TURNER INVESTMENTS COMMENTARY

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SLOWLY FOR SURELY:
Prospering in a World of Slow Economic Growth

We've all had mornings where we feel our age—more aches and pains than usual and movement that's more Betty White than Usain Bolt. Well, that's how the entire world is starting to feel. The world is getting older and the impact of a rapidly ageing population is starting to manifest itself in slower economic growth. Naturally, there are other contributing factors—more saving, less spending following the credit crisis, for example—but the main issue is age and a rapid slowdown in the number of working-age people. According to the United Nations:

In 2015, there are 901 million people aged 60 or over comprising 12% of the global population [more than four times higher than the 202 million that lived in 1950]… by 2050, all major areas of the world except Africa will have nearly a quarter or more of their populations aged 60 or over. The number of older persons in the world is projected to be…2.1 billion by 2050.

According to Ruchir Sharma, head of global macro strategy at Morgan Stanley, the "primary threat most countries now face, in fact, is not too many people but too few young workers." So, the world, particularly the developed world, is suffering from a decline in young workers and a slowdown in economic growth. Slowly but surely, the global GDP growth rate is grinding lower:

Slowing Down: Global GDP Growth Waning

Source: World Bank

WHAT CAN BE DONE?

Governments, of course, are not standing still in the face of slowing growth and declining workforces. Many countries have reversed population control policies, such as China, which ended its one-child policy last year. Other countries have increased the retirement age, such as Germany, which in 2007 boosted it to 67 from 65. Expanded immigration policies and efforts to include more women in the labour force are other strategies that have been implemented. While these changes may eventually have a positive impact, it will take decades before real change occurs. In the meantime, global growth continues to fade. So, given the new reality of slower economic growth, what are the best, most constructive ways to position our clients' portfolios? We have adopted three key strategies:

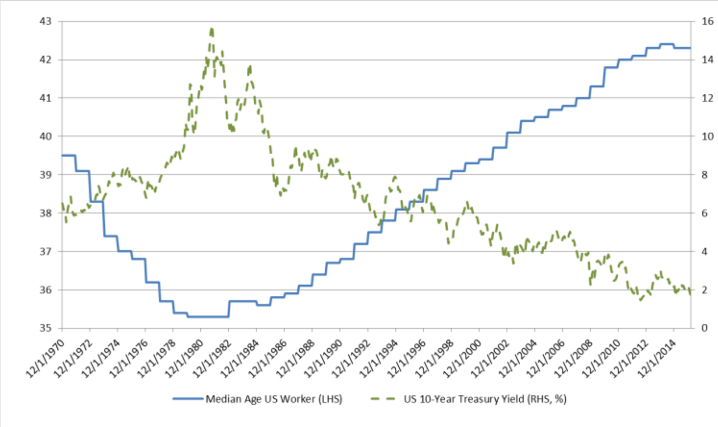
1. NEVER BET AGAINST THE US

Though the US economy is slowing relative to previous decades, we have to recognize the country's incredible ability to innovate. Such innovation can instantly spur growth despite unfavourable demographics. We don't know exactly what form this future innovation will take, but it will likely occur rapidly. Smart phones, for example, barely existed 10 years ago—now they dominate our lives. We also can't predict exactly what the 'next big thing' will be, but we're fairly certain that it will involve either technology or medicine and that these advances will either be developed or perfected by a US company. It's no coincidence that the 10 largest companies in the world by market cap are all US-based with Apple, Alphabet (formerly Google), Johnson & Johnson and Microsoft amongst the leaders. This is why US equities have the largest weighting in our client portfolios. If you want to combat slow growth, you have to be positioned where innovation is mostly likely to occur—the US of A. And innovation usually translates into better market returns: the S&P 500 Index (US equities) has returned 10.9% annually over the past 40 years vs. only a 6.9% return for the MSCI World (global equities).

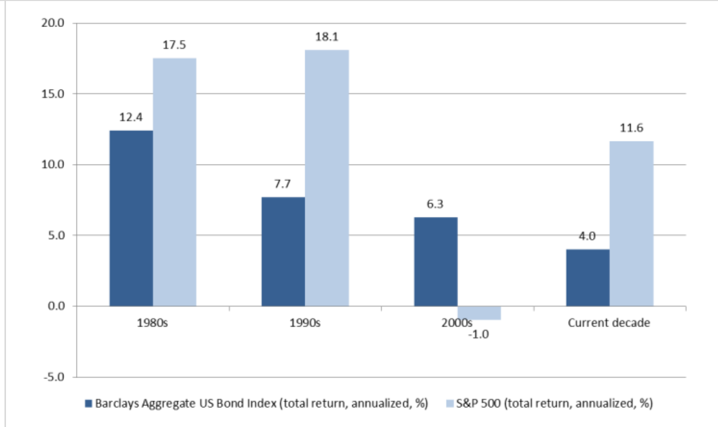
2. ASSET ALLOCATION: OVERWEIGHT EQUITIES

An older population demands more investment security and therefore it is not surprising that as the population has aged bond yields have fallen. In fact, since the early 1970s, the *inverse* correlation between the median US worker age and the 10-year Treasury yield is a remarkable 92%. In other words, as workers age (and eventually retire) demand increases for bonds, which drives yields lower. Lower yields generally translate into lower overall returns for bondholders. In fact, overall returns from US bonds have fallen every decade since the 1980s and are likely to continue to fall (see chart below). Therefore, it is a poor long-term investment strategy, in our view, to overweight—or even equal weight—fixed income. Most investors need to maintain an overweight position in higher-returning asset classes, such as equities, to compensate for the current slow-growth environment. While it's tempting to shelter oneself in bonds for the peace of mind they provide, an overweight bond portfolio is unlikely to provide investors with the long-term returns required to fund their retirements.

Demographics Have Driven Yields Lower



Bond Returns Are Diminishing

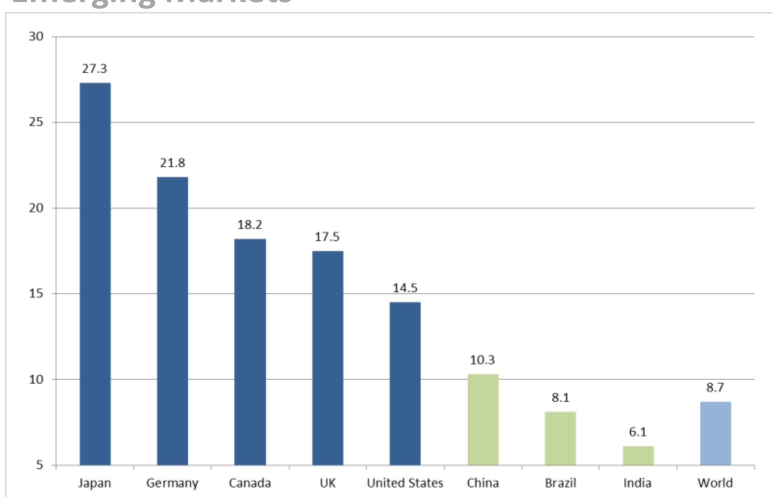


Source: Bloomberg

3. MAINTAIN EMERGING MARKETS EXPOSURE

It's been a tough few years for emerging market countries as commodity prices, which are critical to their economies, have weakened. But commodity prices are now at 15-year lows, which suggest we may be close to a bottom. However, regardless of where commodity prices move next, what we know for certain is that the demographics of emerging markets are more favourable than those of the developed world. Emerging market populations are larger, faster growing and, importantly, younger (see adjacent chart). Like it or not, young people are more productive and consume more than older people and we are confident that the main driver of long-term global economic growth will be emerging markets. While our clients' current weighting to emerging markets is modest due to recent volatility, we fully expect that over the next few years we will meaningfully increase this exposure.

% Population Over 65—Demographics Favour Emerging Markets



Source: Bloomberg

AGEING, BUT NOT DEAD

Actor and entertainer Maurice Chevalier once famously said that "Old age isn't so bad when you consider the alternative." That's how we feel about the global economy: slow growth is better than no growth. Therefore, we have to adapt to an ageing world that is limiting global expansion but hasn't yet ground it to a halt. We've positioned our client portfolios in a manner that we believe will achieve the best growth possible over the long term without incurring undue risk. There might have been a time when adequately increasing your wealth meant simply buying bonds with a sprinkling of domestic equities, but the world's changed. We believe the only way to secure sufficient portfolio gains now is to focus more on equities and on US and international markets. The world may be slowing down, but our job is to ensure that your investments don't do the same.

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