



Uncertainty, “Black Swans” and the Global Economy

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Nassim Nicholas Taleb developed the “Black Swan Theory” to help explain hard-to-predict and rare events that have a major impact and are subsequently explained as having been predictable in hindsight. He also wrote about the psychological biases that make people blind to uncertainty and unaware of the significant role of rare events in historical context. Over the last few years, 9/11, the United States’ sub-prime mortgage crisis in 2007, the earthquake and subsequent tsunami in Japan have been rare events that have had and are having a major impact. The financial markets have reacted to these events, as well. While negative on impact, subsequent green shoots with consequential economic growth have spurred new growth.

Recent unexpected events that may be viewed as “Black Swans” because it is a wide degree away from the likely have given rise to what we perceive to be a greater fear of the uncertainty of the future. We are so often biased in our expectations by recent experiences. These unexpected events that are explained in hindsight have seemingly become more frequent over the last few years, as well. While disruptive, we believe the global community has become increasingly proactive and cooperative in its response to such events. For example, the cooperative United Nations effort in response to Libya’s uprising and China’s supportive response to both Japan’s catastrophe and Greece’s debt crisis exemplify proactive support. This may be indicative of the recognition that in order for individual countries to thrive, the global ecosystem must function. The impact globally of the U.S. housing crisis, as well as the most recent concerns about supply chain disruptions for automobile parts and semiconductors due to the Japanese earthquake, has highlighted the interconnectedness of individual country economic growth. That China, a developing country with the world’s largest trade and current account surplus, as well as about one third of the world currency reserves, has responded to support the well being of the affected countries demonstrates to us the recognition that the global ecosystem matters.

We observe both tremendous global headwinds and opportunities. The greatest long term challenge revolves around the need to reduce debt levels in countries such as Greece, Portugal, Japan, and the United States, in our opinion. The greatest opportunity we see is the changing complexion of the global economy to support industrialization in developing and emerging countries such as China and India.

Coincident with change, dislocations can occur such as operational issues for global companies which may lead to more “nearshoring” rather than “offshoring” to accommodate future growth. This creates uncertainty, but not necessarily Black Swans. Natural disasters and political upheaval may be considered “Black Swans”, yet it may be when we look back with historical perspective that these hard to predict and rare events are no longer that rare and impactful in the greater scheme of the global ecosystem, but rather are a challenge that the global community will respond to collectively within the greater picture of industrialization. This time period may have similarities to that which the United States experienced as it industrialized and that which Great Britain experienced a century earlier.

The International Monetary Fund forecast for 2011 world output growth is 4.4% with 2.5% attributed to the advanced economies and 6.5% attributed to emerging and developing economies. The recent Japanese earthquake, while devastating in its human toll, should not derail the global growth potential. Both the added liquidity by the Bank of Japan and government fiscal stimulus should alleviate the near term economic risks, while the continued industrialization in emerging and developing countries promotes adjustments to accommodate dislocations caused by the unanticipated disruptions such as those caused by events in Japan. China, for example, continues to be on a trajectory for about 20 million cars and trucks to be sold there in 2011. This would be greater than the 2005 peak year in the United States. Car ownership in China is estimated to be about 4-5% versus 70% in the United States. While 70% may not be realistic, there is much room in between given 1.4 billion people in China.

As investors move through 2011 and into 2012, dealing with uncertainty may become the norm. The relatively more important data points may be the global response to what can be termed a “Black Swan”, which, in reality, is a step in the changing complexion of the economic growth for the world. By way of example, China’s influence in the world is growing, it is a developing country ruled by the Communist party, and it has the world’s largest currency reserves. A stable and cooperative global community is a key component of the circumstances under which we would anticipate the likelihood of success of China’s smooth transition to a healthy, vibrant developed country over the coming years. Within that context, [size, momentum, and velocity](#) should benefit those companies that adjust to the changing needs of the world.

~Julie Bryan, Director of Research, CFA

~Mark Gaskill, Chief Investment Officer

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