**Insights and Observations: Second Quarter 2023**

China’s economy seems to be following the “East Asian Development Model”, the same approach used by South Korea and Taiwan. The model emphasizes exports, investments in infrastructure, and heavy industry. In addition, economic and political control is centralized.

Such economies follow a cycle of strong initial growth, but growth eventually levels off amid political and financial distress. At some point, economies are forced to move to more market-oriented economic and political management.

> **The drivers of super-growth have been property, infrastructure, and urbanization. By 2030, those will be largely exhausted … Amortizing the debt from property and infrastructure bubbles and from local governments’ excesses will take many years … and the cost of an aging population will rise exponentially.**
>
> **Without structural change, however, China is unlikely to ever achieve levels of income and technology comparable to the U.S., the EU, Japan, Australia, South Korea, Taiwan, or Singapore.**
>
> **William H. Overholt – Barron’s 5/26/23**

China's economic growth is struggling under the weight of massive debt levels and an aging population. Even with youth unemployment at a record high and the overall working age population on the decline, China continues to double down on centralized economic controls.

According to the Bank of International Settlements, China's total nonfinancial debt was $49.9 trillion last September. That has grown three-fold in just ten years.

> **The world's No. 2 economy binged for years on credit to finance everything from canyon-spanning bridges to new apartments. Now China finds itself facing a protracted period of what economists call deleveraging – the painful process in which borrowers divert income to pay down debts instead of spending and investing.**
>
> **Stella Yifan Xie – WSJ 6/11/23**

The problem is not the central government. It is the private sector, local governments, and households. Total debt as a percent of GDP has risen to 295% in China … compared to 257% in the U.S. and 258% in the eurozone. As a result, consumers are hoarding cash and trying to paydown debts.

**The only way to keep China's growth rate high is to let debts keep growing. It appears policy makers are choosing a hard constraint on debt.**

**Michael Pettis, Peking University – WSJ 6/11/23**

Approximately 6,100 bank branches closed over the past three calendar years according to FDIC data … the highest number of closures over a three-year span in history. While deposits at traditional banks fell by the most on record during the first quarter of 2023, online banks saw an increase in deposits.

**The future of everything in banking is digital.**

**Richard Fair, Capital One – WSJ 6/3/23**

Online banks can offer higher rates, as they do not have the costs associated with branch networks. It can cost about $500,000 annually to run a small branch and as much as $1.3 million annually to run a midsize branch in a major city.

**Without the cost of branches, we can offer a higher rate. I think a lot of the traditional banks have to adjust their models because people are focused on getting a good return on their money.**

**Roger Hochschild, Discover Financial – WSJ 6/3/23**

The Labor Department reported U.S. labor productivity (*defined as output per hour worked*) declined at an annualized rate of 2.1% in the first quarter of 2023 from the fourth quarter of 2022. Also, the measure was down 0.8% from a year earlier. Labor productivity year-over-year has declined for five straight quarters … the longest period of decline since records began in 1948.

While GDP (gross domestic product), a measure of goods and services produced, has been expanding, GDI (gross domestic income), a measure of incomes earned in wages and profits, has been falling. In other words, GDP tells us the U.S. economy is growing, but GDI is indicating we are actually in recession.

**GDI is the yin to GDP's yang. In theory, the two should be equal, since someone's spending is another's income. What explains these dissonant signals is productivity … it is cratering.**

**Gwynn Guilford – WSJ 6/5/23**

So, while employers have added jobs at a blistering pace, real domestic income has been on the decline. One reason could be "labor hoarding". After struggling to hire and train workers during the pandemic, employers are cautious about letting people go during periods of declining sales.

> **It's also plausible that the shift to working from home generated a hit to productivity, whose impact grows with the cumulative loss of creative exchange and mentoring.**
>
> **Moreover, if GDI is a better indicator of output than GDP, it would mean that the economy has slowed more than we had thought, without bringing down inflation that much.**
>
> **Jason Furman, Harvard University – WSJ 6/5/23**

According to research by Cerulli Associates and the Employee Benefit Research Institute, running out of money remains the top retirement planning concern. Consider the following:

- Social Security is the primary source of income for 54% of U.S. retirees … with about one-fifth of that group having no secondary source of retirement income.
- The median *nest egg* for a family headed by someone in their early sixties, and with household income of $71,000 to $126,000, was approximately $150,000.
- Among higher earning household, the *nest egg* balance was $535,000.

Overall, 58% of respondents reported the greatest fear in retirement as outliving their assets due to poor planning or investment performance. This concern topped other worries, such as trusting the wrong advisor, incapacity, falling victim to scams, and inflation.

> **This sense of precarity isn't surprising given the lengthening lifespans, inadequate savings, and the financial woes facing social security.**
>
> **Elizabeth O'Brien – Barron's 6/9/23**

Due to rising rates and the recent concerns surrounding the stability of regional banks, small business lending could get severely squeezed. Nearly half of all U.S. banks said they are raising lending standards for loans to small businesses.

> **Large companies raise most of their funds from capital markets … smaller companies rely predominantly on lending from banks. And commercial and industrial lending by banks to businesses has fallen every month this year.**
>
> **Dion Rabouin – WSJ 5/22/23**

In a recent Goldman Sachs survey of small-business owners, 77% of respondents reported concerns about their ability to access capital. Goldman called it a *stunning shift* from a year ago, when 77% reported they were confident about accessing capital.

Every year, Schwab surveys 1,000 Americans on what it means to feel wealthy.  Consider their findings:

- 40% mentioned well-being over money (32%) and assets (26%)
- 62% said that enjoying healthy relationships with their loved ones better describes wealth than having a lot of money.
- 70% said that wealth is more about not having to stress about money than having more of it.
- Of those who have a documented financial plan, 90% said they feel confident that they will reach their financial goals.

**Feeling and being wealthy is about much more than a bank account balance.  It's about choice, control, and clarity and also social life, family, career balance and flexibility, experiences, and good health.**

**Rob Williams, Charles Schwab – Advisor Perspectives 6/16/23**

A small group of Americans (12%) describe themselves as not just happy, but "very happy" … this according to the latest WSJ-NORC poll.  This is the smallest share of "very happy" ever recorded since the inception of the survey back in 1972.

Those "very happy" folks value strong relationships, tend to be more religious, and are more involved in community activities. Fitness is also a common interest. The "very happy" also tend to be older, with respondents aged 60 and above accounting for 30% of the people surveyed … but 44% of the happiest group. Also, far more women than men described themselves as "very happy".

> **Americans aren't a particularly happy bunch, as large majorities said they felt pessimistic about the economy and prospects for the next generation … all this makes the slice of "very happy" people stand out. Overwhelmingly, the very happy value strong relationships. And while many of the very happy are satisfied with their personal finances, as a group they don't attach high importance to money.**
>
> **Aaron Zitner – WSJ 4/21/23**

At the start of this century, total debt was less than $6 trillion, after four consecutive years of budget surpluses. Believe it or not, Fed Chairman Alan Greenspan actually gave a speech outlining his concerns over the consequences of paying off the debt.

Now, of course, the total debt level is in excess of $30 trillion. In just two decades, the ratio of debt to economic output in the U.S. has tripled. Including the unrecorded obligations of our entitlement programs, the total debt would technically be at or around $100 trillion.

**We can't fix the problem in a single stroke, but we can stop it from getting worse. Preventing the national debt from growing faster than the economy over the next decade would be a demanding but reasonable interim step.**

**William A. Galston, Brookings Institute – WSJ 4/11/23**

Studies have shown that utilizing forecasts leads to poor outcomes.

**One of the most interesting, and perhaps surprising, results is that despite their greater financial literacy, the professional forecasters produced significantly worse forecasts than the average household. Market forecasts should be ignored, whomever they come from.**

**Larry Swedroe, Buckingham Wealth – Advisor Perspectives**

The investment marketplace is forward looking, while recessions are only declared after the fact by the National Bureau of Economic Research. As such, markets may be on their way to recovery by the time a recession is formally announced.

**Daniel G. Corrigan, CPA/PFS, CFP®**