Foresight: A Global Shift in Economic Power

Analyzing various scenarios that may help you thrive in an uncertain economic landscape.

BY JACK EL-HAI

Investors who are aware of the possible paths the economy might follow may be able to resist the temptation to place all their eggs in one basket. “We believe the best course is a set of investment strategies tailored to the possible outcomes we see ahead,” says Tim Leach, Chief Investment Officer of U.S. Bank’s Wealth Management Group. “Whether we realize it or not, there’s been a grand unfolding of a new international economy. We’re seeing the start of a global shift in economic power. This change underscores the importance of trying to look ahead.”

Along with other members of The Private Client Reserve investment team, Leach recently took part in a conference call with Mohamed A. El-Erian, CEO and Co-Chief Investment Officer of PIMCO, an internationally respected investment management firm. The following highlights key themes of the discussion—including the future leadership of the global economy and the impulses that drive government planners to resist inevitable economic change.

THE NEW GLOBAL LEADERS

While Western economies will certainly remain important and influential in the near future, there’s no doubt that such emerging nations as China and India will have increasing global financial responsibility thrust upon them, El-Erian believes. “This may happen, though, at a time when those countries want to focus on their domestic economic responsibilities,” he says. “We may expect China to assume global responsibilities, but they may say they have a duty to address such problems as their own low per-capita income.” As a result, the current approach to international economic leadership may undergo a transformation, with few nations willing to give attention to the global economy in the same way the U.S. has in the past.

RESHAPING INVESTMENT APPROACHES

According to El-Erian, the state and federal governments in the U.S. will resist what may become a “new normal” economic course of sluggish growth yoked to high unemployment. Through governmental stimulus measures, “they will try to delay it. They will try to kick the can down the road,” he predicts. El-Erian expects an economic bounce in 2011, the result of stimulus policies. “It will look like a good old-fashioned recovery,” he says, “and there will be a sell-off of fixed income investments and a rally in stocks. But are we creating growth or borrowing it from the future? We think it is the latter.” As a result, he recommends that investors be careful about buying into the bounce and instead look ahead to the inevitable time when the structural flaws in the economy become apparent.

Considering safety along with investment return is important. “When investments look similar on the surface, you examine which involves taking more risk,” Leach comments. “You discount the historic expectation of returns by looking ahead to risk in order to attempt to reach a safe spread. U.S. Bank strives to anticipate the most likely scenarios and risks of an investment decision. We try to achieve an investment strategy for clients that is tailored to a potential future, instead of relying exclusively on long-term data from the past.”

SOMETHING NEW UNDER THE SUN?

El-Erian’s forecasts raise important questions: Is the current international economic picture really different from what we’ve seen before? Is the past useless as a guide? “Throughout my career, I’ve built up resistance to any declaration that this time things are different from what we’ve ever seen before,” Leach says. “There’s a powerful tendency in history for relationships and situations to pull toward what’s been normal in the past. That said, things certainly feel very different to me as I look out over today’s economic stage. Industrialized countries are in a debt-hobbled condition, and that is a new situation. It’s also very different to see the rapid ascendency of the emerging market countries. China and India represent 2.5 billion people who can now truly come into their own.”

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