VAN LIEW TRUST COMPANY

as we see it

Holiday 2016

THOUGHTS FROM OUR CHAIRMAN

At Van Liew Trust Company our individualized investment process takes into consideration each customer's investment goals and needs, along with tolerance for risk and time horizon. Our formal ongoing process strives to identify those publically traded investments that can help meet customer objectives.

In the last 30 years, we've witnessed significant growth in consumer-related, financial, technology and industrial companies. They have been the beneficiary of globalization or defined more specifically by the Levin Institute at SUNY as "the interaction and integration among the people, companies, and governments of different nations, a process driven by international trade and investment". Around the world there is now a growing movement for countries to be more self-sufficient and inclusive, note the recent examples of the Brexit decision and election of Donald Trump. Whether this revised form of isolationism goes beyond trade and manufacturing remains to be seen, but many doubt countries will abandon allies in times of military outreach by other opportunistic global players. If there is more manufacturing at home or higher tariffs, it is likely much of what we consume and some services will cost more. From an investment perspective, in such an environment, companies providing consumer-related services and products may generally provide lower returns to their investors. In such an evolving landscape, those companies with pricing power will likely show the best returns. As investment managers our job is to follow and analyze our changing world and balance exposure to the asset classes, sectors, and companies that can help customers best realize their objectives.

These are changing times but the changes may be more gradual than anticipated. The Executive, Legislative, and Judicial branches of our government will all be players in this process of change. Elected officials will push their agendas, but change will likely be slow thanks to our built in checks and balances.

Our associate Elizabeth Dellenbaugh's contribution in this issue of As We See It focuses on the struggles of productivity in the US economy.

Alfred B. Van Liew

The Rise and Fall of Productivity

Elizabeth Gordon Dellenbaugh

Are you being productive? How much more productive could you be? Are you sure? Productivity is the latest whipping boy in the effort of economists and the economic press to explain why economic growth has been stuck at low levels. Productivity measures the efficiency of production. It is a measure of output per unit of input. Inputs include labor and capital, while output is typically measured in revenues and other GDP components such as inventories. We can also think of productivity as the goods and services a worker produces in an hour. Since the current economic recovery began in 2009, productivity has grown at an average annual rate of 1.3%. According to The Wall Street Journal, that is the worst performance over a seven-year period since the late 1970s to mid-1980s, which included back-to-back recessions. It turns out that, like our personal productivity, the economy's productivity can be hard to boost.

Why is productivity growth important? Because productivity is key to economic growth. It drives wages, consumer prices and living standards. When productivity is low, wages stay low and operating margins stagnate. "Absent a sudden and dramatic improvement in productivity

Investment Management and Trust Services
One Regency Plaza, Suite One, Providence, Rhode Island 02903 401.272.2510
Nine Memorial Boulevard, Newport, Rhode Island 02840 401.846.5550
www.vanliewtrust.com

growth, we see little reason for profitability to improve," Deutsche Bank concluded in its U.S. Daily Economic Notes, 12 October 2016. America enjoyed extraordinary annual increases in productivity of 4% to 5% following World War II. The years from 1948 to 1970 have been called the Golden Age. But those levels have not been seen for years and economists lately question whether we will see them again. Marc Levinson, former finance and economics editor of *The Economist*, in his new book *An Extraordinary Time: The End of the Postwar Boom and the Return of the Ordinary Economy*, argues that the Golden Age was an anomaly that created productivity and growth expectations that are unrealistic. Once the workforce became more highly educated, workers shifted into factories, highways were built, and electricity and telephones became fully integrated into the workplace, there was room for only marginal additional improvement. "What some economists now call "secular stagnation" might better be termed "ordinary performance" writes Levinson. A more reasonable expectation might be an average growth rate of around 1.5% to 2% per year.

With today's focus on technological innovation, many assume technology must be boosting productivity. Robert J. Gordon's book *The Rise and Fall of American Growth* took technology optimists by surprise earlier this year, however, when he concluded that nothing we have created in the last several decades has had close to the impact of the inventions of the first half of this century, such as electric lights, the telephone, indoor plumbing, the combustion engine and national highways. Looking ahead, Gordon contends that U.S. productivity growth will be held back by the headwinds of rising inequality, stagnating education, an aging population, and the rising debt of college students and the federal government. If Gordon is right, our best hope is for a long-term slow growth economy.

Politicians in every party think they know what will lead to increased productivity and economic growth. But research suggests that productivity is something over which politicians and governments have very little control, something they are not likely to admit. Marc Levinson examined productivity under different government regimes. He concluded "[r]apid productivity growth has occurred in countries with low tax rates but also in nations where tax rates were sky high. Slashing government regulations has unleashed productivity growth at some times and places but undermined it at others. The claim that freer markets and smaller governments are always better for productivity than a larger, more powerful state is not one that can be verified by the data." Levinson shows that conservative policies of deregulation, privatization, lower tax rates, balanced budgets and rigid rules for monetary policy in the 70's and 80's proved no more successful at boosting productivity than the statist policies that preceded them.

Additional theories are emerging to explain the current low productivity numbers. One suggests the huge increase in the amount of the economy represented by the service sector skews productivity numbers to the low side, since manufacturing productivity is easiest to measure and services productivity is traditionally much lower. As economist William Baumol joked, "it's fairly difficult to reduce the number of actors necessary for a performance of Henry IV". Another theory is that the way productivity is measured may not be accurate. Others argue that we have not yet felt the productivity benefits of recent technological innovations.

So how do we become more productive? For you and me, the first step is probably to get off of the couch. For the economy, Levinson's research suggests the best hope is a recipe of cost-effective investments in education, infrastructure, innovation and healthcare. Sustained investments are an exercise in faith, since the timetable for results is notoriously uncertain. For example, more than forty years passed between the invention of the electric light and its use to increase productivity in U.S. factories. Will we reap productivity increases in the future from the technology around us today like 3-D printers, virtual reality and drones? It seems likely. Will robots continue to improve manufacturing productivity as well as make inroads into service sector productivity? That seems likely as well. Will any of this provide the huge scale of improvement produced by the innovations of the Golden Age? We can hope. The recent scholarship on productivity teaches us, however, that we must not become complacent in our expectations.