Views & Visions

A publication of Bowles Rice LLP

Fall 2014

Global Markets Offer Potential for Great Reward

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H. Craig Slaughter is the Executive Director of the West Virginia Investment Management Board, the entity responsible for investing the state's moneys, its defined benefit plans, and workers' compensation funds.

Mr. Slaughter has been responsible for the state's investment portfolio since leaving the practice of law in 1989. He has been instrumental in bringing the state's investment structure into the modern era.

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Mr. Slaughter serves on the board of the West Virginia Land Trust, the West Virginia Cycling Foundation, and the Kanawha Valley Community and Technical College Foundation. He is a member of the National Association of Public Pension Attorneys, as well as the West Virginia State Bar.

He received his law degree from the West Virginia University College of Law. He earned his bachelor of arts degree in history from Cornell University.

In 1790, when the last two states ratified the U.S. Constitution, the United States was an emerging country without a stock exchange. It wasn't until two years later that its first exchange was formed under a buttonwood tree at 68 Wall Street.

At the time, the "developed" world was centered in Europe, with functioning centralized exchanges in London, Paris, Brussels and Amsterdam. Trade with the United States was probably less important to the commercial interests in Europe than trade with markets in the Far East, principally, India and China. By 1900, the United States had come a long way but was still considered a second-tier country along with the likes of Argentina.

It is possible, if one works hard, to navigate this global world of opportunity successfully.

Flash forward to 2014, where the United States is the dominant force in the economic world. Its share of world equity market capitalization is 48 percent. The next closest country is the United Kingdom at 7.8 percent. It took more than 100 years for the United States to compete on an equal footing with the rest of the developed world.

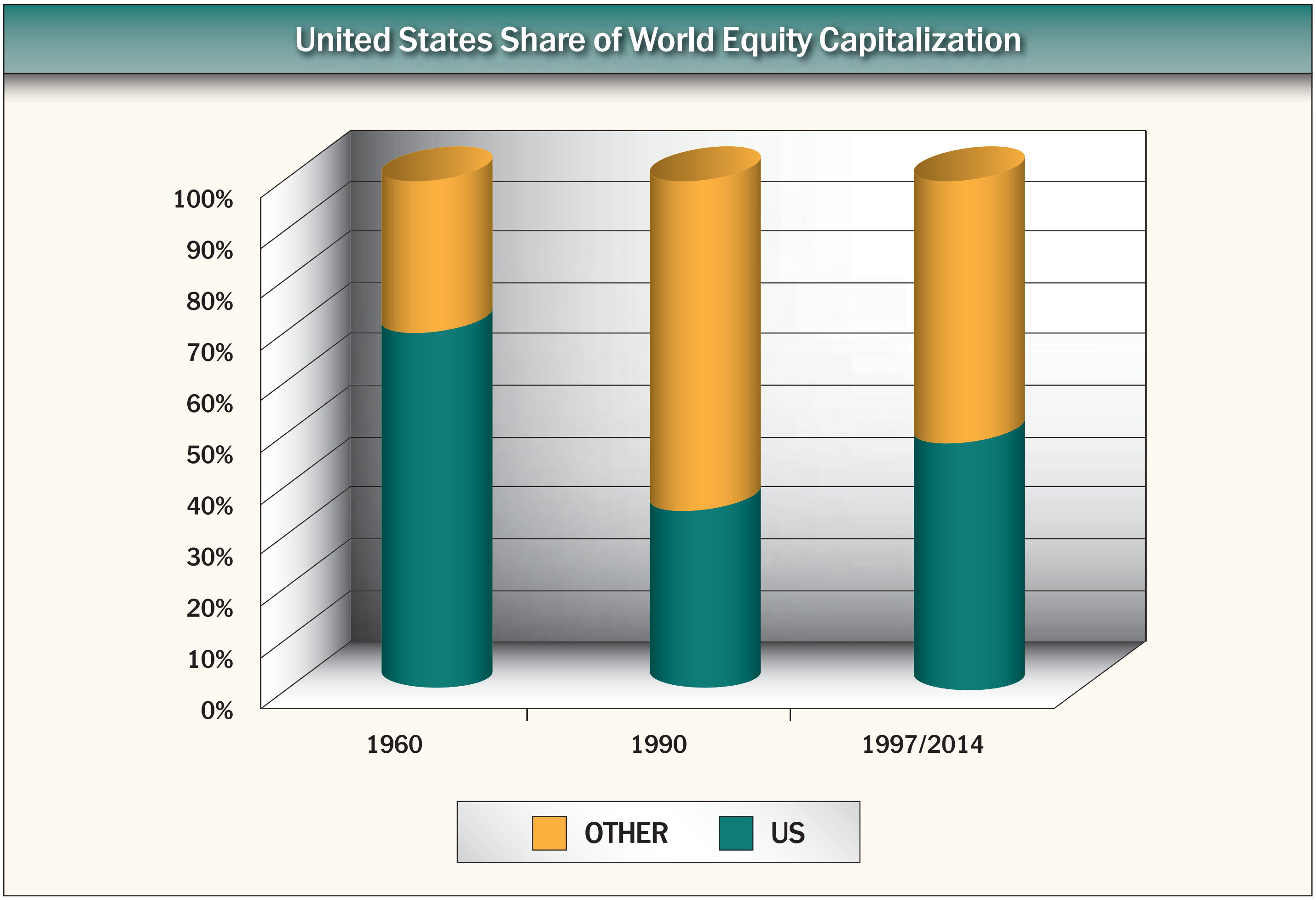
Throughout most of the 20th century, the United States was the best and most consistent place in the world to invest. I happen to believe that the United States is special but, as an investor, one must consider possibilities that there may be equal or better opportunities elsewhere. After all, the United States was an emerging market at one time.

In 1997, the West Virginia Investment Management Board was charged with investing a large portfolio of assets to satisfy needs that would go on indefinitely. Should it have invested only locally, i.e., in the United States, counting on the United States to continue to generate the kind of growth it had over the past 200 years?

The West Virginia Investment Management Board chose to consider the possibility that the world could change. It invested 15 percent of its total portfolio in international stocks, including emerging market stocks. Signs that the world would not remain the same already existed. In the 1960s, the U.S. share of equity market capitalization was 70 percent. By 1990, it had fallen all the way to 35 percent, although it rebounded to 47 percent by 1997. That is approximately where it is today. Equally significant, however, is the fact that today, 40 percent of sales by companies in the S&P 500 come from overseas.

What is behind these numbers? The fact that everyone wants a better life. That means growth and opportunity for investors. However, it is more complicated than that. Advances in wealth are only possible where the environment is conducive.

The basic ingredients for growth are increasing labor inputs, availability of capital and increases in productivity, generally related to the effective application of technology and government policies. The developed world has plenty of capital, but suffers from a declining labor participation rate, engendered by its aging populations. In some cases, governmental policies hinder economic activity as well. The rest of the world is generally characterized by growing populations and low, but increasing, levels of technological usage.



Where governmental policies and structures are sound and encourage private competition and support education and health, the environment for growth is ripe. Of course, political policies and structures are notoriously fickle in undeveloped countries. This injects a degree of uncertainty for the investor, but also opportunity.

It is possible, if one works hard, to navigate this global world of opportunity successfully. For those who do a better job of predicting the successes and failures, it can be rewarding. The Investment Management Board invested in international markets, counting on diversification and spreading its risk away from the United States and, in doing so, the board expected better than average returns. Over the 16 years in which it has invested in U.S. and international stocks, the Investment Management Board's international portfolio has beaten the U.S. portfolio by 42 basis points, in spite of the fact that the U.S. stock market outperformed the international markets over that same period. The Investment Management Board was significantly better than average at finding situations in international markets where opportunities were rewarded.

Whether one is considering London in 1790 or the United States in 2014, the world of opportunity is in the future, not the past. The United States was once an emerging market with the potential to be something greater – to grow into the dominant force it still is today.

While I believe that the United States will find a way to remain a dominant economic force, it would be a mistake to assume that it will not face challenges. Where the environment is ripe, other opportunities for growth have the potential to exceed what the United States can produce.