

TOTAL RETURN

Get Ready for the New Normal

The financial crisis will have lasting effects—most of them positive

IN THE AFTERMATH OF THE ECONOMIC crisis, a number of financial pundits are spreading fear of a “new normal” in which Americans radically reduce their spending and ultimately stifle economic growth. Worries over this new normal are deeply rooted in the difficulties of the last decade or so. We lived through two bear markets; two recessions; two wars; the bursting of the Internet, oil, and housing bubbles; the biggest Ponzi scheme ever; a handful of high-profile bankruptcies; not to mention a couple of devastating natural disasters and the worst decade for stocks in the modern era.

Proponents of the new normal claim skyrocketing personal savings (for those who are employed) will cause personal spending to plummet. Since the American consumer represents two-thirds of our country’s gross domestic product, a “saver nation” would therefore cause the U.S. economy to struggle and wither—making the lackluster first decade of the new millennium a precursor to a prolonged stock market and economic slump. The end result of this doomsday forecast: America’s troubles drag down the global economy, creating a different and more difficult world.

My take on the new normal? It’s another way of saying, “This time is different.” But there is nothing new about the post-recession America I’m anticipating. I expect the recovery to play out in much the same way as it has in times past. People will save a rational amount—somewhere closer to historic norms in the mid-to-high single-digits, as opposed to the anemic near-zero percent savings rates of the 2000s. Consumers will spend, but without engaging in the high-octane consumption that took place toward the end of the last decade.

In my view, the last decade was abnormal. In this new decade, we’ll return to behaviors that were normal

for a long time. Normal will mean a resumption of reasonable borrowing and lending (the kind with documentation!). Normal economic growth should head back to its +3.5% long-term average, and that’s already begun. I expect to see job growth at some point very late in the recovery, which is when it usually happens. And unlike those who are concerned the U.S. economy will be impaled by the sharply rising growth of the emerging economies, I see the growth of China and India as a key ingredient of a bigger world pie.

So I am quite enthusiastic in my outlook for the stock market. That’s partially rooted in the market’s dismal performance in the decade we just left behind—where the S&P 500 Index averaged a -0.95% annual return. Keep in mind that the S&P has never had two back-to-back decades with negative returns. I take additional comfort in knowing the first decade of the new millennium ended with a rush to bonds and international stocks with U.S. stocks largely ignored. Why? When the crowd gives up on an asset class, it becomes relatively cheap, which drives better returns in the future.

In 2010, I believe U.S. stocks will continue the upward trajectory that began last March. After severe cost-cutting, U.S. corporations have never been leaner and therefore will not have to reach peak earnings to return to peak profits. Their curtailed spending means there should be pent-up demand. Inventories are low and will need to be replenished at some point in the near future. I think the piles of cash now held by private equity firms will ultimately boost takeover activity amongst financial buyers. Similarly, expect to see mergers and acquisitions heat up as strategic buyers attempt to juice their growth rates through combinations and consolidations.

Beyond 2010 and into this decade, I think investing great Warren Buffett



was spot-on in his Berkshire Hathaway 2008 annual letter when he wrote: “Though the path has not been smooth, our economic system has worked extraordinarily well over time. It has unleashed human potential as no other system has, and it will continue to do so. America’s best days lie ahead.”

What does this mean for you? Try not to overreact to yesterday’s crisis or the gloom-and-doom prognostications. You don’t need to sell all your U.S. stocks or find a bunker for stockpiling gold bullion. Instead, save sensibly, maintain an emergency fund of six to nine month’s of living expenses, and follow a rational asset allocation policy with your investments. In other words, prepare for a regular life rather than a financial ice age.

—Mellody Hobson

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