-period inflation rate was +0.6%, deflation occurred in five years including a three-year run from 2009 to 2011. Japan's inflation experience and its adverse impact guided other economies to pursue low, stable inflation targets. The inflation outlook ahead remains a bit uncertain for each economy.

Real growth and low, stable inflation may be necessary conditions for favorable investment outcomes across economies. Chart III shows annual rates of return in U.S. dollar terms for broad stock indexes of the four largest economies. Extreme returns for China 2006 (+132.9%) and 2007 (+181.4%) were truncated. These outcomes contributed importantly to the whole-period China return of +10.3%. The whole-period USA stock return was highest at +10.9%, achieved with lower volatility. Returns lagged for both Japan and Europe. Currency exposure comes with investing across economies unless it is offset through hedging strategies. Relatively favorable growth and inflation often are reflected in favorable currency trends.

INVESTMENT IMPLICATIONS

New U.S. presidential leadership already has identified economic policy initiatives that place a clear priority on the country's own interests. The potential for extensive tariffs speaks to this priority. A new globalization regime appears to be emerging in many economies, the impacts of which are yet to be seen. If adoption of "beggar-thy-neighbor" policies were to emerge, growth and inflation outcomes could vary widely by economy as could investment returns for both stocks and bonds. Diversifying among and within asset classes once again will be an important strategy for managing portfolio risks.

CHART I

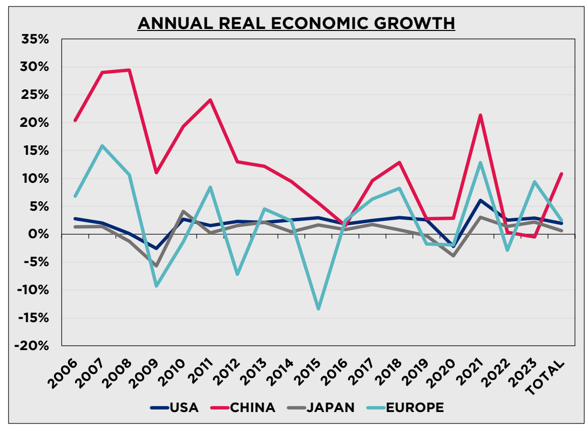

CHART II

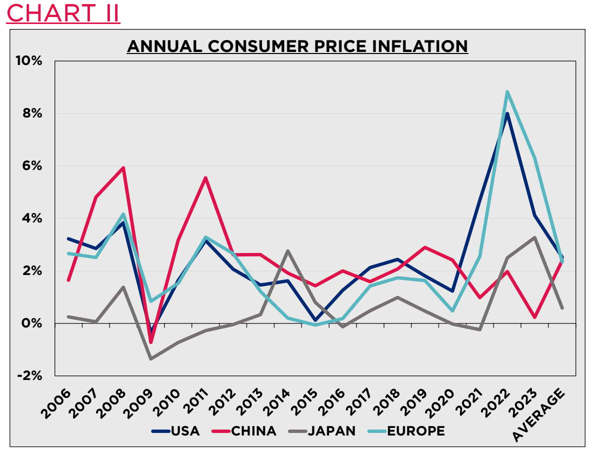

CHART III