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"Easy Money versus Weak Growth"

The tag-line above was the subject of a conference in New York last week. The sponsor - BCA Research, an economic/market research organization with many institutional clients - has been producing data since 1949. This gathering drew the largest audience in BCA history. Speakers included a long and balanced list of luminaries as well as their own staff researchers.

Attendee polling showed that:

- 63% of North American attendees felt monetary policy was too easy, but only 39% of Europeans felt so.
- 47% believed that U.S. GDP real growth would average between 1% and 2% for the next decade, and 44% forecast it would be between 2% and 3%.
- 65% believed that inflation would be between 1% and 3% in five years.
- 40% felt that unwinding the Fed's money printing is the biggest issue for the next year, and 23% felt the biggest issue is the worsening prospects for emerging markets.
- 27% believed that U.S. fiscal trends would create a major financial crisis in the next decade.
- For the coming year, attendees saw equities to be the asset to own (76%), with 45% favoring developed market equities and 31% favoring emerging market equities.

I did not attend, but reading the summary of proceedings, I felt that the speakers gave a balanced view of where the world economies and markets are as we head into 4Q13. To paraphrase highlights from the reported proceedings:

> **Donald Kohn**, former Vice chairman of the Fed, now with Brookings: Weak demand remains the key problem. We are in uncharted territory, and history shows it is important that the Fed tighten too late rather than too early.
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> **William White**, Chairman of the OECD Economic Development and Review Committee: Developed country debt is 30% above pre-crisis levels. Zombie banks are keeping zombie companies alive with ultra-low rates. Asset prices have been driven to unsustainable levels. The low rates and rising asset prices advantage the rich and widen income distribution. Social unrest is rising in the world. Fed policies to date have prevented a far worse fate, but we do not know how to "unwind it."
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> **James Grant**, Author and Founder of Grant's Interest Rate Observer: Political pressure will keep us from "unwinding it," and we will have a "window rattling" episode of inflation at some point.

Larry Summers, Charles Eliot Professor at the Harvard Kennedy School: With rates so low, now is a prime opportunity for the Government to borrow money and rebuild decaying infrastructure. This would fuel growth and have a better fiscal impact than Simpson/Bowles. The risk of wage inflation is very low, and continuing to print money risks asset bubbles.

Byron Wien, Vice Chairman Blackstone Advisory Partners, **Robert von Rekowsky,** Vice-President, EM strategy, Fidelity: Even with the addiction to easy money, the world will have trouble reaching 2.5% real growth. Fortunately, Abenomics is working in Japan and that will shift a major player from the minus to the plus column. Emerging markets are no longer a monolithic class. The countries facing both fiscal and trade deficits (Brazil, India, South Africa, Turkey) are facing a difficult stretch as Quantitative Easing (QE) unwinds in the U.S. Elsewhere, the bear market in emerging markets is quite advanced.

William Raduchel, Independent Technology Consultant: Everyone is concerned about falling productivity and what that does to growth. We have six reasons for hope:

1. Medicine: DNA is essentially code and we can figure it out.
2. Education: Accounts for 7% of GDP and reform can be achieved.
3. 3D printing: The potential of digital technology meeting physical uses is limitless.
4. Emerging Markets: People want better lives and will work hard to seek them out.
5. Democracy: Markets will work if artificial barriers are removed.
6. Bill Joy's Law: Innovation happens where you do not expect. Ten years ago the words "smartphone" and "fracking" did not appear in the Financial Times newspaper.

Athanasios Orphanides, MIT Professor and former member of the ECB Governing Council, and **Nicholas Véron**, Senior Fellow, Bruegel (European think tank) and Visiting Fellow at the Peterson Institute for International Economics: The German election will not change much. To grow, Europe must give up "state banking champions" and move to a unified banking system. It is hard for Germans to put their credit behind EU-wide credit risks, and it is very difficult for other governments to give up sovereignty over banking. This is yet another example of the tension between sovereignty and much needed cooperation. The current system is good for Germany, Netherlands, Austria and Finland, but bad for everyone else. Europe cannot grow without growth in bank lending. Lack of cooperation over banking reform is the main risk for 2014.

Wan Yang, BCA's Chief China Strategist, and **Arthur Budaghyan**, BCA's Chief Emerging Markets Strategist: All aspects of the Chinese economy are slowing – exports, consumption, investment, and government spending. There has been some ill-advised lending, and debt is an issue that looms large in very report. However, the government can manage this, and "slower growth" is still high by world standards. There will be upsets and unrest, but progress continues at a slower but nonetheless remarkable rate.

What does that add up to? U.S. growth continues but at a slower pace than we would like. Shrinking government spending is a drag in 2013, and we hope growth can accelerate to 3+% in 2014. Europe is pulling out of its recession, but growth there remains a fraction of growth in the U.S. Global companies in Europe are attractive and in some cases cheaper than their U.S. global counter-parts. Emerging markets' growth has fallen, and in some cases trade deficit countries are facing funding problems as money printing in the U.S.

slows down. However, emerging market growth should still exceed developed market growth by two or three times.

World markets generally did well in the third quarter, recovering from the swoon in late June following the Fed's QE tapering talk. For the quarter the S&P 500 gained 5.3%, the Russell 3000® Index was up 6.4%, the MSCI AC World Index gained 8 %, the MSCI AC World Index ex the USA rose 10.2 %, and the MSCI AC Far East ex Japan Index was up 6.9%. Year to date, the S&P 500 rose 19.8%, the Russell 3000® Index was up 21.3%, the MSCI AC World Index gained 14.92%, the MSCI AC World Index ex the USA was up 10.5%, and the MSCI AC Far East ex Japan Index was up 1.2%.[1]

The fourth quarter begins with our Federal Government on a funding holiday and the prospect of a commencement of Fed tapering before yearend. As reported in our last letter, we have reduced our exposure to bond losses due to rising interest rates. Our hope is that the earnings of companies in our portfolios will be strong enough to lift values even if the overall market stalls. One never knows, but that is the hope!

With best wishes,

Garnett L. Keith

Note we have attached some additional comments by John Conti and David Descalzi with a focus on SeaBridge's Core Global Strategy and Asia Strategy.

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[1] Results for these indices (S&P 500, Russell 3000®, Morgan Stanley Capital International All Country (MSCI AC) World Index, MSCI AC World Index ex USA and the MSCI AC Far East ex Japan Index) are quoted as being somewhat representative of the broader equity markets for comparison to SeaBridge U.S., global, foreign and Asian portfolios. The SeaBridge portfolios differ from these indices (in number of securities held, industry, sector and country weightings, etc). Therefore, in any given period, results for SeaBridge portfolios are likely to differ from the results for these market indices.

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