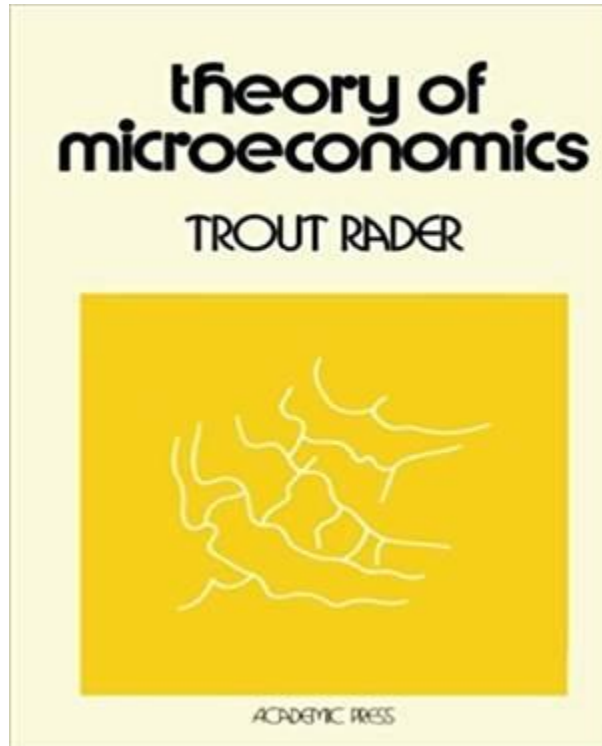


The Outlook: May 30, 2017

Economics: a little more clear, once in a while.

A long time ago, on the very first day of his Ph.D. program in Economics, a student sat in the back row of his first graduate-level class, waiting to be enlightened, feeling a certain mixture of eagerness and worry. The class textbook was handed around. It looked like this:

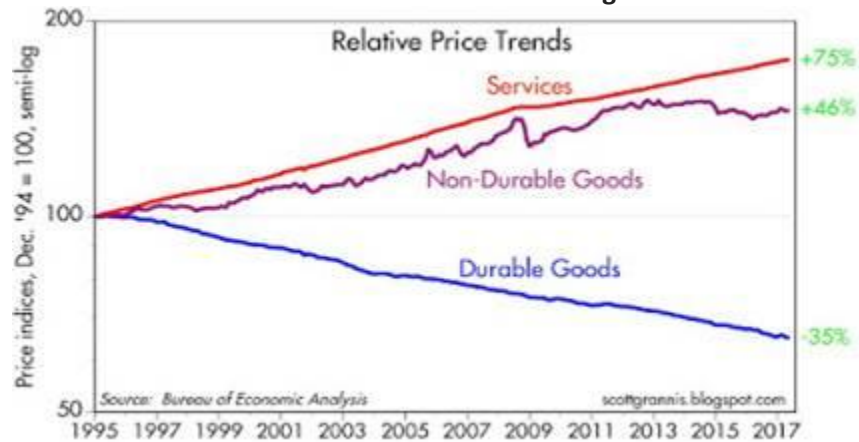


As the first faint warning bells clanged in the back of the student's brain, he opened up the book and began flipping through pages. Yes . . . the chart on the cover (above) was the easy part. Inside, there weren't many English words and sentences; but there were endless equations from advanced math and physics. That cover chart, it turned out, wasn't the brain waves of an economist in a lunatic asylum (as the dismayed grad students had theorized), but merely a standard economic "consumption function" which the professor—an ex-physicist converted to economics—had thunk up from his mastery of topology (the mathematics of irregular shapes and surfaces.) With the mental warning bells now clanging loudly, the young man looked aside at a friend, who was pointing a piece of cardboard his way, on which he'd scrawled the word "HELP!"

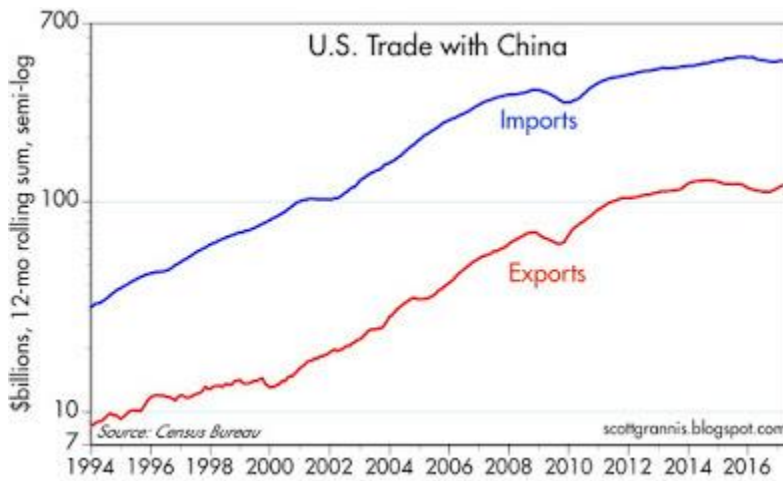
That's one side of the grand subject called "Economics," which many practitioners tend to make, shall we say, a little more puzzling rather than a little more clear.

But there is another side, rare though it is. That's the occasional economist who captures a profound truth about how the world works with a simple graph or two, making it so clear that it jumps out and grabs you, so to speak, saying "Here is what is going on!" with such clarity that we know it's true. Here are a couple of those rare ones from economist Scott Grannis, an Outlook favorite.

Durable Goods: 22 Years of Falling Prices



U.S. Trade with China: 22 Years



China's Currency, 22 Years



Why 22 years, in these 3 charts? As Mr. Grannis points out, that's about when China began to explode as a global manufacturing and exporting powerhouse. Before 1995, the general price level for durable goods

(meaning items like computers, TV's, refrigerators, cameras, cars, etc.) had never fallen for more than a few months. After 1995 it did nothing but fall, pretty much, and now stands 35% under its 1995 level.

Chart # 2 shows the tremendous growth of U.S. trade with China during those 22 years; and Chart # 3 shows that this trade happened even though the yuan was generally rising (making Chinese goods more expensive) rather than falling, against the currencies of China's trading partners. Here's how Mr. Grannis sums it up:

I don't think it's a coincidence that the emergence of China as a major exporter of durable goods coincided with the beginning of a sustained decline in the prices of durable goods. If there's been an identifiable source of deflation in the US economy, it's not been the Fed, but the vast increase in the productivity of the Chinese economy, and the vast increase in the volume of imported Chinese goods to the US economy. Thanks to the industrialization of China, the world has been able to produce manufactured goods much more cheaply than ever before.

The whole picture, of course, can never be captured in just one chart. The "Tech Revolution" also came on like a global tidal wave in the 1990's, and it created "more durable goods for less money" in many categories reaching well beyond computers and electronics. But China's incredible change from stagnant communism to charging capitalism enabled the Tech Revolution to work its miracles faster and more broadly around the world. Here's more from Mr. Grannis:

This has been a boon to just about everyone in the US economy, and the first chart is also proof of that. What the chart shows is that the earnings of the great majority of US workers have increased 2.7 times more than the price of durable goods. In other words, an hour's worth of work for the typical American today buys 2.7 times more in the way of durable goods than it did in 1995. When it comes to durable goods, the average American's purchasing power has nearly tripled over the past 22 years, thanks largely to China . . . We could use more countries like China, and so could the world. When it comes to trade, everyone is a winner.

It's easy to see why we pay so much attention to China, as we continually ask ourselves whether the companies we own really do have room to keep growing for a long time. And it's easy to see why we look so carefully at India, a sleeping economic giant which isn't much beyond China's position 22 years ago . . . but whose current leader emphatically understands that following China's example is the only road to a better future for India's 1.3 billion citizens. If he succeeds in pushing India along that road, global economic growth will also benefit, just as it has from China's progress.

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