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U.S., Global Economies Won't Return to High Growth of Past, Economists and Portfolio Manager Tell Financial Practitioners

LOS ANGELES – More pain lies ahead for the U.S. and global economies as they adjust from a long period of credit-fueled prosperity to a new era in which both economic growth and investment returns are likely to be lower, three highly respected experts told attendees Thursday at the 2009 Economic and Investment Forecast Dinner presented by The CFA Society of Los Angeles (CFALA).

Efforts by governments in the U.S. and other developed nations to stimulate their economies, while necessary, are not going to quickly reverse the recession, the panelists said.

"We are in the process of de-leveraging after a 15-year period of gradually increasing borrowing by consumers and others," said Paul Donovan, Managing Director and Global Economist for UBS. "Policymakers can work to speed up the process of de-leveraging but they cannot stop it. They can try to prevent things from getting worse, and may be able to bring forward the time when we can look forward to a resumption of growth, but what they are doing is not directly stimulating growth at this stage."

American banks are going to need substantial additional help before they will begin lending again, said Dr. Sung Won Sohn, former Chief Economist for Wells Fargo Bank and now Professor of Economics and Finance at Cal State Channel Islands.

"First of all, banks need additional capital and although the government has made some efforts there, more will have to be done," he said. "Second, bad loans will have to be extricated from the banks. That hasn't even begun yet. The third thing that has to happen is the government guaranteeing individual bank loans to small and medium-sized businesses. Things have to go in those three stages. We're in the middle of the first stage."

Efforts thus far by Washington policymakers to deal with the financial crisis got failing grades from Robert L. Rodriguez, CEO of First Pacific Advisors, LLC, who oversees some $6.2 billion in investor assets and was recently named Fixed Income Manager of the Year by Morningstar Research.

"I have been highly critical of the actions taken by (Federal Reserve Board Chairman Ben) Bernanke and (Former Treasury Secretary Henry) Paulson, and the rest of the federal government, throughout this credit crisis," he said. "They have been on the wrong road and wasted precious time and resources. Recent actions do not give me any more confidence in the government's actions."

Rodriguez is particularly concerned about mounting government debt.

"Our ratio of debt to GDP is skyrocketing," he said. "How we finance that expansion in our debt is a very important question. Do we finance it by printing money or by selling bonds? If the answer is bonds, who is going to purchase them? Excess debt creation led to asset inflation and over-consumption, culminating in this credit crisis mess. A cleansing of the credit system and a reprioritization of economic initiatives are required."

Despite the grim economic outlook, Dr. Sohn and Donovan said there was a possibility for stock market gains this year.

"We're not likely to see the kind of equity gains we've seen in the past," Dr. Sohn said. "But equity markets over-react, and stocks have clearly over-reacted on the downside. Even in the middle of long recession or depression, we have seen equities jumping 40% to 50%. It can happen. We may be in a secular bear market, which can last 12 to 15 years, in this case dating from 2000. But you can have significant bear market rallies within that time frame."

While cautioning that investors remain highly risk-averse, Donovan said "You could probably argue that U.S. equities do have some ability to outperform European shares, given what is priced into market."

The panel discussion at the Omni Hotel in downtown Los Angeles was moderated by Bloomberg TV Anchor Kathleen Hays. CFALA is a network of investment management professionals working to disseminate useful financial information and increase awareness of the value of the Chartered Financial Analyst (CFA®) designation, which is intended to lead the investment profession by setting the highest standards of ethics, education, and professional excellence.

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