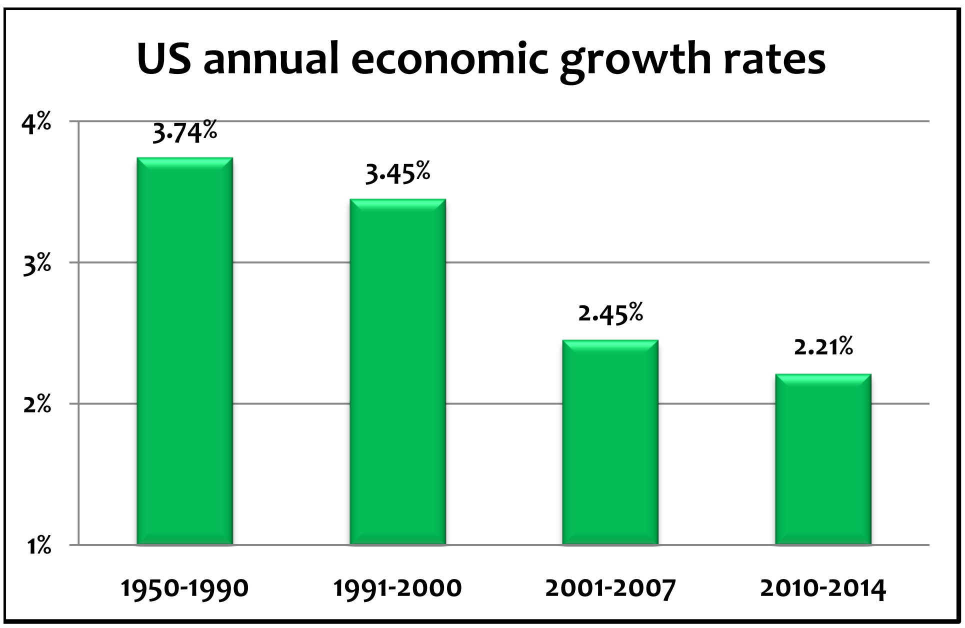
Mimosa Investment Management

4th Quarter 2015

Economic Growth = Population + Productivity

The US economy has grown steadily since the recession of 2008-2009. It has grown about 2.2% over the past five years. How does that stack up historically? What can we do about it? As chart 1 below illustrates, the rate of recent growth is far slower than the historical norms.

Chart 1



Source: US Commerce Department

In spite of record breaking low interest rates engineered by the Federal Reserve and the US government spending significantly more than it takes in every year, the economy has still grown painfully slowly. How fast our economy can grow in the long run is primarily a function of two simple things: population growth and productivity.

<u>Population Growth</u>

According to the census, the number of people living in the US grew by just 0.75% in

2014. That's the lowest rate since World War II. The current political climate surrounding immigration would suggest that this source of growth is likely to stay low for the foreseeable future. Since the baby boomers are now past child bearing age, the internal rate of growth will not likely be a source of much economic growth in the short term. Finally, the labor force participation rate recently touched a 38 year low at 62.4%, based on the September jobs report. Will more people return to the work force as jobs become more plentiful? While Janet Yellen seems to think so, it remains to be seen.

Productivity

Productivity is simply how much more the average employee can produce in an hour of work. According to the Bureau of Labor statistics, the average annual increase in productivity from 1948 to 2007 was 2.5%. From 2010 to 2014, the average increase has been only 1.2%. Economists are not sure why this rate has slowed so dramatically. Part of the reason could be that corporations are not investing in the capital goods necessary to drive higher growth. Recently passed legislation like ObamaCare and Dodd Frank are increasing regulatory costs for businesses. Some companies have also shifted research and development overseas. Cash strapped state and federal governments are not spending as much on infrastructure to make it faster and cheaper to transport goods. Some have suggested that game changing innovations have slowed down or stopped coming altogether.

We're more than ever part of a global economy where jobs and resources move at a rapid rate. It now appears that China is no longer the low cost manufacturer, and that fact has begun to slow its economic growth as well.

How will we fare?

Our current economy is growing steadily and such growth, in the 2% to 2.5% range, is predicted for the next three years by private economists and the Federal Reserve. In order to increase the rate of growth, we'll have to see an increase in the labor participation rate or have some significant technological improvements that result in substantial increases in productivity. While both are possible, neither seems highly likely. So it would appear that we need to adjust our expectation to a lower US growth rate for the foreseeable future.