

Economy

The Global Human Capital Journal

Economic Outlook for 2008—Executives' Club of Chicago

By Christopher S. Rollyson — Sunday, 13 January 2007

U.S. Economy Due for Sideways Year—Special Effects by Presidential Election—Uncomfortable Long-term Questions Waiting in Wings

The [Executives' Club of Chicago](#) assembled an all-star panel to give Midwest business leaders their guidance for various aspects of the U.S. economy in 2008. **Diane Swonk, Chief Economist of Mesirow Financial** and **Robert "Bob" Froehlich, Chairman of the Investment Strategy Committee, Deutsche Asset Management** returned, and the **mystery panelist was Jack Ablin, Chief Investment Officer, Harris Private Bank**. They broke out their respective crystal balls for 2008, along with comedic effects. The session was brilliantly moderated by **Terry Savage, Financial Columnist of the Chicago Sun-Times** who didn't miss a beat and extracted specific predictions from panelists.

Panelists agreed that the U.S. economy would struggle in 2008, but it would move mostly sideways, probably eking out a 1-2% gain for the year after an unsatisfying first half. All panelists predicted that the Dow would touch 14,000 sometime during the year. Froehlich again emphasized the importance of looking beyond the U.S. for investments. Swonk and Ablin were less outspoken but had high non-U.S. allocations in their recommended investments for 2008.

After reportage on the panelists conversation, I will add my analysis and points to ponder, about the economy, opportunities and the election.

I covered [last year's 2007 Forecast](#), with this summary of panelists Swonk, Murray and Froehlich: "The consensus was that the U.S. economy would have a relatively benign year in 2007. All panelists predicted a higher Dow. Little of import will happen on the political front, the U.S. economy will grow at a slower pace, and investment returns will be generally highest outside the U.S."

Terry Savage set the context with tongue very much in cheek, summarizing 2007's panelists' predictions and the aftermath: "We began the year with too much liquidity, and mostly wrote it off as a subprime year." The U.S. now lives on the kindness of strangers, with Citi, Merrill and JP Morgan having accepted ~\$37 billion in capital injections to shore up their capital bases after writing down the value of their subprime tainted holdings. After the 2001 tech wreck, U.S. investors sought refuge in their homes. A little too much so, in my opinion.

Diane Swonk, Chief Economist, Mesirow Financial

Diane is a widely quoted economist who serves on committees to the Federal Reserve Board and the (U.S.) Congressional Budget Office, among others. In introducing her, Terry quoted her metaphorical comment on Bernanke's performance as Fed Chairman, which had been printed in the Wall Street Journal that morning: "If he were an Olympic skater, his technical score would be close to a 9 or 9.5, because we have gotten a lot of stimulus in monetary policy in recent months. His artistic score, or the execution of those moves, however, are (sic) closer to a 3.5 or a 4, which would knock him out of medal territory. There is no performance without passion and conviction," Swonk had said. that made for a few awkward moments, as two members of the Chicago Fed were sitting at the head table, but she acknowledged it and recovered gracefully.

- Asked if a recession were in the cards, Diane said that it was the wrong question. More interesting would be why do things seem so bad, and why are people so concerned? Overall, she is not bearish on 2008. Historically, recessions require (exogenous) shocks;



they do not usually happen solely due to internal factors.

- As she had last year, Diane brought up the widening disparity of the composition of growth: the top 1% earned 23% of U.S. wealth in 2007, with the bottom 50% earning 12%. People have jobs, but they don't feel wealthy as income isn't growing and housing prices are falling. Companies are not giving raises, and corporate profits remain high.
- Moreover, the consumer led the U.S. through the tech bust that had rung in the 21st century, while business investment and trade had been restrained. The opposite is happening now, and one of the results is that people do not feel as good.
- Diane referenced (threats) by a group of investment bankers that are suing over low/nonexistent bonuses this year. "Since when did Wall Street become socialist?" she barbed. "They sound more like the UAW."
- She expects the U.S. economy to struggle, and perhaps contract somewhat (but probably not) during Q1 and Q2. The second half should see the economy coming back solidly.
- On the Fed's actions, Diane reminded the audience that it always required six-twelve months for the full impact of monetary policy to be felt. In a significant change of approach ("coming out of the shadows"), Bernanke virtually disclosed a further .5 percent cut at the next Federal Open Market Committee meeting. We may well have to worry about overstimulating the economy.
- Turning to politics, she predicted that Congress would cut taxes because it's virtually undisputable that lower taxes have stimulated the economy. However, disparity of income brings the risks of populism and setbacks for free trade. China is the scapegoat, but she reminded the audience that China was largely responsible for convincing North Korea to back down from its nuclear weapons program, having cut off energy for months. China's intervention with Iran is also helping, not to mention trade.
- The U.S. immigration policy is misguided, as the U.S. sends most of the best and brightest foreign students back to their homelands to make their fortunes there, when U.S. companies cannot find enough knowledge workers here.
- Issues abound for the next president, and his/her chances of reelection are slim because it will undoubtedly be a difficult term. Boomer retirement and concomitant deficits will kick in, and Iraq will continue in some form or other.
- Diane flatly stated that she did not want anyone "controlling" the economy, but she sought to emphasize the importance of leadership during a time of difficulty.
- We will not "relive the 1970s" stagflation due to global deregulation (and liberalization of trade); however, she is concerned about protectionism as well as inflation, but the latter not until the end of 2008. Productivity is not so great.
- **Predictions for January 2009:** the Dow will revisit 14,000 this year. We'll see a 3.5% Fed Funds rate and 2.5% growth for the U.S. economy in 2008. Tellingly, she is much more worried about the four-five year horizon.
- **If I had an extra \$100,000 to invest:** 30% in financial services, 30% in export-focused industrial equipment (i.e. John Deere) and 40% in global [ETFs](#); Brazil especially strong as well as Asia.

Jack Ablin, Chief Investment Officer, Harris Private Bank

Jack Ablin is a "Top 100 Wealth Advisor" with \$55 billion under investment. As the "mystery panelist," he gave an investor's perspective on the economy.

- Jack opened by pointing out that, historically, economists only manage to predict 38% of the recessions that we actually have, and they usually over-predict recessions. In other words, all the recession predicting quoted in myriad newspapers will likely end up being false.
- He anticipates softness in the U.S. economy in 2008, but the likelihood is that we will have a "touch and go" recession.
- The U.S. currently has a housing-centric economy, but historically, residential investment is "coincidental" with recessions; it is not a cause.
- He is not worried about inflation. Typically, the PPI (Producer Price Index) rises first, and producers pass price increases on to consumers, boosting the CPI (Consumer Price Index). Currently the PPI is not rising but CPI is. There is weakness in discretionary stocks and retail. Weakening housing prices add a deflationary energy to the economy, and unemployment is increasing which will also serve to dampen inflation.
- Wages as a percent of GDP are at a 40-year low; corporations are taking profits; there are no raises.
- The credit crunch is easing in commercial paper, as rates moving toward the Fed Funds rate.
- The S&P 500 is overvalued by 5-8%.
- **Predictions for January 2009:** the Dow will drop below 12,000 during 2008, but it will rally in Q3 and Q4. Fed Funds rate will be 2.75%.
- **If I had an extra \$100,000 to invest:** as you might suspect, Jack over-achieved in the investment advice part of the panel: 10% ETF TWM (ultra-short Russell 2000) because it's overvalued by 30%, but take that trade off in May 2008; 90% in commodities, DLS international small caps, emerging markets.

Dr. Robert "Bob" Froehlich, Chairman, Investment Strategy Committee, Deutsche Asset Management

Widely quoted in myriad venues as "Dr. Bob," Bob Froehlich was as entertaining as he was insightful. I especially appreciated his

insights on the impact of the U.S. presidential election. Terry congratulated his on predicting a 14,000+ Dow and for the call on Chinese stocks; however, he missed the housing bubble last year, having said that there was no "U.S. housing market" (housing markets were local). Moreover, he predicted a bumper year for investment banks due to extraordinary M&A activity.

- Bob opened flamboyantly, gesticulating away Terry's recession question. "I don't care whether there's a recession. What does it matter?" Sure, the U.S. economy will have a lackluster year in 2008 and probably grow 1-2%, but, echoing Diane, he pointed out that knowing why was more important than whether we would have two consecutive quarters of negative growth this year.
- More serious now, he owned up to having missed the subprime mess completely in his comments last year. However, he was in good company, and he reminded the audience of the real issues:
 1. The magnitude of the problem was difficult to discern: due to the innovation and creativity involved in [structured finance](#), investors no longer could see the connection between reward and risk; effectively they became decoupled.
 2. Intellectual Property (regarding structured finance) is not distributed evenly, and regulators and investors did not understand these sophisticated products. Investment bankers, their attorneys and accountants knew of the risks, but no one else appreciated them. The problem was, further, that the former parties did not go out of their way to point it out to the latter. Rating agencies were asleep at the wheel.
 3. People have a funny attitude toward disclosure. Defending the industry (he's in investment banking), he reminded the audience that investors never like disclosure when times are good, but they grouse when things are going south. But the industry has to be more proactive and consistent with disclosure, whether investors want it or not.
- Subprime will weigh down the U.S. economy in 2008, as will high oil prices. Let's not forget that crude was at \$60 a barrel last year, and it hit the 40s during 2007. Those are tremendous swings (and they aren't based on its value but probably on widely varying perceptions of risk).
- Monetary policy affects markets more directly than the economy. Let's not forget that.
- The big story was the election. You can't talk about politics with clients because it's such a divisive issue in the U.S. (but that's too bad because the impact on the market will be palpable). It will be the most divisive and bitter election in modern history, not because of the issues but because of who's running and what they represent personally. Bob's a master of being serious while joking, and I can't come close to capturing the humor channel.
 - Republicans: the three front runners have strong religious components to their lives, a very divisive characteristic: Romney, a wealthy Mormon; Huckabee, a Baptist minister; Giuliani, a Catholic who has been divorced several times.
 - Democrats: it already looks like a two-headed race. Obama, an African American, is a strong contender for white house, running against Clinton, the first woman with serious contention for the post. "I know a lot of people who would have a lot of problems with that," he added. However, he would like to see Hillary win, if only to confer on Bill the title of "First Gentleman" , ^) lol
 - When it comes to business interests, people are comfortable with elections in which policies and rational discussions take center stage, not elections about messy issues like religion, gender and race. He foresees a significant outflow of foreign capital, which will add difficulty to a laboring U.S. economy.
- We are in the fifth year of a long commodity retrenching cycle (in which prices will remain high), and he expects ten more years. In China, there is a huge disparity in disposable income between urban and agricultural populations. We will not "relive the 1970s" because the technology-driven productivity revolution is ongoing. We're only in the second inning.
- Bob shared the investment banker's version of the old litmus test of bad times (if your neighbor is out of a job, there's a recession; if you are jobless, there's a depression , ^): why all the gnashing of teeth? "We lose money and lay people off all the time. But when the CEO loses his job, *that's* a crisis." (referring to Citi's Prince, Merrill's O'Neal and Bear's Cayne).
- But all of this need not prevent you from making money this year. "There are always ways to make money." Here are some of his tips:
 - "Feed the world." The earth gains 75 million people every year, and two billion will come out of poverty (in emerging markets; I didn't get the time frame). When people emerge from poverty, they first improve the food they eat (and shelter). Generally transportation is of secondary importance and entertainment third. Soft commodities (food) should be strong for some time.
 - "Be the world." Go global with investments. The global GDP in 2008 will be 6% and the U.S. will be 1-2%. China's immense demand for commodities drives up prices, and countries with raw materials benefit (Africa, Latin America, Asia). This points to sustainable demand for commodities.
- **Predictions for January 2009:** the Dow will go over 14,000 (again), and inflation will hold steady; we'll skate by, avoiding a recession with about 1% GDP growth.
- **If I had an extra \$100,000 to invest:** 12.5% each in Monsanto, ADM, China Mobile and China Petroleum; 50% in the best managed company (in the U.S.), the [CME](#).

Analysis and Conclusions

So, the U.S. economy will have a sideways year and an exciting election. Put more of your money abroad, specifically in Asia.

As a humorous aside, last year's panelist Alan Murray of the Wall Street Journal recommended, for the second consecutive year, to dump Apple's stock because the company was so overvalued (stock price ~82). It finished 2007 at 199.83. [As I wrote in my conclusion](#), I would have followed his advice had I believed Apple to be a computer or a software company. Instead, I perceive it as a life experience company that offers connecting with friends, immense hipness and individuality. Harley-Davidson is not a motorcycle company, either. It offers the open road, and I believe its fastest growing segment is women. They are both "manufacturers" that almost perished, but they subsequently transformed themselves into knowledge companies by explicitly focusing on experience. For more on this, see [The Knowledge Economy: The Ultimate Context for Understanding the Future](#).

Now for some insights into strategic issues regarding the U.S. economy.

A Building Self-Made U.S. Economic Crisis Can Still Be Avoided but Decisive Action Required

- During the discussion, the words of Caterpillar's James Owens were constantly ringing in my ears. Also an economist by training, Owens had implored the [Executives' Club audience in October](#) to reawaken the courage to compete. He saw the U.S. as being at a turning point: either we recognize and honor our emerging competitors and meet them on the global stage, or we retreat into ourselves, raise trade barriers, maintain or worsen our misguided immigration policy and snipe at countries who out-hustle us. These remarks are coming from the helm of one of companies represented in Diane's recommended investments. Owens clearly sees danger ahead for the company he leads, and the danger is from a lack of courage—and from a widespread sense of entitlement (Wall Street guaranteed bonuses, Detroit healthcare and full pay for not working largesse, homeowners who can't pay their mortgages want a federal bailout, etc.).
- Connected with this, Bob's statements about U.S. GDP (1-2%) and global GDP (6%) could indicate a profound structural limitation unless the U.S. fundamentally changes its attitude toward the world and its place in it. Time was short for questions, but I will ask Diane about her concerns about the U.S. economy 4-5 years hence at my earliest opportunity.
- At events I covered in 2007, executives constantly referenced the U.S. shortage of students in engineering, math and science. Xerox's Anne Mulcahy, for one, pointedly remarked that she was worried because we won't feel the gap until boomer scientists retire; at that point there will be no recourse because we will have no one to take their places. Due to Diane's time frame, I conjecture that she was referring to this as well.
- A related problem is that the global economy requires more knowledge and imagination to understand, and U.S. voters and Congressmen do not understand it (according to the E.U.'s Jonathan Evans, [70% of Congressmen do not even have passports](#)). In the Industrial Economy, enterprises created value through efficiency and distribution (workers could keep heads down, do their jobs and create value). In the Knowledge Economy, efficiency is understood, and companies will have to innovate to create differentiating value. To innovate, workers will have to collaborate with people all over the world, and customers are increasingly all over the world. This change of affairs is a grave threat to the U.S., which is a huge market unto itself and is relatively inward-looking.
- Having been several times a marketing executive myself, I have found that it is a good practice to constantly ask yourself where your customers are—and where are they moving. Did you know that China is already the third largest market in the world for luxury goods? Did you know that India already has the ninth largest population of millionaires (PPP) in the world? My point is, rapidly growing markets for almost any product you can name are in places that few Americans can find on a map. How are U.S. companies going to compete to develop offers for these markets? The irony is, they will be hurt less than the U.S. population because they will go to where the workers are.
- Sam Palmisano spoke persuasively on a new vision for the global enterprise in 2007; for his insights, see my coverage, ["Leadership, Trust and the Globally Integrated Enterprise."](#)
- Although I'm no economist, I believe that globalization 2.0 is also serving to dampen inflation (companies can go to where the workers are, which enables them to give fewer automatic raises). Also, China's being the shop floor for the world, including the U.S., adds a deflationary element to the U.S. economy because we get cheaper products. In a sense, the world has cheaper and more knowledgeable production and knowledge workers that companies can invoke in a global delivery model, and that capacity is growing. True, workers abroad raise their expectations and wages as they gain experience, but other countries (i.e. Botswana for call centres) are coming online all the time. My point is that most economic models with which I'm familiar treat the U.S. as a relatively closed system, so they have an uneven sense of what is happening. This is a long-term, fundamental trend.
- Seen from this perspective, I can't overemphasize my appreciation for Bob's advice. Global is the default now, and the sooner you recognize it and act on it, the better off you will be.

The U.S. Presidential Election

- In my mind, this election will add extensive uncertainty to the economy in 2008 because it offers so much uncharted territory,

which can be fortunate or not. Business investors want to understand risk and reward, which will be more difficult this year. Bob's context around this election resonated with me, all the more because I consult on emerging trends regarding social networks and Web 2.0 technologies. It smacks of disruption from many perspectives. Try these on for size:

- In the 2004 election, Howard Dean's campaign was one of the first to show some of the potential of Web 2.0, and the 2008 campaign may see some surprises in terms of tactics. Obama is one of the most active in using social networking to help his supporters to find each other and organize. In addition, fundraising via the Internet has extensive untapped potential.
- Having had several conversations with friends in Mumbai this week, I appreciate that the very fact that Obama is serious contender has not gone unnoticed abroad. During the Bush years especially, the U.S. has lost enormous prestige and credibility abroad due to our government's lone wolf approach to foreign policy. In many quarters, we have lost respect as leaders of democracy. Already, the presidential race is signaling that things might be changing, and people are more than ready for it. This is very meaningful for democracies looking for inspiration.
- According to Wikipedia, 2008 is the first election without incumbents in the primaries since 1928. Although literally true, Hillary's candidacy raises interesting questions, with husband Bill having been a two-term president. How much influence would he have, especially since Ms. Clinton would undoubtedly call on many members of the old crew, whose context was set with Bill as president? This dynamic could produce some unwarranted special effects should she win the office.
- Many political leaders have been risk averse in recent years, and they need to press to educate voters about the stakes of globalization. Education is absolutely critical: every individual is now global because Web 2.0 makes global actionable at the P2P (peer to peer) level. This means that the bedrock of all economies, small and medium sized businesses, can go global. But their leaders usually do not appreciate the opportunity or have the knowledge to make it a reality. They need leadership, examples and mentoring.
- As if these uncertainties were not enough, the U.S. has many structural issues to address, like global warming, terrorism, and boomer entitlements. I hope they will not get as short a shrift as Bob predicted because delay increases consequences. To quote Diane's rendition of Walter Cronkite's admonition to the generation in power at her 1984 commencement address, "We screwed up, it's your job to fix it." We all want to avoid this, but it means making immediate term sacrifices for long-term gains. The sooner we sign up, the better!

About the Author

Christopher S. Rollyson launched *The Global Human Capital Journal* in 2005 to address the most poignant issues of day for chief executives, namely global transformation, the reinvention of the enterprise, technology and culture. Mr. Rollyson has been a technology and marketing visionary and pioneer for over fifteen years, with distinction in corporate strategy and innovation. As a consultant and marketing executive, he has had a leading role in launching such game-changing offerings as: Java with Sun, e-business strategy with PwC Consulting, and SOA, Web services and architecture solutions with IBM and nVISIA. In 2006, he launched The Consumer Empowerment Adoption Curve™ and Transourcing™, a new approach to innovation that leverages high performance collaborative partner networks. He currently advises global enterprises on collaborating with Web 2.0-enabled customers—to drive innovation and to engage emerging markets.

Recently the Vice President of Marketing at nVISIA, he developed executive marketing programs and service offerings to drive the value of software transformation through service-oriented architecture and Web services, working with IBM, Rational and Grand Central. Previously a subject matter expert for e-business and knowledge strategy in PricewaterhouseCoopers' Strategic Change practice, Mr. Rollyson developed original models and services frameworks for e-business strategy consulting. He consulted to clients in automotive, software, telecoms, consumer electronics, chemicals and petroleum industries, advising global enterprises in e-business strategy and technology start-ups on innovation and business strategy. Prior to PwC, he led marketing for KPMG's Midwest High Technology practice, where he built one of the firm's first intranets to transform the marketing organization to a real-time team. Before that the head of marketing at a leading edge Java consultancy, he played a key role in co-launching Java via marketing alliances with Sun and Netscape. Mr. Rollyson has done graduate work in corporate strategy and economics at the University of Chicago, with additional studies at Die Freie Universität Berlin, L'Université de Clermont-Ferrand in France and il Liceo Americano d'Aviano in Italy. He earned his undergraduate degree from Kalamazoo College. <http://rollyson.net>

About the Global Human Capital Journal

The Global Human Capital Journal addresses the global shift from the Industrial Economy to the Knowledge Economy, which is changing how human beings work and deliver value. In the Industrial Economy, products encapsulated the value of human work; in the Knowledge Economy, information produces the lion's share of value, and customer experience itself is the focus of commerce and government. A greater degree of collaboration among people of the world is possible than ever before, and increased interaction will bring unprecedented surprise and opportunity, especially because the potential is great to "level the playing field" among people of the

world. Obviously, these developments hold significant ramifications for business and organizational strategy.

Global Human Capital covers two prongs of economic transformation: 1) strategically, how organizations can rejuvenate their relationships with customers and constituents by collaborating with them to drive innovation and 2) operationally, how organizations can build strong collaborative cultures and skills to engage the world's emergent network of expertise, both within and without their walls. We analyze how global sourcing and collaboration are transforming enterprise and government organizations, as they transition from relatively self-contained, closed entities to more networked, open organizations.

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