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Illuminating Wealth, Accelerating Investments

December 6, 2013

Top "Turtle Trends" of the World

It is understandable that most Americans pay little attention to the "marginal improvement" of economic indicators (especially those of other countries) when the perception of "material deterioration" in the effectiveness of our government is so frequently and brightly highlighted by media pundits. Nonetheless, it is the slow and persistent forces that have the greatest long-term impact even though they are hardly noticed as they go about their evolution. Government shutdowns and faulty national healthcare websites are hard to ignore in the short-term, but they are easy to overestimate in terms of their long-term importance. The opposite is true for incremental, cumulative and "sticky" advances in communications, technology and knowledge in general, as well as major, secular, cultural trends. The world's "turtle trends" are similar in that they are almost imperceptible in the short-term due to their slow, but methodical pace, but their ultimate impact cannot be ignored.

Turtle Trend #1: China Matures

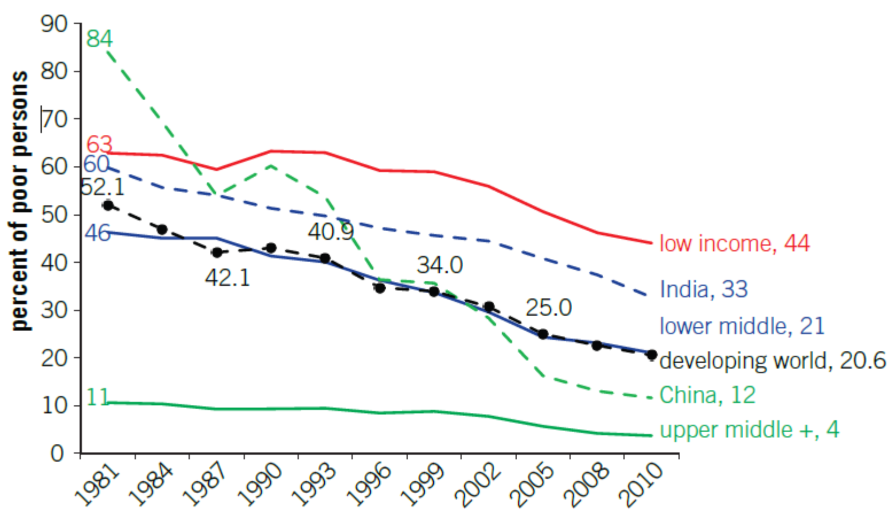
China has been transitioning from a communist economy to a partially capitalist economy for over 30 years. Its economy grew at a very high rate for most of that time, but around 2000 it had a very sharp acceleration in GDP growth as "offshoring/outsourcing" business practices became "*de rigueur*":

The global financial crisis brought that era to an abrupt end, but as the crisis subsided we found things had fundamentally changed in China. The supply of employees eager to move to the cities, work long hours under less than desirable conditions for meager wages, dwindled. As a result, labor costs rose and China's manufacturing cost advantages shrank. As this fundamental change rolled its way through the Chinese economy, the Chinese government also came to the realization that an economy whose primary driver was government-directed capital investment was not sustainable as it was resulting in the misallocation of resources (which were in short supply largely due to China's "investment binge"), poor productivity gains and dangerous "bubbles" in areas such as credit, land/building prices, pollution and widespread corruption. China is now trying to shift towards an increasingly consumer-driven (vs. government-planned) economy that is more market-driven and less controlled in term of capital flows (both in and out of the country). This transition will be slow, but it has negative price implications for items such as cyclical commodities and positive price implications for both real and financial assets in other countries as capital controls are relaxed and as wealthy Chinese investors buy assets outside their homeland.

Turtle Trend #2: Frontier Markets Get Their Turn

As China cedes the "low cost manufacturer" crown, many lesser developed countries will have a chance to "bid" for the business, or at the very least, use China as an example for how a country can transform itself into a more prosperous nation if it adopts some meaningful reforms. What are some of the fastest growing countries these days? Nigeria, the Philippines, Iraq, Indonesia, Turkey, the United Arab Emirates and Argentina. These countries vary widely in their geography, political heritage, national wealth, economic stability and caliber of "business friendliness", but what they do share is a potential to benefit most greatly from advances in technology, access to investment capital/education and/or a variety of economic development "roadmaps" that have been followed (some successfully....others, not so much) by China, South Korea, Russia, Eastern European nations and others over the past 50 years. Selecting what mix of capitalism, open trade, socialism, government planning and/or political system works best for a given country is very complex, but the world seems to be getting it right more often these days as extreme poverty rates have dropped by over half since 1981:

The Developing World Has Experienced a Large Decline in Extreme Poverty Rates

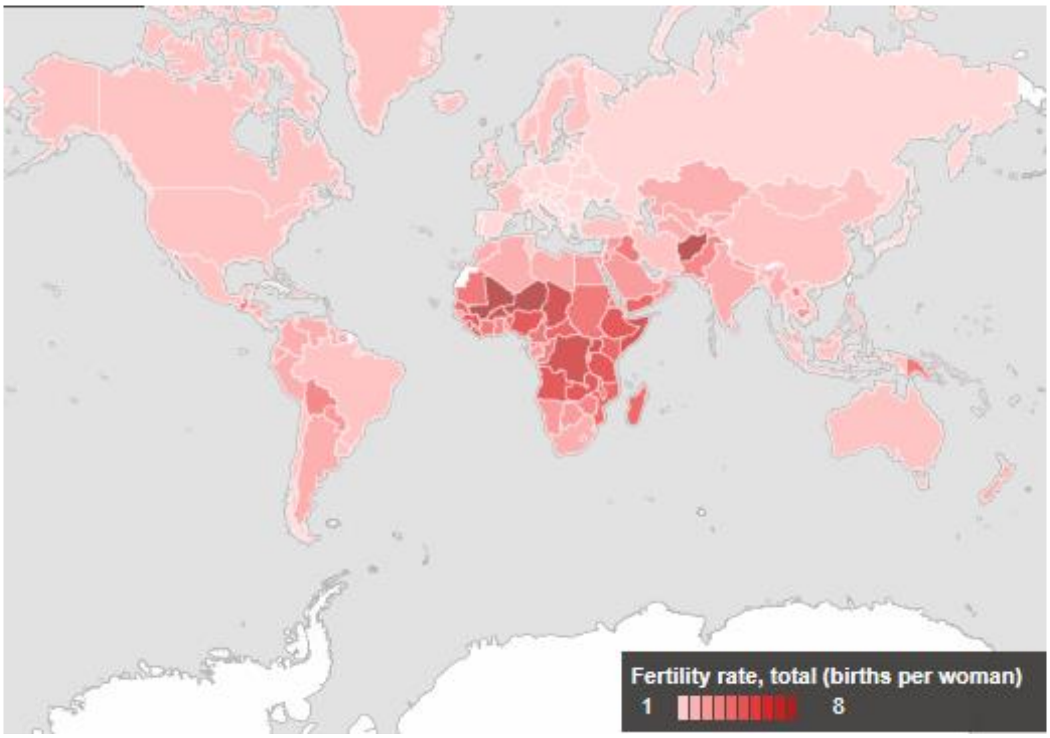


Source: World Bank staff estimates based on PovcalNet

<u>Turtle Trend #3: The More Prosperity, The Fewer People to Enjoy It</u>

There is a well-established relationship between a rise in a country's economic prosperity and a corresponding fall in fertility rates within that country's population. There are many reasons for this, such as greater access to birth control, women obtaining higher levels of education/entering the workforce (resulting in delayed marriages/age at which first child is born), less rigid gender roles (greater cultural acceptance of a woman choosing a professional career over full time motherhood) and less economic motivation due to urbanization (agriculture-based societies tend to value larger families). Most countries around the world have fertility rates that are barely above (if not below) the 2.1-2.3 births per woman "replacement rate". The largest exceptions to this general condition are many of the countries within the African continent:

<u>Global Fertility Rates</u>



Source: The World Bank, 2009-2013 Estimates

The recent change to the Chinese government's "one child policy" is not likely to have much impact on the slowing growth in global population:

"Demographers at the United Nations Population Division (UNPD) and the U.S. Census Bureau calculate that Chinese fertility levels today are far below the level necessary for population replacement. By their reckonings, <u>current childbearing patterns, if continued, would mean each successive generation would shrink by 25% (UNPD) or 27% (Census Bureau). Official Chinese estimates, and the work of some independent Chinese demographers, suggest an even steeper drop</u>."

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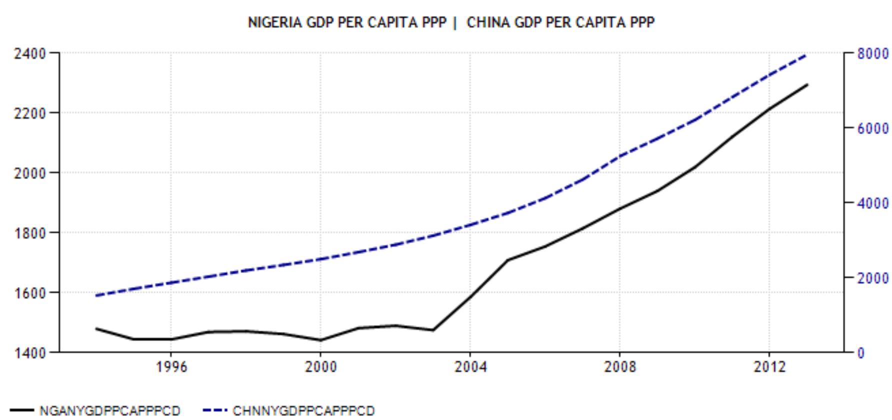
"These fertility estimates are nationwide averages. In China's cities, birthrates are far lower. In Beijing and Shanghai, for instance, official estimates suggest that women are having far fewer than one birth per lifetime (around 0.7 on average). In such settings, scrapping the One Child Policy will make no demographic difference whatsoever: People aren't even using their given birth-quota permits now." – Wall Street Journal, 11/26/13

It is particularly difficult to make accurate, general statements about the state of affairs of the countries which comprise Africa as they are extremely varied in terms political, social, religious, economic and historical influences. Further, detailed and current economic data for the continent is difficult to obtain since many of the countries are too small, underdeveloped/poor and/or unstable to provide the data. Nonetheless, I have chosen Nigeria as a "barometer" because it is the most populous country in Africa (8th most populous in the world per the CIA World FactBook); about half the population of the U.S.), it has suffered many of the economic obstacles of other African nations (history of political turmoil/corruption/mismanagement/overly dependent on commodity exports), and its population has been hard hit by HIV/AIDS (second largest population of HIV/AIDS infected patients; over 60% of population is under the age of 24). Given these headwinds, evidence of progress in Nigeria should provide some hope for the potential for progress by other frontier countries within Africa.

20-Year Comparison of the GDP Per Capita of Nigeria vs. China
(On a Purchasing Power Parity ("PPP") Basis)



Source: Trading Economics

The above chart shows a very steady increase in China's GDP per capita for the entire 20-year period. Nigeria had almost no increase in GDP per capita for the first half of the 20-year period. Yet, beginning just before 2004, Nigeria's GDP per capita began a steep ascent that has almost brought its level of productivity on par with China's. Admittedly, some of this progress was due to the sharp rise in oil/commodity prices during the last decade, but the progress continued unabated through the global financial crisis period in which commodity prices were quite weak. At least part of the explanation for this impressive trajectory is attributed to economic reforms begun in the early 2000's that focused on repairing Nigeria's financial situation and on diversifying its economy.

Despite an above average incidence of multiple-births, and a cultural preference for larger families, and against birth control, the fertility rate has fallen at a steady rate over the past several years (though still well over twice the previously stated 2.0-2.3 replacement rate):

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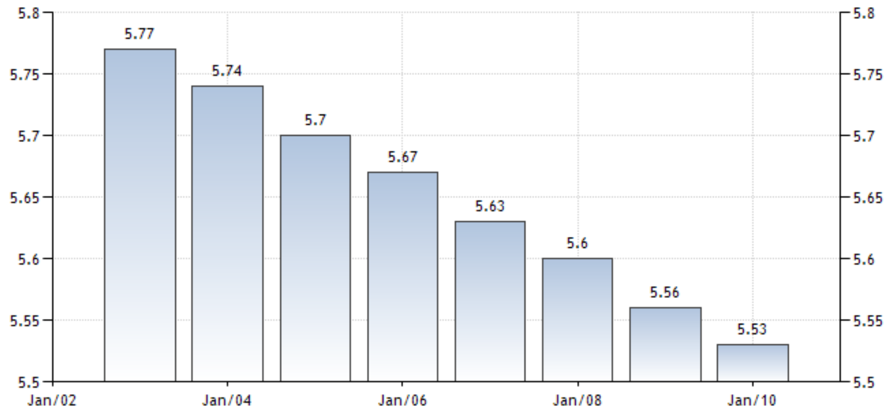
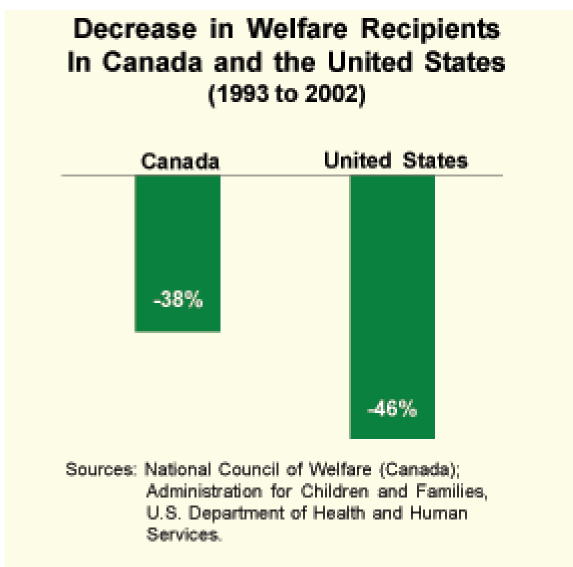
Fertility rate; total (births per woman) in Nigeria



Source: Trading Economics/World Bank

Turtle Trend #4: The "Right-Sizing" of Social Programs

Countries/societies change policies over time, but "hard decisions", especially ones that are unpopular with large segments of the population (particularly voters!) tend to only come about after "hard lessons". During the 1990's, both Canada and the U.S. implemented significant reforms to their welfare programs in response to fiscal pressures:



A more current example can be found in Australia which is presently engaged in a reform of their welfare programs. The following quotes are from Australia's Department of Social Services website:

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"The Australian Government is committed to reforming the welfare and family assistance payment system <u>to foster responsibility and to provide a platform for people to move out of welfare dependency</u>."

"In the 2011-12 Budget, the Australian Government announced the extension of income management to five new sites from 1 July 2012 as part of the <u>Building Australia's Future Workforce</u> *package. The initiatives in the package are aimed at assisting vulnerable families and children, and <u>enhancing opportunities for people to enter or return to the workforce</u>."*

"The reforms, which have been in place since 1 July 2008, aim to create incentives for individuals to engage in the real economy, reduce passivity and re-establish positive social norms. The idea behind the reforms is that <u>passive welfare dependence is damaging to individuals and communities and erodes personal responsibility and motivation</u>."

Both Canada and Australia are voluntary members of the Commonwealth of Nations (formerly known as the British Commonwealth) and as a consequence they share a political heritage with their former ruler, Great Britain. They not only share a political heritage, but they also share in their current efforts to reform their social services programs. The Parliament of the United Kingdom enacted the "Welfare Reform Act 2012".

From the British government's "Gov.UK" website:

"Many people on benefits believe that the financial risks of moving into work are too great. For some, the gains from work, particularly if they work part-time, are small, and any gain can easily be cancelled out by costs such as transport.

The government believes that the current system is too complex and there are insufficient incentives to encourage people on benefits to start paid work or increase their hours.

We are aiming to make the benefit system fairer and more affordable to help reduce poverty, worklessness and welfare dependency and to reduce levels of fraud and error."

Greece and Cyprus became the poster children for fiscal imprudence during the global financial crisis. While their social program "reforms" were largely involuntary, a heightened degree of financial discipline is likely to remain in place for many years to come as they are unlikely to want to run the risk of reliving the recent hardships brought about by severe budget cuts.

As the below chart illustrates, the European Union is emerging from the second half of its "double-dip recession", but it is likely that the fiscal stresses that the region experienced, and are still experiencing, are going to have long-lasting effects on the "social welfare mindset" that appeared to have swung too far in one direction that resulted in an unsustainable situation. If addressed properly, social program reforms may lead to the EU becoming more competitive and productive global economic players:

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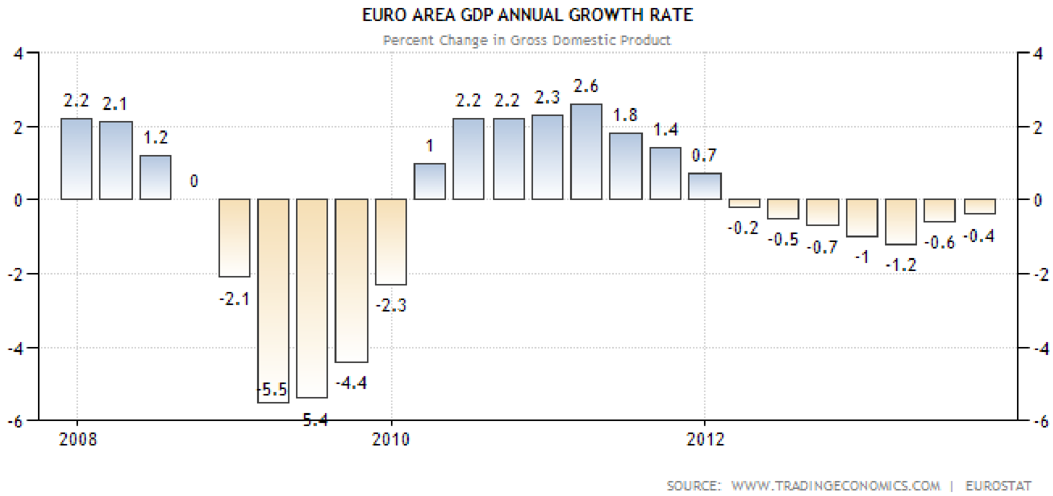

Obviously, with the current efforts to implement the Affordable Care Act within the U.S. it is difficult to make the case that social programs are being curtailed domestically. Nonetheless, on an overall global basis there does appear to movement from the extremes towards some balance between competitiveness/productivity and government support for those less privileged.

Strategy Implications

"Turtle Trends" do not establish a rationale for investing in a particular investment on a given day, week or year, but their consideration do prompt the asking of some important questions:

1) What has performed exceptionally well for many years, but may perform more inconsistently due to a changing landscape? (China?)

2) What has performed very poorly for several years, but may be worth considering because the situation is improving more markedly than many perceive? (Europe?)

3) What have I never considered investing in because of circumstances that persisted for many years/decades, but may be in the process of changing/improving? (Africa?)

4) Is the world overall going to be a better place to live and invest in the future? (Less poverty, greater access to education/technology, more educated people interacting with more people from around the globe discussing ways to address problems and make life better for all?)

There was great damage done during the recent global financial crisis, but many valuable lessons were also learned. This was a continuation of, and an addition to, the many lessons learned during the 20th century (i.e. two World Wars, rise/fall of communism, the Great Depression, hyper-inflation, etc.). Yet, there were also amazing strides in innovation/technology, especially since the beginning of the Industrial Revolution. All of these factors are supportive of the notion that the future can be better than the past

Water can cut a rock given enough time, and it does so with little fanfare, but once cut, the rock remains changed forever. It took Nelson Mandela 27 years in prison to cut the rock of Apartheid, but now as the world celebrates his life via the many "miracles" of communication technology available to us today, perhaps we should take a moment and ponder the possibility of a smaller, wiser world, with fewer strangers and enemies, that is better equipped to address our remaining challenges than at any time prior.

“Look to the Future, be Optimistic…but Hedge.”

(We want to keep these commentaries brief and focused so as to provide a good “information-to-text-length ratio”, but if you have specific questions/topics you want me to address, please let us know.)

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