FINANCIAL ANALYSTS AND THE NONGROWTH CULT

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During the 1950's and '60's, many Americans came to believe that continued economic growth and prosperity were here to stay. Immutable forces were at work which would boost GNP to record levels each year *ad infinitum*.

The strongest of these forces were Government policies which would keep the economy from slipping into the major depressions and recessions of the pre-Keynesian era. "Aggregate demand" became the byword. Washington had both the spending power and the inclination to wipe out any sag in aggregate demand that threatened to pull the economy down. At the same time, chronic inflation was seen as an expansive force. Inflation would keep expectations buoyant and would shift income from passive savers to active risk-takers.

In the financial field, "go-go" or "performance"-oriented portfolio management came into vogue. Stocks in a fund not only must go up, but they must go up faster than those in competing funds. The new Adam Smith put it succinctly:

> To the next generation the Depression was only a dim memory, and inflation was much more visible: The haircuts that once cost fifty cents cost seventy-five cents and then one dollar and then two. The next generation also arrived at positions of responsibility without the thirty-year apprenticeship that can bank the fires of the most ambitious. So that was the new generation, itching to shake up things because the old boys had been in the wrong game for twenty years.

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> And then one day there was a pool of money, $400 billion, strong accounting for half the business done on the New York Stock Exchange, and run by a group of tigers who knew they were right just because the old boys had been so wrong. The stage was set for "performance."
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> Not only did the "performance" fund managers buy the growth stocks - they traded them. Trading was not for the Prudent Man, the short term fluctuations in the market were not for him. The "performance" fund managers figured the safest way to preserve capital was to double it. 1/

In short, the name of the game was growth, and as the markets continued to rise the game was played for fun and profit, drawing new believers to the growth altar. In 1969, stock prices tumbled--over 30 percent on some indices. The slump put a crimp in the growth movement, but only for a time.

Now a new threat, and perhaps a more lasting one, faces the notion of continuous growth. Recently a number of scientists and concerned individuals have challenged the belief that growth *per se* is good. They see a continued emphasis on growth leading to a deterioration in the quality of life that cannot be balanced by the increased output of material goods. They see rising GNP and population in terms of more pollution, more congestion, and more human frustration. On top of that, they believe continued growth will, in the not-so-distant future, lead to the doom of mankind. In short, this nongrowth cult is asking for a halt in the hectic pace of change before it's too late.

I would like to examine some of the implications of the nongrowth cult for financial analysts. If a major part of the analyst's

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1/ Adam Smith, *The Money Game* (New York: Random House, 1967), pp. 210-211.

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job is to ferret out situations where growth will produce favorable returns to investors, and if growth is socially bad, then is the analyst's function in jeopardy? As I see it, there are three possibilities:

1) The analyst is doomed. He might as well pack up his charts and P/E ratios and begin looking for a new profession.
2) The nongrowth cult is not to be taken seriously; it's just another passing fad. Thus for the analyst it will be business as usual.
3) The analyst still has a job to do but it will be considerably more difficult.

Possibility 1: The Doomsday Paradigm

A small group of men of different nationalities and callings met in Rome a few years ago to ponder the causes and cures of worldwide chaos--poverty, unemployment, inflation, urban decay, environmental degradation, loss of faith in existing institutions, etc. Sponsored by this Club of Rome, a team of MIT specialists, including a systems analyst and a computer wizard, made a study in breadth--worldwide in scope.

The team ran the whole world and its 3,500 million people through a computer and found that they are multiplying at a rate which would bring about a collapse of civilization in 100 years, if not sooner.

So great is the world's complexity that everything is related to everything else. Consequently, the study called for not just one set of equations and one run through the computer, but about 100 runs. Various assumptions were fed into the computer in the hope of finding a brighter

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future, but invariably the printout was a disappointment. For example, what would happen if unrenewable resources were doubled as a result of new discoveries and new technologies? The answer: greater industrial output but only at the cost of intolerable levels of pollution. Or, feed the computer with "unlimited resources" and pollution held to 1/4 its present level, where do we come out? Answer: food per capita sinks to the subsistence level, the death rate rises, and population growth grinds to a full stop.

If the MIT team did its homework properly, a limit on exponential growth is inevitable. Either we impose it, or nature imposes it for us. In either case the financial analyst faces doom. If nature drives us to a subsistence level, investor capital dries up. If we manage to ease ourselves into zero growth, investment funds will be available, but the prospects will not. How can an analyst ferret out situations where growth will produce profitable returns for investors when the lid is on growth? Self-defenestration may again be in vogue.

Possibility 2: Nothing Serious

The second possibility is that the nongrowth cult is not to be taken seriously. It's just another fad--like the tail fins on cars of a decade ago--or just a 175 year old rerun of Parson Malthus' prediction dressed up with mathematical models. The Parson's forecast, you may recall, was put to rest by the phenomenal economic growth of the past two centuries.

Moreover, since Malthus' time the record is replete with nongrowth fads. Karl Marx saw the doom of capitalism. In 1844, Henry L. Ellsworth, Commissioner of Patents, concluded: "The advancement of

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the arts from year to year taxes our credulity and seems to presage the arrival of that period when human improvement must end." The depression of the 1930's gave birth to the thesis of chronic economic stagnation. Alvin Hansen was perhaps its outstanding proponent.

> ...Looking at the census figures of the 1930's, Dr. Hansen found an alarming trend. The rate of population growth was slowing down....
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> ...This meant that the single greatest stimulus to investment could not henceforth be counted on.
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> ...It meant that in the future the stimulus of capitalism's investment would rest on the shoulders of technological progress alone.
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> The future might be equally as inventive as the past--perhaps even more so. But the path of invention was likewise apt to be as sporadic and irregular. Unless the economy were bolstered between its periods of technological advance, it would surely develop a succession of depressions--deep depressions made all the more intractable by the lack of an undercurrent of steady human growth or the easy availability of new geographical markets.[2/]

The chronic stagnation fad was buried by the baby boom of the 1940's and an astounding pace of technological development.

Thus, in view of the past record, the gloomy MIT report could be just another growth "scare." If so, it will fade away as did its predecessors. For the analyst it would be business as usual.

Possibility 3: Hard Work for Analysts

It seems to me that neither Possibility 1 nor 2 offers a realistic or viable alternative for society, much less financial analysts.

[2/] Robert L. Heilbroner, The Worldly Philosophers, (New York: Simon and Schuster, 1953), pp. 290-292.

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For one reason, a number of questions have been raised about the validity of the MIT model and its implications. Leonard Silk has pointed out in one of his columns in the New York Times, for example, that the model underestimates the ability of resources to expand.

> ...The price system is the way mankind - and not merely economists - measures and regulates scarcity.
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> Is there, then, evidence from price behavior that the world's resources are growing scarcer and may soon run out? The evidence, on the contrary, tends to go the other way. World resource prices have been soft; the resource-producing underdeveloped countries have been pressing the industrialized countries, especially in the United Nations, to support prices of their exports.
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> The MIT scholars may have underestimated the rate at which the pond /of resources/ itself can be expected to expand.
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> That was the basic error of their distinguished early nineteenth-century predecessor, the Reverend Thomas M. Malthus - the error of regarding resources as essentially a fixed pool rather than as a function of changing technology. Iron was not a resource at all before the Iron Age, nor coal before the Steam Age, nor uranium before the Nuclear Age.[3/]

In addition to questions about the realism of the MIT model, there is the fundamental one of whether we really want to put a freeze on growth. I find it hard to see the average American sitting still while a slower-growing pie is being sliced up in a radically different way. It would seem more acceptable to most people to enlarge the size of the pie so everyone can have a bigger slice. Furthermore, economic growth is necessary to provide the technological equipment and methods

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3/ Leonard Silk, "Questions Must Be Raised about the Imminence of Disaster," (New York Times, March 13, 1972).

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and the income needed to attack the pollution we already have.

Moreover, to abandon economic growth is to abandon millions of people in Third World nations by locking them into poverty. Indeed, economic growth itself might help to slow, rather than speed up, population growth in these countries, as it has for much of Europe and the U.S. On a motor trip in Asia, Justice Douglas once had a conversation with his native chauffeur. Upon learning that his chauffeur had a wife and ten children, Justice Douglas commented that "it takes a lot of children to keep a man young."

"Not on one hundred rupees (about twenty dollars) a month," said the chauffeur....

Justice Douglas asked him why he had so many children if he had always been so poor.

After a long silence, the native chauffeur replied: "Sahib, you go home at night and what happens? You have magazines and books you can read. You have a radio. Maybe, Sahib, you have, what is it, television? And you can see. I go home and what do I have? Nothing but my wife. Night after night after night. Only my wife. That's why I have ten children."[4/]

Yet, despite the need for growth the MIT report does bring one point home: rapid economic growth has some undesirable effects which must be taken seriously by all. To limit these undesirable effects we will need to rely more on incentive, technology, and planning. Tax incentives, for example, can be used to channel growth away from activities particularly damaging to the environment. Technology, while much

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4/ William O. Douglas, Behind the High Himalayas, (New York: Doubleday, 1952), p. 24.

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maligned, provides the best hope for a cleaner automobile engine, more effective sewage disposal, and ecologically sound productive processes. Finally, planning offers the means for avoiding many problems associated with rapid growth before they occur. For example, zoning plans for a region can be used to avoid future congestion or to limit further industrialization of an area threatened with ecological overload.

What will these changes spell for the financial analyst? First, he must factor them into the profit potentialities of industries. Rather than homing in on Continental Conglomerates' five-year sales projections, he must assess the likelihood of several of its plants being closed from stiffer pollution controls. He must examine the ability of its management to seek out environmentally acceptable products and its willingness to plan for the company's survival in a world where the premium is on the quality of life rather than an increase in material goods and gadgets. In short, the analyst has the tough job of factoring into the profit picture of firms the "costs" of growth.

Second, the effort to limit the undesirable effects of growth may result in a slowing of overall economic growth. If so, the financial analyst's job becomes even tougher. When the economy is expanding by 8 or 9 percent, it is considerably easier to find profitable growth situations for investors than when it is moving at a sluggish 2 or 3 percent.

Conclusion

Possibility 3, I think, is the appropriate response. The nongrowth cult is reacting against the blind forces of economic growth. Its remedy, however, is to kill the goose that lays the golden egg. Economic growth is needed to deal with the multitude of social problems facing us.

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But today's financial analyst cannot afford to ignore the nongrowth cult's warning. As the undesirable effects of growth pile up, increasing pressure will come to bear on business to change its ways. This pressure may even result in some slowing of economic growth. It will be government's job to provide the incentives for rechanneling growth to socially desirable ends. And, it will be the job of the analyst to pick for investors those firms that can adapt through technology and planning to a world worried about the consequences of growth. Analysts who are able to factor social demands into the profit potentials of corporations will be the "performance" leaders of the '70's and '80's.

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