



American Century
Investments®

Economic Growth, Company Earnings, and Uncertainty



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The United States has been endowed with one of the most innovative, dynamic, and resilient economies in the history of nations.

Economic growth since we exited the Great Recession has been disappointing. The potential for strong growth is there, but until we address the underlying issues that have created substantial uncertainty among businesses, households and investors, it's unlikely we'll fully exploit the opportunity for our economy to grow at its full potential.

Where's the Growth?

If there is one question on the mind of nearly everyone, it's "Where is the anticipated and expected robust economic growth that typically accompanies recoveries from recessions?"

In a typical economic recovery, GDP (gross domestic product) growth accelerates as we exit the recession. In this recovery, the trend has been just the opposite. After posting an impressive 5.0% annual rate of growth in the fourth quarter last year, GDP growth declined to 3.7% in the first quarter this year and is now 1.6% (based on the second estimate) for the second quarter.

The potential for growth is there. The United States has been endowed with one of the most innovative, dynamic, and resilient economies in the history of nations. Unlike Europe or Japan, where population growth is stagnant or in decline, we have a natural growth rate of slightly over 1% based on higher birth rates and large net immigration. We also enjoy the advantage of having one of the most open, entrepreneurial, and innovative economies and societies in the world.

Economic Growth and Business Profits

A nation's economic growth potential depends on its population growth and the innovative capabilities of its workforce. This growth potential is fully realized through supportive government policies, effective education programs, fair legal systems, efficient capital markets, and competitive markets that reward success. When these factors are present, we have (to paraphrase Alan Greenspan) a "virtuous cycle" that

instills confidence in businesses to hire and invest, workers to innovate and seek new skills, consumers to spend and save, and our citizenry overall to plan and anticipate a better future. In this environment, the earnings, dividends, and capital gains which businesses generate also grow and feed a continuation of the growth cycle.

In today's environment, we have seen an interesting dichotomy where economic growth has been weak but business earnings growth since the recession ended has been impressive. A key factor responsible for this dichotomy is uncertainty among businesses and investors regarding new regulations, taxes, laws, and the costs of doing business. This uncertainty also extends to households as home prices remain soft and the job market weak—despite extraordinary government incentives and record low borrowing costs. The growing indebtedness of government at both the state and national level is also a contributing factor to uncertainty.

Addressing the Causes of Uncertainty

Addressing the underlying causes of uncertainty is going to be necessary before we can fully exploit the economic growth potential, jobs creation potential, and earnings potential for the U.S. economy. Fortunately, in the interim, there are parts of the world—notably the developing economies—where robust growth will help the global economy maintain positive overall economic growth. But in this type of environment where uncertainty is a key determinant of short-term performance for sales and earnings growth, broad and effective asset allocation is a crucial element of any investment strategy.