Country Profile: The United States

November 2009
It has never been more important for you to understand what is occurring in the world beyond your country’s borders. Whether you realize it or not, we are now all fellow citizens…Global Citizens.

The Thomas White organization was founded in 1992 with the goal of bringing the benefits of globalization to investors around the world. We believed that once investors understood that globalization was a positive force, they would also see the advantages of adding international equities to their portfolios. It only makes common sense that professional investors would begin searching the globe for the most attractive opportunities. Researching a wider universe of companies should improve long-term performance. Moreover, broad diversification typically lowers return volatility. Multinational corporations have been using this global strategy for years; why shouldn’t investors do the same?

Now 15 years later, our firm growth and strong subsequent portfolio performance has confirmed our investment premise. Currently, Thomas White professionals are performing research and managing over one billion dollars in close to 50 countries. We believe one reason for our success is that the nationalities of these analysts are as globally diverse as our portfolios.
The United States: Fulfilling the Promise of the American Dream

The world’s oldest democracy, the only super power, the single largest economy, the leader of the free world, the biggest influence on global pop culture and the most diverse country in the world – the sobriquets about the United States are as grand and varied as the land itself. No other nation has played a bigger role than the U.S. in shaping history in the 20th century, and no other great power in history has enjoyed as much global influence as the U.S. does now, without assuming direct political control over vast territories. And perhaps, no other country has occupied the global conscience over the last century like the U.S., or has been as loved or misunderstood as much either.

Flanked by the Atlantic and the Pacific oceans, the U.S. is the third largest country by area and the third most populous. The 50 states which form the country cover an incredibly diverse topography, from snow-tipped mountains and vast deserts to long coastlines. For the last many centuries, ‘the land of the free’ has attracted more fortune seekers and other migrants than any other country.

The New World that rose to global domination

A vast, abundant, and hitherto unknown world lay before the first Europeans who landed on the east coast of the Americas, which they aptly called the New World. Though dazzling in its spread and natural riches, colonization of this newly discovered land by the major European powers was gradual. While the Spanish, the French and the Dutch were successful in annexing territory and establishing trading posts in the 16th and
17th centuries, it was the British who became the dominant power in North America after The French and Indian War in the mid-18th century.

British attempts to recover the heavy cost of The French and Indian War through higher taxes in its American colonies led to widespread discontentment. To make matters worse, Britain refused to grant political representation to the colonists. Disenchantment with British rule eventually led to the American Revolution and the Declaration of Independence. From the 13 colonies which declared independence, the U.S. later expanded its territory to the Pacific coast in the 19th century.

Territorial expansion facilitated large-scale organized farming which led to substantial economic growth. Expansion of the road and railroad networks provided easy market access for farm produce from hinterlands. The second half of the 19th century saw rapid industrialization and the share of manufacturing in national income steadily increased. Cotton ginning and cloth manufacturing formed the primary industry during this period.

Towards the end of the 19th century, exploitation of the country’s vast mineral wealth accelerated the process of industrialization which came to be known as the Second Industrial Revolution. Yet, unlike European countries which relied on resources from distant colonies, the U.S. had extensive reserves of natural resources within its own borders. The steady flow of immigrants into the country ensured that a sufficiently large labor force was always available to meet industry demands. Coal and oil became the primary energy sources, large mines were opened, and mills were built to process the minerals into metal. Mass-production methods created unprecedented entrepreneurial opportunities, establishment of large industrial empires, and creation of incredible wealth for their owners. The era came to be known as the Gilded Age and by the turn of the century the U.S. became the world’s largest economy.

### United States and the World

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<thead>
<tr>
<th>Metric</th>
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<tr>
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**Major Industries**

- Financial Services
- Oil & gas
- Automobiles
- Defense and Aerospace
- Telecommunications
- Consumer Goods
- Retailing
- Pharmaceuticals
The American century

The Spanish – American War, which resulted in the U.S. gaining control over the remnants of the Spanish Empire, coupled with the World War I, established the U.S. as the dominant global power. Though the country did not enter the conflict until after three years, it was American intervention which turned the Great War decidedly in favor of the Allies. The U.S. also provided the most financial support to the Allied war effort.

Over there…the Yanks are coming! Decisive intervention in the Great War – the war to end all wars – established the military primacy of the U.S. By then, the U.S. economy was twice as large as Britain’s.

During the decade after the Great War, U.S. economic growth accelerated as the workforce returned to the factories and private consumption increased substantially. Massive development of transport infrastructure, electrification at an unprecedented scale, and advancements in telecommunications led to a surge in industrial output. Technological and industrial innovations like automobiles became accessible to large sections of the population as “Yankee ingenuity” and Henry Ford’s mass-production techniques made them affordable. The period came to be known as the ‘Roaring Twenties’ and was marked by increasing urbanization, emergence of labor movements, and progressive government policies.

This decade of spectacular growth was followed by the Great American Depression, which began in 1929. The excesses of the credit-driven boom during the Roaring Twenties created highly inflated asset prices, which eventually corrected in the massive stock market crash that year. Restrictive monetary policies followed by the U.S. Federal Reserve worsened the situation. The U.S economy steadily contracted for the next four years and after another three grueling years finally bounced back to pre-Depression levels. The economy again fell into recession a year later and it took increased military production before World War II to hoist economic growth back on track.
Like in the prior Great War, the U.S. was a late entrant in World War II and once again played a decisive role. The country provided military equipment and financial support to the Allies during the early stages, before the Pearl Harbor incident forced the U.S to join the conflict. The U.S. then contributed substantially to the Allied invasion of Europe and secured the surrender of Japan which effectively ended the war. After the war, the U.S. took the lead in rebuilding Europe and Japan. Helped by the economic and technical assistance offered under the Marshall Plan of reconstruction, the economies of Western Europe and Japan started reindustrialization and recovered at a fast pace.

The period of nearly two decades after World War II was marked by unprecedented economic changes in the U.S. Triggered by increased government spending in post-war reconstruction, economic growth accelerated further on the back of technological innovation. The most significant change was the dilution of economic disparities and the emergence of a vast middle class.

Except for a period in the early 80s when tight monetary policies aimed at fighting runaway inflation led to an economic slowdown, the American economy enjoyed sustained growth. Then the 'technology bubble burst' in 2000, and in the following year, the country was devastated by the 9/11 terrorist attacks. Despite this, the U.S. was helped by a favorable monetary policy, and the economy recovered and expanded at a good pace until the credit crisis in 2007. Even though the housing market has corrected appreciably, other segments like manufacturing remained resilient and have bolstered the economy.

**In search of the American Dream**

Though America was new to the early European settlers, the land was home to hundreds of different communities of indigenous people for many millennia before that. It is widely believed that the continent was first inhabited by people of Asian origin who crossed over during the Ice Age to modern day Alaska. Left alone after the ice bridge across the continents melted, these early settlers spread across the land and developed very distinct and dynamic cultures, complete with their own languages. While many of these communities were lost to successive waves of migration into America, some still preserve their culture in reservations set aside for them.

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The first major group to migrate to the U.S. comprised English settlers who set up the first colonies in the first half of the 17th century. While many were exiled by the British government to the penal settlements, others were fleeing from religious persecution or were in search of better economic opportunities.

The distance from Europe and the difficult circumstances under which most of them moved to America led to the development of a very distinct ethos among the new settlers. Unlike societies in Continental Europe, the new settlements in America developed without rigid class structures. Land ownership was within the reach of even the poorest immigrants, and many were willing to accept indentured labor for a few years in return for a passage to America.

The image of America as the ultimate destination of every immigrant seeking to escape poverty and persecution at home was built on the success of these pioneering settlers. During the 19th century, millions of Europeans migrated across the Atlantic in search of the great American Dream – the idea of a land which offers immense opportunities for material success, unrestrained by class, race or ethnicity. This wave of migrants provided an abundant and cheap source of labor, and was the primary driver of U.S. economic growth during that period.

The Gilded Age saw a dramatic jump in economic opportunities and redefined the American Dream by establishing industrial entrepreneurship as a way to create immeasurable wealth. The social programs of the 20th century, like the New Deal and the G.I. Bill, added a new dimension by offering economic opportunities to more people. This led to the expansion of the middle class.

**Still a land of promise and hope for many**

Though the American Dream emphasized opportunities for everyone irrespective of gender, race or color, in reality the American society was far from that dream. It was only during the Great War that women entered the workforce in large numbers, an event which had significant economic consequences. Similarly, African-Americans suffered decades of slavery, discrimination and denial of basic human rights. Though slavery was abolished in the U.S. during the 19th century, it was not until a century later that African-Americans were accepted...
into the mainstream. In a testimony to America’s resiliency, both a woman and an African-American sought their party’s nomination to run for the highest political office in the U.S. in 2008.

The social programs, the Civil Rights Movement which led to the assimilation of African-Americans, and the emergence of a vast middle class, increased the attractiveness of the U.S. as a destination for people from all over the world. Another factor was the emergence of American universities as major centers of learning, which attracted the best and brightest students from across the world. The post-war years also saw the establishment and growth of major scientific and research organizations. The wide range of opportunities and better standard of living encouraged the students, researchers and highly skilled individuals to come to the U.S., and provided the economy with an enviable talent pool. To this day, the country is a land of opportunities, promise and hope for many and is likely to remain so in the foreseeable future.

The American way of life

The U.S. owes its cultural diversity to centuries of migration by people of different color, race, and creed from all corners of the world. As most of the early settlers were of European origin, the country was distinctly European in customs, arts, music, and cuisine even before becoming an independent nation. The cultures of the indigenous people gradually disappeared as they lost ground or were sidelined by the new settlers. Following the abolition of slavery, African influences started entering the popular culture and this process gained strength during the last century. With the influx of immigrants from other parts of the world, especially Asia and Latin America, the American culture added many more layers of diversity and vibrancy during the last century.

The media explosion during the last century, mostly a result of the rapid growth in radio and television broadcasting, saw the spread of American culture to other parts of the world. Even before that, Hollywood had cast its spell and became ‘the world’s dream factory’. As the U.S. was by far the dominant economic power by then, it naturally became home to the biggest media and entertainment corporations which accentuated the American influence over global popular culture.
The media and entertainment channels helped spread across the globe the concept of an ‘American way of life’, a distinct culture with its emphasis on individual liberty, freedom of expression, and free-market capitalism. As the concept of the U.S. as the land of opportunity, encapsulated in the American Dream’, was well-established, the American way of life easily gained currency in most parts of the world. The advent of the Internet accelerated this process. With more than 70% of America using the net now, content about the land and the people is plentiful on the web. So great has this influence become, that it is now safe to say the global popular culture is predominantly American.

**Biggest source and destination for investments**

Being the largest economy on the planet, it is only natural that the U.S. is the leading source of investment for other countries. America is home to large-scale worldwide corporations which have been at the forefront of the globalization wave. In search of new markets, production bases and other opportunities, these corporations have spread their tentacles across the world, bringing much needed capital and technology to underdeveloped regions.

It may surprise many that the U.S. remains the biggest destination for investment, despite the rise of other major economies in recent years. During 2008, when the global financial crisis caused foreign direct investments to developed economies to fall nearly 30%, investment inflows into the U.S. increased to an all-time high of $316 billion. The cumulative stock of such foreign investments in the U.S. now exceeds $2.4 trillion, many times the investments into China which has supposedly been the most attractive destination for foreign investments for the last two decades. Investors are attracted to the U.S. and its open and free economic environment, vibrant business environment, healthy corporate governance standards and the wide range of investment opportunities. The country remained the biggest source of investments for the rest of the world, with outflows of $312 billion in 2008.

No other country comes anywhere close to the U.S. when aggregate financial investment inflows are considered. The healthy capital inflows have also helped the U.S. to finance its excessive New York, along with London, is the global financial nerve center and, despite the financial crisis, remains a major driver of U.S. economic growth. The entrepreneurial empire, as the U.S. is often called, remains the most competitive economy and has accounted for over a quarter of global economic output for more than a century.
trade account deficits in recent years. Probably the most significant factor which enhances America’s attractiveness as an investment destination is the presence of highly developed financial markets. These markets offer a wide range of financial securities and other asset classes which suit the needs of every kind of investor, from large sovereign wealth funds to retail investors. The depth of these markets ensures a very high ability to absorb large investment flows. These factors continue to sustain New York’s reign as a major global financial center, a status that helps the U.S. economy considerably.

The global financial crisis might have dulled the attractiveness of financial investments in general. However, the sheer size, transparency, efficiency, and above all liquidity of America’s financial markets remain unrivaled. Unless markets in other countries catch up, the U.S. is likely to remain a major destination for investment flows. Also, as global uncertainties increase, investors usually look for markets which are the most liquid and the safest in terms of sovereign ratings. Despite concerns over weakening U.S. government finances, there is no other market which can rival the U.S. on both the factors, as yet.

**Policy efforts prevent depression, lead to recovery**

The recent financial market turmoil and the economic recession that followed was the worst crisis to have hit the American economy since the Great Depression. The crisis had its roots in the spectacular housing boom that lasted several years until 2007. The very low interest rates that were necessary to tide over the post-9/11 economic decline paved the way for an unprecedented increase in housing prices across the country. At the peak of the rally in 2006, average housing prices were way above their long term trend. Subsequently, when interest rates started rising, housing demand waned and prices started declining.

Unfortunately, a large number of mortgage borrowers were not prepared for the housing decline and defaulted on repayments. As a result of the fast growth in securitization over the last few years, these mortgage assets were held by investors in the form of complex financial instruments. When the mortgage defaults started rising, these instruments lost value rapidly as they were relatively illiquid. The large institutional investors who held large positions in these securities
suffered huge losses, which led to an erosion of their capital base, investor confidence, and market liquidity.

Many large banks and other financial firms across the globe were pushed to the verge of failure and marked confidence dipped. Central banks stepped in with interest rate cuts and liquidity infusions to revive the markets, but the credit markets remained frozen as markets were unsure of the financial strength of most banks. As the banking sector was the worst affected, credit availability to businesses and consumers declined dramatically and the crisis spread to the broader economy.

Realizing the scale of the crisis, the U.S. government and the Federal Reserve stepped in with emergency measures to stabilize the markets and lessen the pain to Main Street. The Fed reduced interest rates sharply to the lowest in history, besides providing liquidity support to banks and even non-depository financial institutions which were struggling. To ease credit markets, the Fed intervened directly in fixed income markets and purchased securities, including treasuries and agency debt.

On its part, the U.S. government launched a series of programs aimed at providing financial support to troubled firms and to revive demand in the economy. Among the major initiatives were the $700 billion Troubled Assets Relief Program or TARP which provided capital support to banks, the $787 billion American Recovery and Reinvestment Act which offered tax cuts, financial incentives and infrastructure project funding to revive the economy, and the Public Private Investment Program for Legacy Assets designed to clean up the toxic financial assets from bank balance sheets. The U.S. government also took the lead in coordinating international efforts to manage the crisis and revive the global economy. These efforts led to the formal recognition of the G-20 as the forum to promote international economic cooperation.

The exceptionally large interventions by the government and the Fed helped in containing the economic downturn and preventing a repeat of the Great Depression. Though the recession was the worst in several decades, the recovery happened soon enough to avoid an extended period of weak economic activity. However, a combination of factors including consumer deleveraging, excess capacity in the manufacturing sector and, inadequate credit availability to small businesses has kept the unemployment rate higher. The housing market recovery has been slow-paced because of stagnant income levels, the overhang of unsold homes, and tighter credit standards.

**Despite doubts, the greenback remains world’s reserve currency**

After the U.S. emerged as the dominant global economic power and the major influence on global trade and investment flows, the U.S. dollar achieved the status of ‘reserve currency’. Supported by the ‘strong dollar policy’ of successive American governments, the currency has held pride of place among major world currencies. Also, the U.S. dollar is the only currency which is more in circulation abroad than the home country.
The dollar’s status as the world’s reserve currency also allowed the U.S. to run large current account deficits. Eventually, the deficit rose to unsustainable levels and, coupled with higher fiscal deficit, led to a decline in the value of the dollar. In a steady decline which lasted many years, the currency nearly halved in value against the euro, the European common currency, which has gained strength after a subdued introduction in the late 90s. The weakening dollar trend was briefly disrupted during the peak of the global financial crisis, when investors flocked to dollar denominated assets, like U.S. government bonds, as a safe haven. As the crisis ebbed, the dollar gave up its gains.

The currency weakness actually led to an improvement in the current account deficit, as American exports became more price-competitive in foreign markets. This increased export demand helped the manufacturing sector and has been a major support for economic growth recently. The weak dollar also benefits the increasing number of American corporations which are expanding their overseas businesses. Because of strong domestic consumer demand, the weak dollar’s impact on imports has not been very significant until the onset of the recession.

The sustained dollar decline has led to fears that the currency will lose its reserve status, as foreign governments increase their holdings of other currencies. So far, these fears have been unfounded. Despite the decline, nearly two-thirds of global currency reserves continue to be in the U.S. dollar.

While there have been public statements from select countries, especially China and Russia, about the need to end the dollar dominance, none of them have significantly reduced their dollar assets.

While the immediate risks to the dollar’s status are limited, the expected strain on government finances because of the financial rescue and economic stimulus programs may cast a shadow over the dollar’s long term outlook. If the deficits are not brought under control, the country’s creditworthiness and the currency’s status will be eroded. Calls for a new global currency to replace the dollar will increase and existing investors moving out of dollar assets will worsen the decline.

The mantra, “the bigger the better” faded as Americans were forced to shed their fascination with supersized products like big cars and SUVs as energy prices climbed before the crisis. Though oil prices have corrected sharply, the quest for alternate fuels which will foster energy security remain critical for future American growth.
Global growth engine, ready to face down challenges

In recent years, there has been no dearth of economic studies and forecasts which have predicted that the U.S. will lose its economic preeminence to other large economies like China over the course of this century. The economic recession, which affected developed economies like the U.S. more than the emerging economies, has strengthened this proposition. The factors cited in favor of the emerging economies include a young and large population, fast growing middle class, increased globalization which benefits emerging economies and, technological and logistical advancements which provide easier market access.

While it is true that all these factors have contributed to rapid economic growth in countries like China and India, developed economies like the U.S. continue to enjoy significant economic advantages. In the long run, economic performance depends more on technological innovation, and equally important, the development of markets which foster competition and efficiency. In all these areas the U.S. has been way ahead of other large economies for over a century now.

That is not to say there are no major challenges facing the U.S. economy now. Lower domestic demand because of the economic downturn and cheaper commodity prices have led to a decline in imports, and a narrower trade deficit. However, unless American exports become more competitive, the gains will be reversed as domestic consumption growth revives. Additional government spending for the financial rescue and economic stimulus plans has widened the fiscal deficit. Ambitious policy initiatives like the healthcare reforms will make it even worse, and erase the prospect of any improvement for several years. To reduce growth risks and prevent economic growth from stagnating, these structural challenges need to be addressed without delay.

Until recently, there had been a lot of debate in the country on improving energy efficiency to reduce reliance on imported oil, which is a major factor behind the country’s deficits. From less than a third of total consumption in the 70s, the share of oil imports has nearly doubled and is expected to touch 70% in another decade. This rising ‘transfer of resources’ to the big oil
producers has immense strategic significance too. The quest for energy security has dominated public discourse and has become central to American foreign policy.

However, the decline in energy prices and the economic crisis have already pushed the energy debate to the back burner. Decreased availability of capital and credit because of the financial crisis has affected investments in research and development of alternate energy sources. Many renewable energy projects launched before the crisis have either stalled or have been abandoned. Though lower fuel prices offer some relief in the short term, if conscious efforts are not made now, the reliance on imported oil will remain as a big risk for the American economy.

As the emerging economies are investing heavily and bridging the infrastructure gap with the U.S, additional investments will be required to upgrade existing infrastructure which will make the economy even more efficient. As more government funds are diverted to fight the financial crisis and the economic slowdown, infrastructure projects which are essential to improve long term productivity in the American economy may suffer a shortage of funds. The country has been trying hard for decades to revamp its healthcare system to ensure that it is accessible and affordable to all. An acceptable and optimum solution is yet to be in place and remains a daunting policy challenge. The aging American population adds another dimension to the healthcare challenge, besides increasing burdens on the Social Security system.

Another significant challenge facing America is whether the country can retain its position as an innovation powerhouse. While the U.S. remains the major base for research in cutting edge technologies, other nations are poised to catch up. More than financial investments, this sector needs a large resource base fueled by a highly skilled workforce, which the country has successfully attracted in the past. To retain the edge in technology and innovation, America has to ensure that the human resource base remains as large as it is.

Even in the wake of the financial crisis and the economic recession, it will be a mistake to restrain the push towards increased trade with other economies. Increased integration with the

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rest of the world has helped America, especially in the form of higher exports of goods and services which support a large number of domestic jobs. In the recent past, imports of lower cost consumer goods has increased the consumer surplus and helped contain domestic inflation. Continued openness to external trade will help the economy in the future as well. The nation also needs to adopt a truly global mindset, which looks beyond its borders in areas such as the environment, and in the case of energy, the U.S. must begin the transformation into increased use of renewable sources. Achieving these goals, the U.S. can continue to be the global economic growth engine that it is today.

This, together with the country’s promise to provide its people the freedom to grow, prosper, love, and pray in the manner they choose, will foster America’s status as a world leader.

“If, as I have said, the things already listed were all we had to contribute, America would have made no distinctive and unique gift to mankind. But there has been also the American dream, that dream of a land in which life should be better and richer and fuller for every man, with opportunity for each according to his ability or achievement” – James Truslow Adams, The Epic of America.
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