

ICI VIEWPOINTS

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Investment Management in a Rapidly Changing World

Industry leaders exchanged views on developments in China, the ongoing European debt crisis, and how the United States is doing compared to other major economies in a lively and insightful session at ICI's General Membership Meeting.

William F. "Ted" Truscott, CEO, U.S. Asset Management and Columbia Management and moderator for the session, kicked off a conversation about China by asking about recent changes and continuities. Michael A. Avery, President, Waddell & Reed Financial, Inc., and Executive Vice President, Ivy Investment Management Company, said China is at another crossroads: more and more people are joining a middle class and becoming prosperous, while the rise in use of social media is making this population very aware of opportunities. Richard H. Frank, CEO, Darby Overseas, agreed, and pointed out that wages in China have been rising an average of 16 percent year over year. What these rising wages means is not just more purchasing power for people, but "pressure on the markets to find less expensive venues" for manufactured goods. Vietnam, Frank said, is increasingly seen as the place for high-quality, low-cost, efficient manufacturing.

Avery agreed with Truscott's point that everyone is "long on China," because there is so much opportunity there and so much continued growth. Avery said that being long on China is believing in a group of people who are becoming rapidly prosperous and who have discretionary income to spend. All panelists agreed with Avery's comment that as this group increases, the country as a whole will turn their attention to healthcare, entertainment, and financial services. Kathleen C. Gaffney, Vice President, Portfolio Manager, Loomis, Sayles & Company, said that from an investment perspective, while there is some issuance coming out of China, two major issues were liquidity and getting the required information. One way to get exposure to China, though, was through other countries like Korea and Singapore.

Turning to Europe, Gaffney said she thinks the eurozone will hold together "because they need each other. Their ability to kick the can down the road," she said, has been astounding—and that they've done it just right. Avery said that if Greece leaves the eurozone, there would be "potentially catastrophic consequences." He added that he suspects what will happen is a continuation of the "extend and pretend" strategy: Greece will be given more time to repay its debts, and everyone will pretend Greece will eventually pay those debts.

Truscott turned to Frank and asked if a plan like the Brady Bonds plan effected in Latin

America in the 1980s would work for Greece. Frank said that the Brady Bonds worked well because each country agreed to accelerated reforms: they privatized industries, opened their markets, and liberalized the financial markets. They also had the ability to devalue their currency. Greece doesn't have all these tools available, said Frank, but what would help is a debt reduction plan coupled with changes to the financial system that would indicate to investors that there are growth prospects.

Talking about the United States, the panelists agreed that among all the major economies, the U.S. system is gaining traction. The United States is generating positive GDP—not large, but consistent—and auto sales are better, housing seems stabilized, and the United States is the only major economy where more energy is being produced. The cost of labor has also fallen, making the United States attractive to foreign companies. Avery reminded attendees that the new demographic cycle of millennials (those born between 1976 and 1999) is as big as the Baby Boomer Generation, and the leading edge is just entering their peak earning years.

One threat, all agreed, was the low interest rate environment. The Fed has done a good job, they agreed, of infusing cash into the economy and allowing the markets to “take a breath.” As the United States continues to gain traction, the real challenge will be for the Fed to pull back that cash fast enough to avoid a rapidly rising rate environment.

Because rates are going to rise, said Gaffney in a theme echoed throughout the panel, investors must be educated that “the safety they seek in bond funds is actually quite risky.” Instead, the panelists said investors should consider equities, emerging markets, and a long-term investing horizon as opportunities.

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