INSIGHT: Risks to growth overshadow 'false dawn' on financial markets

26 February 2013 15:13 [Source: ICIS news]

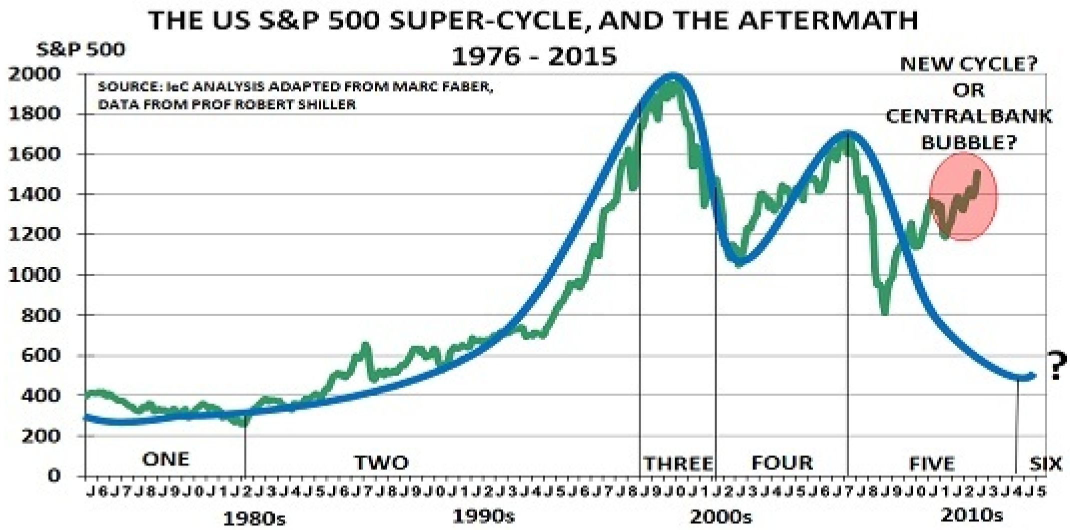
LONDON (ICIS)--Investors and companies are pursuing a "false dawn" if they believe that today's financial market recovery will translate into a recovery in the "real economy where we all live and work", International e-Chem chairman, Paul Hodges says this week in his Chemicals & the Economy blog.

Hodges questions the notion that full economic recovery is inevitable following the 2008 crash and the intervention of central banks worldwide to stimulate growth. He also suggests that we are not at a new beginning but still at the end of an economic Super Cycle that persisted from 1982 to 2007. Some serious money can be lost in these uncertain times.

"I've been listening to a lot of people telling me that business is not very good since New Year, but that they remain totally confident things are about to pick up, " Hodges told ICIS.

"'Everybody knows' that full economic recovery is inevitable. And today, everybody absolutely knows that it must now be very close. After all, it has now been 4 years since the crisis began," he says in his **blog**. "This expectation is understandable, as anybody who began work from 1982 onwards has only ever known constant growth. There might have been the odd short-lived downturn, but global GDP growth averaged a steady 3.5%/year between 1982-2007.

"The blog however has an alternate view. It believes this 25-year period was actually an economic Super Cycle, which will never be repeated in our lifetimes. The chart illustrates its argument, using the US S&P 500 stock index (the world's most important index), adjusted to reflect inflation by Prof Robert Shiller.



"The analysis is based on work originally published by leading investor (and EPCA speaker) Marc Faber on the life cycle of emerging markets. He argued in Barrons (13 July 1992) that markets had a common life cycle, divided into 6 different Phases. He thus headed his article 'A time to buy, and a time to sell'."

Hodges has applied Faber's concept to the S&P 500 and the chart needs some explanation.

• The green line represents monthly movements in the S&P 500 since 1980
• The blue line shows Faber's Life Cycle trend applied to the S&P 500
• The trend is then used to identify the 6 Phases of the lifecycle

"**Phase 1.** The 1970s saw major dislocation," Hodges says. "The Baby Boom generation (born 1946-70) created a major increase in demand as they grew up, unbalancing overall supply/demand. But slowly the balance began to improve as more Boomers joined the Wealth Creating 25-54 age group, and moved into their most productive years

"**Phase 2.** The average Boomer joined the Wealth Creators in 1983, and now supply began to increase quite dramatically. Interest rates and inflation fell, allowing companies to invest in new capacity. Businesses became optimistic, as they saw new opportunities everywhere

"Phase 3. Nervousness appeared as we approached the millennium. People worried that the dot-com phenomenon highlighted how the availability of easy credit was leading to excess capacity being put in place. The oldest Boomers were also beginning to join the New Old 55+ group

"Phase 4. The economy seemed to recover in the early 2000s after the dotcom crash and the horror of 9/11. But China began to expand capacity, just as more and more Boomers were leaving the Wealth Creator cohort. Equally, the stock market crash led many Boomers to decide housing should become their pension fund

"Phase 5. 2008 saw a greatly increased risk of deflation, car/house sales collapsed, whilst corporate profits declined along with stock prices. Until this moment, we were exactly following Faber's model. However, from March 2009 central banks have intervened on an unprecedented scale, pumping cash into the economy in all major regions

"Today. The Boomers represent the largest and wealthiest generation that has ever lived and now have the benefit of the longest life expectancy. But retirees only need replacement products, and have to survive on a pension, not a salary.

"As the chart shows, we are now at the parting of the ways. One can believe, with the blog, that the central bank intervention has delayed the inevitable. Or, one can join the consensus that assumes growth must be just about to restart. Readers, as always, will make their own choice."

Hodges says that if his analysis is correct, investors will eventually give up on stocks; currency wars will break out as countries fight to maintain employment; and protectionism will become a real risk.

"At worst, as Unilever CEO Paul Polman warned last month 'the biggest issue in Europe (and perhaps worldwide) is going to be social cohesion'.

The blog would be delighted if its analysis is wrong. But just as in September 2008, it feels the need to set out the risks as clearly as possible. It fears that time spent preparing your business's response to this scenario might well prove by year-end to have been time well spent."

By: **Nigel Davis**
+44 20 8652 3214