The 21st Century: the Wealthy Become Wealthier

By Brian Fabbri
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A very long cycle

In just 9 short months the present US business cycle will eclipse the longest running business cycle in the post-World War II period; an expansion of 120 months. Despite its seniority, this expansion seems to be gathering pace in contrast to many before it that swooned away before their end. In addition, the US stock market (S&P 500) has steadily appreciated for the past 114 months. Thus, it is already a record long, stock market rally.

Cycles typically correspond

Stock market cycles and business cycles are never exactly contemporaneous; however, they are ultimately inseparable.

Length of US Business cycle expansions by quarter

In theory stock cycles typically lead business cycles because stock investment should be forward looking. Thus, in an economic downturn, when stock prices appear relatively cheap and government policy makers are exerting all their multiple means of resurrecting their economies, investors begin to believe in the success of policy makers’ efforts and commit to investment,
which boosts stock prices. Similarly, when the excesses of an extended business expansion build up and become apparent, cautious investors take profits and stock prices plunge heralding the beginning of the end of the mature business expansion.

Nevertheless, as the chart above illustrates, the ratio of broad stock price indexes has never perfectly matched the rise in GDP. Often, they significantly exceed the growth in GDP and during business cycle recessions they seriously implode. Over a long period, several decades, the ratio of the broadest stock price index, the Wilshire 5000 to GDP, has grown abundantly more than GDP, as the second chart reveals a near exponential rise in this ratio. What matters now is the present value of this ratio between the most comprehensive index of US stocks and US GDP. It has begun to exceed GDP substantially, as it did at the end of the dot-com bubble of 1999.

The bedrock of stock prices: corporate profits

Another aspect of this historic and causal relationship between broad stock price indexes and the economy is the role of corporate profits. Investors anticipate that profits will rise during expansions and deteriorate during contractions. Profits increase corporate value, finance capital accumulation, increase dividends and therefore are the underlying worth driving stock prices higher.

Profits rise with the business cycle

At the beginning of business cycle expansions, unemployment is typically high and as initial revenues increase they create higher returns than the same revenue stream would have generated at the top of the business cycle when unemployment is low. Consequently, the share of corporate profits from national income increases at the start of business cycles and usually diminishes as the business expansion matures.

US: shares of national income: Labor vs Profits

This business expansion has been different. The share of national income going to corporate profits has remained relatively high throughout this long expansion. In the past profits share would quickly plunge from its initial early expansion peak. Not this time. Profit’s share plateaued and has even begun to rise again this year. This latest aberration may be attributed to the recent change in the tax code, which materially reduced the tax on corporate profits.
Labor’s share in secular decline

The third chart also reveals the secular decline in national income distributed to labor. Many factors have been cited that contribute to this secular decline including the erosion in union bargaining strength, international sourcing, and the application of labor-saving technology. All of which have tended to shift more of national income to capital.

Global Comparison of Wages share of National Income

It’s not a universal trend

Not all economies have witnessed the same erosion in labor’s share of national income as the US has. The chart above reveals that in some economies labor’s share has increased over time. For example, in many of the European Union economies labor’s share of national income has increased over the past 16 years – it has in Italy, France and the UK, but not in Germany.

Stock market performance in this century (2002-2018)

Performance is related to income share

The next chart highlights the comparative performance of global economies’ stock indexes over the past 16 years. Each economy’s stock performance is represented by its most popular stock index. As can be seen in the above chart, the 16-year comparative performance of stock indexes in Italy, France and the UK were the least successful. Italy’s stock index is below its level at the start of 2002.

The best performing stock indexes represented economies whose share of national income attributed to labor declined over the course of this century. Stock indexes in Germany and the US stand out for their very high appreciation over this period achieving nearly 2.5 times their initial value. In addition, Japan and China also welcomed solid stock price appreciation (China’s was the grandest) and both had a significant decline in the share of national income distributed to labor. Both the US and German economies’ labor share declined as both economies applied more labor-saving technology to production, and outsourced
substantial portions of their production to economies with considerably cheaper labor costs.

Relative Income inequality (Gini coefficients)*

Wealth is becoming more concentrated

The outcome of capital gaining at the expense of labor during recent business cycle expansions in highly-developed economies is greater concentrations of wealth and much larger income inequality gaps among the populations of these economies. In extended business expansions, wealth accumulates quickly especially when the lengthy expansion is matched by a long stock market rally, as we have seen over most of the past two decades. Naturally, the most developed countries are the wealthiest and they gather greater and greater percentages of global wealth. And within these developed economies wealth amasses mainly at the top of the wealth pile.

Documenting this accrual of wealth is a report written by Allianz in September 2015*. It documents that the wealthiest countries and people have accumulated the largest quantity of wealth, and that their stockpile is probably getting bigger. They estimated the Gini coefficients for the 55 largest economies in the world and discovered - to no one’s surprise - that the US had the highest Gini coefficient, or concentration of wealth, and that Germany was not very far behind.

Comparison of Greatest Wealth by economy*

Their document also pointed out that the US had accumulated the greatest mass of wealth in the world, 41.6%, far exceeding its nearest competitor. Bear in mind that the results of their study were extracted from data compiled in 2014. Since then, the US stock market has appreciated by an additional 41 percent. Because stocks are mainly owned by the wealthiest citizens, we can only assume that the wealth gap today has widened atrociously further into an even greater chasm than it was in 2014.

Conclusion: the wealthy become wealthier in long cycles

After a profound economic slump, a crash in the real estate market, and near bankruptcy of many banks globally during the 2008-2009
great recession, global economies have enjoyed a prolonged reprieve. The present business expansion looks as though it will outlast all previous post WWII business cycles to become the longest. Along with recovering employment (jobless rates are at all-time lows) and the improvement in the banking systems’ financial health, stock markets have boomed.

The US stock market has sustained its longest rally in the post WWII era and has appreciated to a record high level. Stock prices are typically positively correlated with the business cycle. In the current cycle the ratio of stock prices to the economy outperformed all its past relationships in other cycles mainly because the share of the growing national income increasingly and uncharacteristically went to capital and away from labor. In contrast, in those economies where labors’ share of national wealth increased over time their stock price indexes did not fair nearly as well and in some cases declined.

Naturally, this important distribution feature among global economies and their equity markets is an indispensable product of advanced economies with unrestrained capitalism and buttressed by recent reductions in corporate taxes. The result is to heap more wealth on stockowners. Consequently, today’s Gini coefficient in these advanced economies has advanced significantly higher than it was in 2015, when measured by the Allianz report. The widening hiatus between the rich and poor will certainly lead to significant changes in legislation to the current economic system, or to its destruction; and, to the imposition of a new economic system whether it is more efficient, productive, egalitarian, or fairer, or not.


For more information, please contact camri@nus.edu.sg
## KEY INDICATORS TABLE (AS OF 31 AUGUST 2018)

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*Source: Bloomberg*

## APPENDIX

### GLOSSARY OF KEY TERMS (Source: Bloomberg, with tickers in parenthesis. In US$ where applicable)

**S&P500**: capitalization-weighted index of the prices of 500 US large-cap stocks (SPX)

**FTSE**: capitalization-weighted index of the prices of the 100 largest LSE-listed stocks (UKX)

**NIKKEI**: capitalization-weighted index of the largest 225 stocks of the Tokyo Stock Exchange (NKY)

**HANG SENG**: capitalization-weighted index of companies from the Hong Kong Stock Exchange (HSI)

**STI**: cap-weighted index of the top 30 companies listed on the Singapore Exchange (FSSTI)

**EUR**: USD/EUR exchange rate: 1 EUR = xx USD (EUR)

**YEN**: YEN/USD exchange rate: 1 USD = xx YEN (JPY)

**CMCI**: Constant Maturity Commodity Index (CMCIP)

**Oil**: West Texas Intermediate prices, $ per barrel (CLK1)

**3MO LIBOR**: interbank lending rate for 3-month US dollar loans (US0003M)

**10YR UST**: 10-year US Treasury yield (IYC8 – Sovereigns)

**10YR BUND**: 10-year German government bond yield (IYC8 – Sovereigns)

**10YR SPG**: 10-year Spanish government bond yield, proxy for EU funding problems (IYC8 – Sovereigns)

**10YR SGS**: 10-year Singapore government bond yield (IYC8 – Sovereigns)

**US ISM**: US business survey of more than 300 manufacturing firms by the Institute of Supply Management that monitors employment, production inventories, new orders, etc. (NAPMPMI)

**EU PMI**: Purchasing Managers’ index for the 17 country EU region (PMITMEZ)

**JP TANKAN**: Bank of Japan business survey on the outlook of Japanese capital expenditures, employment and the overall economy, quarterly index (JNTGALLI)

**CHINA IP**: China’s Industrial Production index, with 1-month lag (CHVAIOY)

**LC**: Local Currency

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