Growing into the Future

At the Wellbeing Cafe in November 2022, Steve Watters, Head of Impact at Paradigm Norton Financial Planning, presented a talk to the IFW community, which engaged members so strongly that it went on to form the basis of our January 2023 Regional Meetings with the discussion topic 'How can we survive, and thrive, in a new era of financial planning?' This topic continues to interest IFW members as we look at ways to thrive in future.

This is the summary of Steve's presentation.

The laws of thermodynamics tell us: energy in = energy out. This suggests no closed system can sustain exponential growth forever.

As an example, when brewing beer in a barrel the yeast grows exponentially. The alcohol content steadily rises until the point at which the sugar has all been converted into alcohol. Then equilibrium is reached and the process stops.

What are the limits to growth?

Our economy is underpinned by resources which are finite. Humanity has sustained about 200 years of global economic growth since the industrial revolution. But can this continue? Even if not forever, then for the lifetime of those who are alive today – the next 100 years?

The decline in growth rates we've seen in developed countries may indicate that some of those economies are entering the top of their growth curve, known as 'secular stagnation'. The market crashes of 2000, 2008 and more recently might be symptoms of that.

The idea of limits to growth has been widely debated since it was proposed in the early 1970s. A group of academics predicted that declines in resources and available food per capita, offset by population growth and pollution, would limit industrial output and economic growth.

Commissioned by a parliamentary group, a recent analysis of the original research model found that "there is unsettling evidence that society is still following the standard run of the original study in which overshoot leads to an eventual collapse in production and living standards."

There is another limit to growth that wasn't considered in the original 1970s model, and that is 'planetary boundaries'. In 2009, scientists defined nine systems that regulate resilience of the Earth, or which four have already been breached.

This could have significant implications for economic growth.

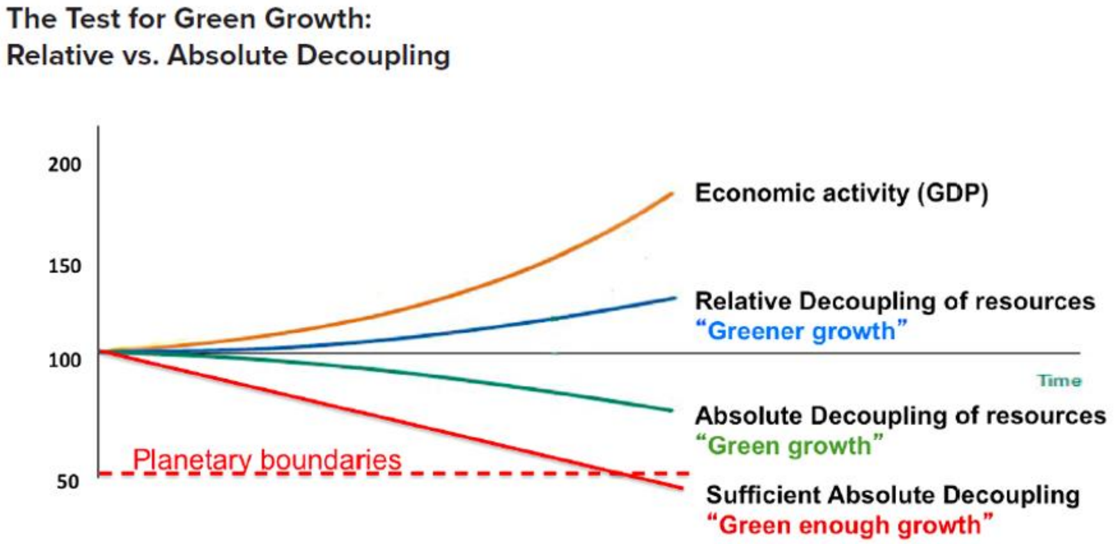
Could 'green growth' be the solution?

The economic growth of the past two centuries has only been possible due to the extraction of fossil fuels. Now we urgently need to change to new sources of energy.

However, unlike a barrel of beer, our Earth is not a completely closed system. The sun provides us with light and energy. Therefore advocates of green growth believe innovation will provide solutions that enable ongoing growth, through this transition.

Certainly, investments in green technologies may stimulate economies and markets in the short and medium term and provide growth. However, the technologies we need don't all exist yet. There are also strong limiting factors. To stay within safe planetary limits, most economies need to completely uncouple growth from it's impact on planetary boundaries.

In high income countries our lifestyles currently take the equivalent of three Planet Earth's resources to sustain. If growth continues, then marginal reductions in resources won't be enough for the planet and humanity. As shown below, for GDP to continue to grow, resource use would need to also continue to reduce, decoupling from growth even more, ad infinitum.



Source: Kate Raworth / Positive Money

Economic modelling suggests that a successful energy transition whilst maintaining growth is highly uncertain and would require actions 'only previously seen in a wartime economy'.

Plus getting to net zero emissions won't be enough. Scientists say we also need the technology both for carbon dioxide removal and for mass climate repair and restoration. This could include weather technology to generate snow on an immense scale (whilst being net-zero) in order to hold rising sea levels in check.

So it's clear we're entering an unprecedented time in human history. Growth may not last forever. It may slow or stop in the future.

How can we adapt the way we forecast and invest?

Even if we still have growth for a while longer, society may now have reached a tipping point, which can be a more significant moment than when something ends altogether.

It seems that financial shocks, perhaps characteristic of slowing growth, are becoming regular. People and economies are being affected now and the financial system doesn't appear to have much resilience to withstand this.

If there are limits to growth, this implies there is probably a limit on the investment that drives that growth and consumption. However, money creation is not currently limited. Banks create loans that are often channelled into activity like buying houses, land, stocks and shares. These investments often do not create new wealth to pay off interest on the loans, but instead earn a return simply by pushing up the price of the existing assets. Quantitative Easing has pumped in eye watering amounts of additional money. Both corporate and government debt are at record highs.

You might question whether the car is still driving or whether we're in one of those old films where people are frantically moving the background to make us believe in the pretence.

When stresses and shocks come amidst this backdrop, economies and markets may suffer greater losses and the global economy may have less resilience to enable a swift recovery. We're perhaps more aware than ever of the world changing around us.

Key drivers of change include:

- Demographics
- Climate crisis
- Technology
- Populism
- Energy transition
- Planetary boundaries

Some key risks are:

- Growing inequality
- Climate shocks
- Pandemics
- Geopolitical tensions
- Inflation
- Sovereign debt crisis
- Currency collapse

We're living through a major change, which in time may lead to a realignment of the global order. It's not 'the end of the world', but our future could bring a world very different to the one we've known. That may not entirely be a bad thing.

What does this mean for advisors, and our clients?

When we advise clients, we rely on historical evidence about long-term investing.

What if fundamental things are changing that mean that historical patterns may not hold in future? What does this mean for those of us who help people plan for that future?

There's more uncertainty than ever, but we can try to increase resilience in the short term.

We should:

- Prepare for unprecedented shocks
- Diversify – important for both your clients and your business
- Start to redefine what it means to be an investor

We can help our clients contribute to the regenerative economy of the future.

There are very likely to continue to be profitable companies who align strong social and environmental purpose with a profitable business model. These businesses will need investment and could pay dividends on profits.

We know that we need to see reallocation of capital in the short term – there are technology solutions that need significant investment to enable us to transition.

There is enough information available to enable us to align our investments and our strategies with the known challenges and needs of humanity in this new era.

What might it mean to be an investor for the future?

- Being less growth-focused – unlinking from consumption
- Focusing on efficiency, not extraction
- Seek sustainable income from corporations, rather than growth
- Less debt-dependent economy
- Embracing 'the art of enough'
- Seeking social & environmental returns
- Being engaged in our money, and by being activist investors.

What do you think?

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