Marble Harbor Investment Counsel, LLC
Fourth Quarter, 2022 Letter

We are pleased to send an excerpt from our quarterly client letter that discusses our current thinking. We welcome your thoughts.

Sincerely,

Paul Davis, L.J. Harrington, Eric Robb, Daniel Rosenblatt and Howie Cowan

****

A country's economy is a product of its population and how much each person produces, while a country's growth is comprised of how the population changes and how efficiently that population can make things. China has many more people than the United States, but they utilize their human capital less efficiently, so China's GDP is still lower than the United States, though for most of the last decade, their population grew, and each worker became increasingly efficient, albeit from a very low starting point.

Population changes slowly over generations, but then all of a sudden we notice the remarkable growth that has taken place. In his 1969 letter, *Three New Years Resolutions* (to read go to *www.marbleharboric.com/resources/quarterlyletters/12_2020_The_Harbor_Light_-_DLB.pdf*), David L. Babson called population growth one of his Predictables. He knew with certainty it would grow, driving economic growth and, in the long-term, stocks, and he was right. Since 1969, population growth has been a steady 1% per year.

For investors today, that once reliable tradewind looks likely to be somewhat less consistent and be spread differently around the world. The Congressional Budget Office (CBO) predicts that the prime working age U.S. population will grow only 0.2% per year for the next forty years. While that is still growth (which is better than some European and Asian countries), it is a much slower rate. The future population growth champions seem to be India and Africa.

Why has global population growth slowed? In 1900, women around the world had on average 6 children. Child mortality was high, and couples had numerous children to ensure that at least some survived into adulthood, often to take over the family farm or business. With the advent of modern medicine and sanitation, child mortality fell, and couples decided to have fewer children. This has been the case all over the world. Only places with high child mortality still have high population growth. This dramatic improvement in childhood survival had some remarkable economic effects. First it ensured that more people reached productive adulthood. Second it unleashed a massive untapped source of growth as women around the globe could move from exclusively being focused on motherhood to also taking jobs in industry.

It turns out most couples around the world want two children, which is just below the rate necessary to maintain the population. At 1.6, the U.S. is almost keeping up, while Western Europe and China have fallen well below this mark. Italy and Japan are far behind at 1.2 and 1.3 respectively. Surveys show that parents would like to have more children, but don't feel that they can afford to do so. In the U.S., we have been able to offset our fecundity shortfall through immigration. Japan, however, discourages immigration and thus is increasingly challenged by a shrinking and aging population.

In the early 2000s, the United States welcomed 1.5 million immigrants per year. Our birth shortfall actually created an opportunity for us to receive some of the most productive and ambitious people from every country around the world as we've done since the nation's founding. Today, the country's attitude toward immigration has shifted, and we accept about 1 million immigrants annually. That same CBO study shows that even at reduced levels, immigration will result in three-quarters of population growth over the next ten years, and after 2043, all of it.

What does it mean investing in a world with lower population growth? We will have to invest in technology that allows fewer people to do more. If you give a laborer a shovel and pick axe, he is ten times as productive as scrabbling with his fingers. If you give him a wheel loader, he is 42,000 times as productive.

Where are we looking for the pick axes and wheel loaders of the new millenium? Technologies like semiconductors, artificial intelligence and robotics will help fewer workers to produce more. Medical devices and pharmaceuticals will allow doctors and nurses to take care of larger, aging populations. Some of these productivity enhancing technologies are in your portfolios and more will be over time.

If Western Europe, Japan and China are shrinking, where is the population growth in the world? Today, it's in India and Africa. China has been the most populous nation for the entirety of recorded history, but soon it will cede that crown to India. Next up, Africa. Of the approximately 3.3 billion more people in the year 2100, most of those will be Africans.

Through emerging markets funds, we are invested in India and South Africa. Demographics are better in emerging markets, as well as valuations. Today, the rest of Africa is still a "frontier" market, since there is little liquidity and the rule of law is not fully developed. Eventually, these nascent markets will develop into emerging markets and become more investable. Many of your companies already have big businesses in Africa that are growing with the next generation of consumers. America is still the best place to headquarter a company – benefiting from the rule of law and deep capital markets. However, your companies see the world as their oyster, and they will continue to invest where the population is growing and people are spending.

How does an aging population affect us personally? As life expectancies grow, we must make sure to keep our investment horizon long enough to provide for our whole lives. Healthy individuals, both men and women, need to plan on living into their 90s. That means asset allocations need to reflect longer life spans. Equities must play a prominent role in keeping up with inflation. High allocations to bonds as you retire virtually guarantee a retirement of steadily declining income and flexibility. If you retire at 65, you should expect to need investment income for perhaps 30 years. That's nearly one third of a lifetime. Volatility in equity markets *seems* risky, but falling behind inflation for 30 years because of a "conservative" asset allocation is a much more insidious risk.

In 1969, Dave Babson was right about population growth, and this insight has served a couple of generations of investors well. Looking forward, this Predictable is still instructive; however, it will be a softer tailwind, and it will come from a somewhat different direction. Our research will take us toward productivity boosters that will drive the next phase of both American and global growth. This is a more challenging prospect but one that will provide us with numerous opportunities.

Please don't hesitate to contact us if you have any questions.

Sincerely,

Paul, Eric, LJ, Dan and Howie

* * * *
