INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

Senator Roberto "Bobby" Gonzales, Chairman
Representative Patricia Roybal Caballero, Vice Chair

State Investment Council: Global Overview of Current Economic and Market Conditions

Robert "Vince" Smith, Chief Investment Officer, Deputy SIO
Tuesday, July 30, 2024

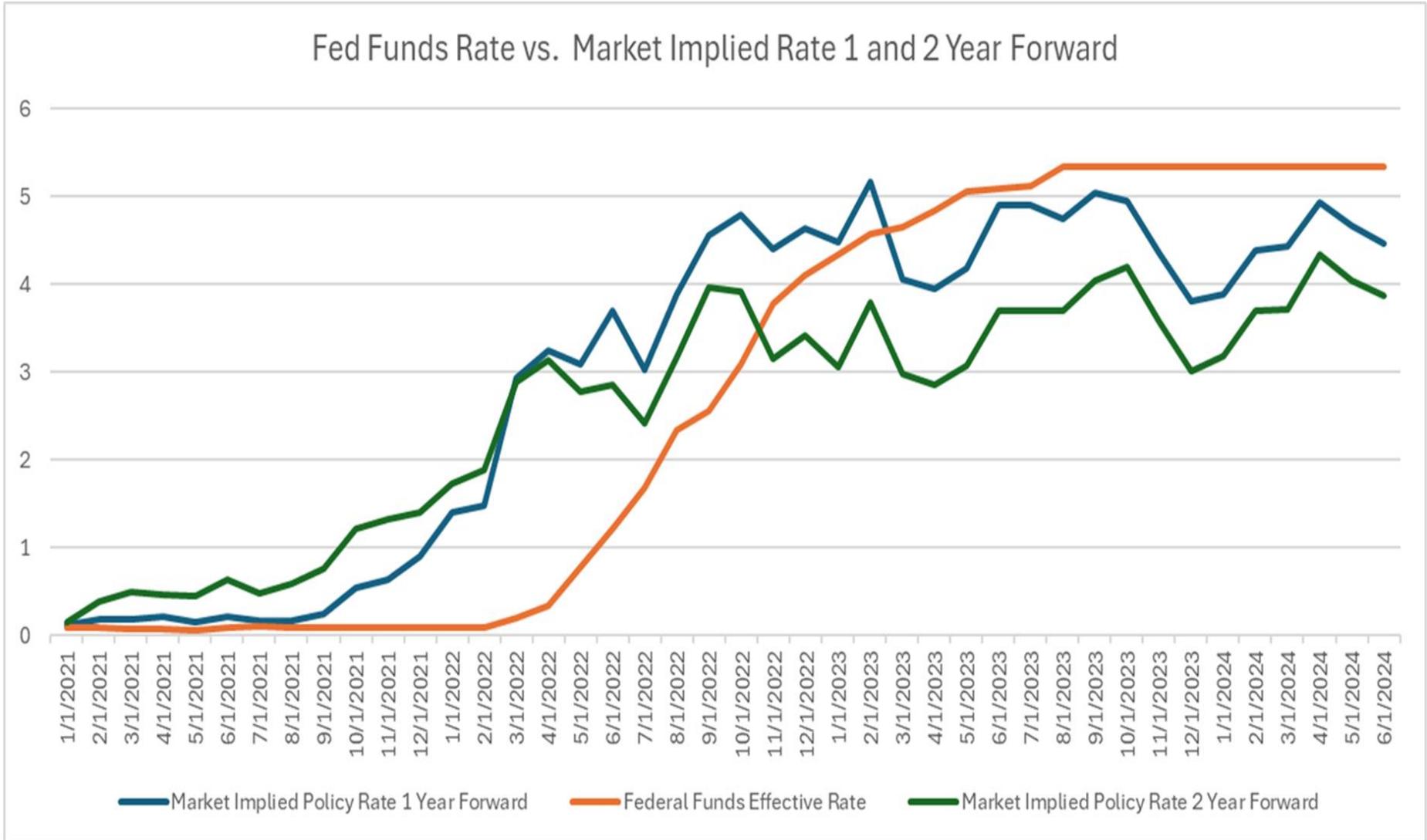**SIC** NEW MEXICO STATE INVESTMENT COUNCIL

CURRENT CONDITIONS

- Over the last 18 months, economists, strategists and other "market seers" have mostly been wrong in their near-term forecasts:
  - Calls for recession in the U.S. have not materialized
    - Despite a massive increase in the Fed Funds rate from zero to 5.25%-5.50% the economy has not slowed materially, yet
    - An inverted yield curve, a favored precursor to recession, has failed to pan out this time, so far
    - Inflation damaged growth in consumers real incomes and consumer confidence, but has not slowed spending materially
  - Expected declines in interest rates have not materialized
    - Despite calls at the start of calendar 2024 of up to seven rate cuts in 2024, none have occurred
    - 10-year rates, expected to decline to 2.5% or lower in recession, have held steady between 4%-5%

CURRENT CONDITIONS, CONTINUED

- The U.S. stock market, despite being materially overvalued in a long-term sense and dependent on just a handful of stocks to a degree rarely seen in history, continues to chug ahead

  - The "Magnificent 7" stocks (Microsoft, Amazon, Meta, Apple, Alphabet, Nvidia, Tesla) have made up as much as about 35% of the total value of the stock market and at one point were responsible for over 75% of the performance of the stock market over the trailing year

- Why?

  - Strong labor markets

  - Massive Federal deficit/over-spending

  - Loose financial conditions

FED FUNDS RATE VS MARKET IMPLIED RATES

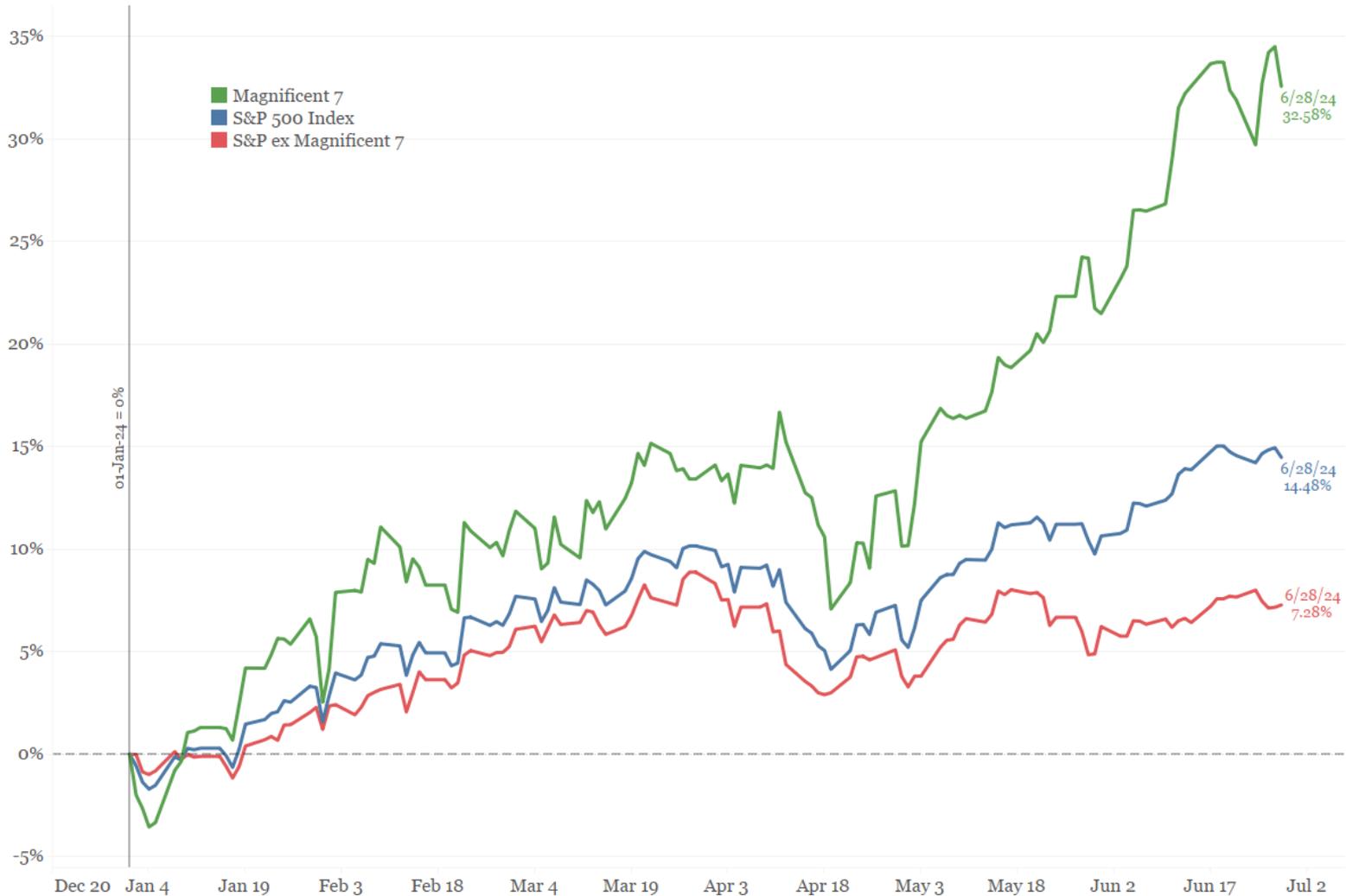Fed Funds Rate vs. Market Implied Rate 1 and 2 Year Forward

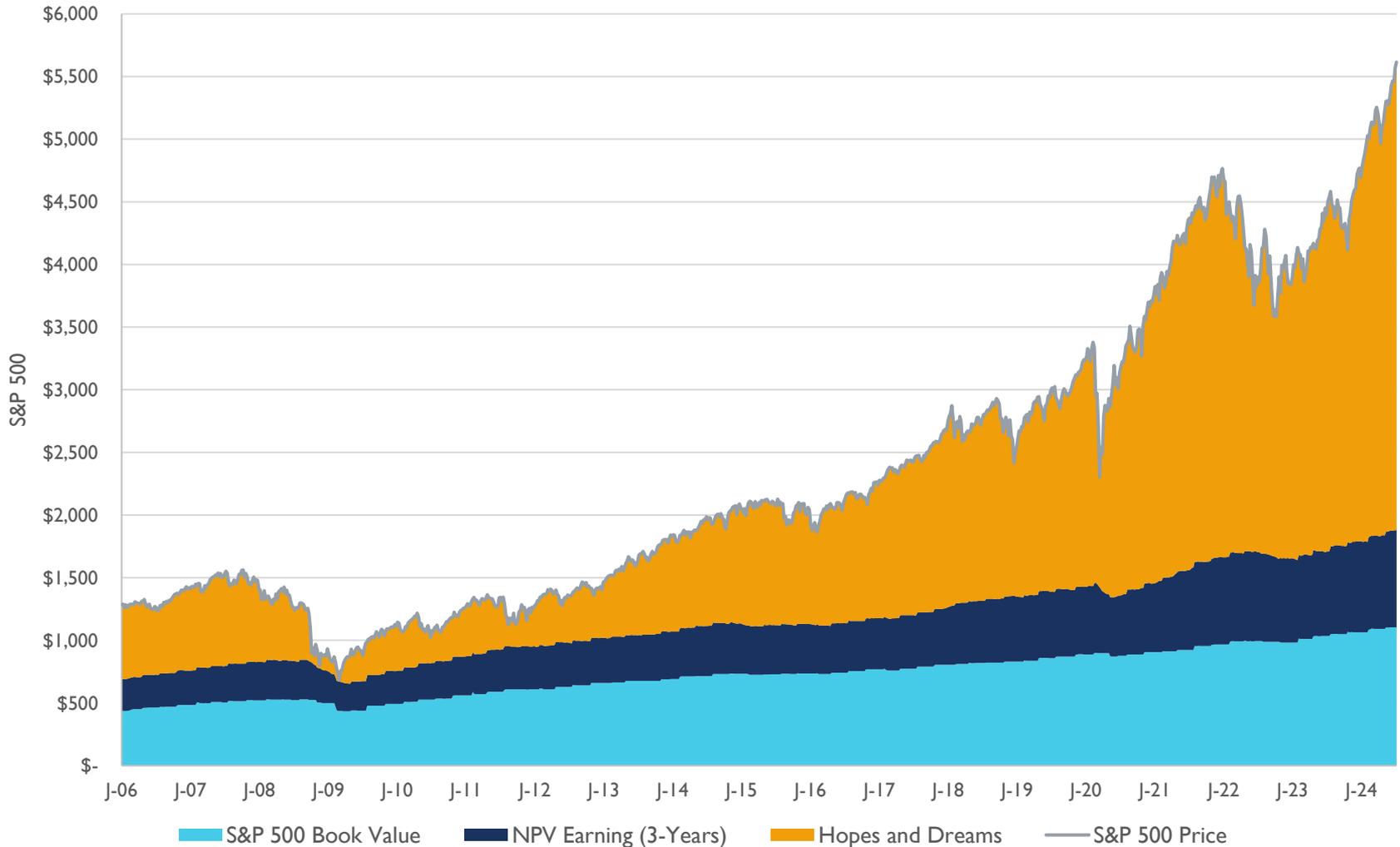# SHAPE OF THE YIELD CURVE

MARKET RETURNS, BROAD MARKET & MAG 7
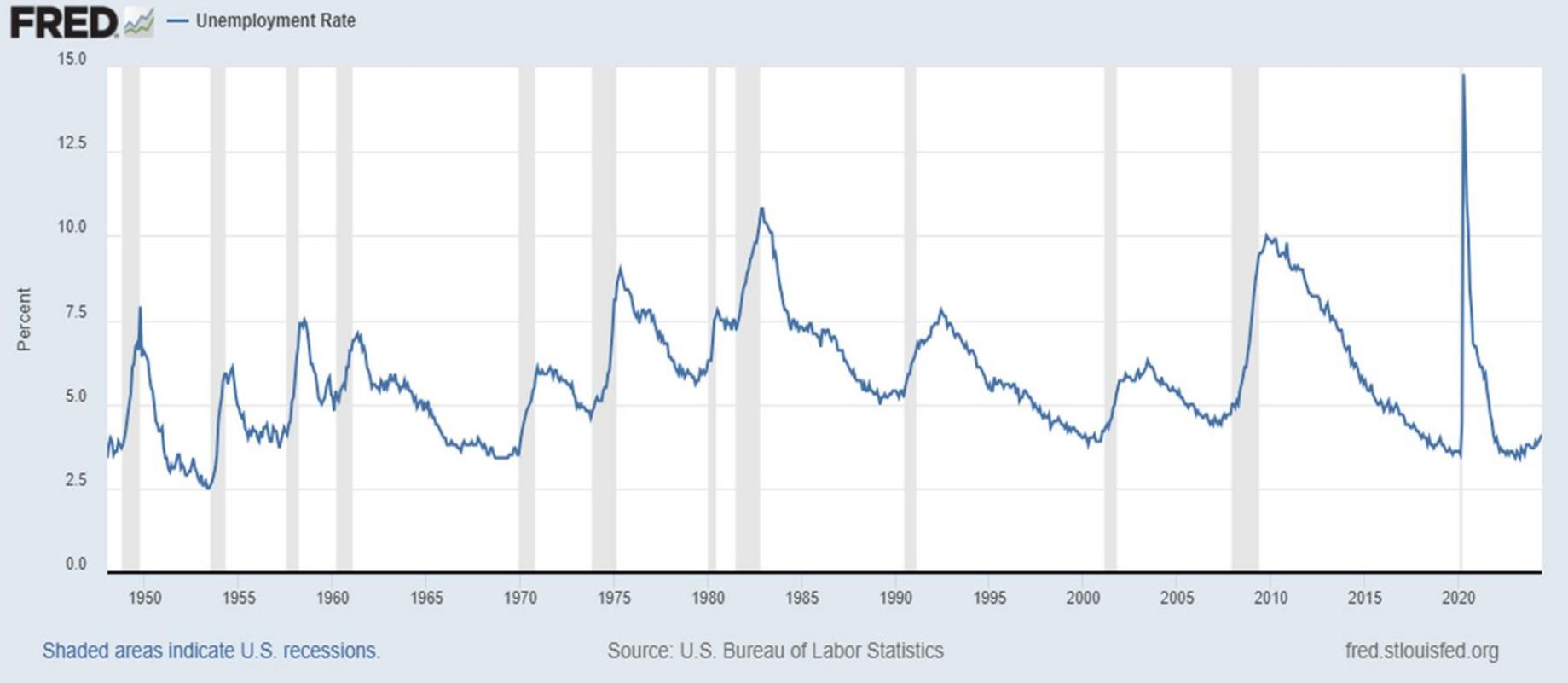
Market Returns This Year

- ■ Magnificent 7
- ■ S&P 500 Index
- ■ S&P ex Magnificent 7

6/28/24
32.58%

6/28/24
14.48%

6/28/24
7.28%

01-Jan-24 = 0%

Source: Bloomberg, UBS Securities

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"HOPES AND DREAMS" CHART

S&P 500 Valuation Breakdown

Legend: S&P 500 Book Value · NPV Earning (3-Years) · Hopes and Dreams · S&P 500 Price

U.S. UNEMPLOYMENT RATE – PRESENTLY STRONG LABOR MARKET

LOOSE FINANCIAL CONDITIONS

Source: Federal Reserve Bank of Chicago

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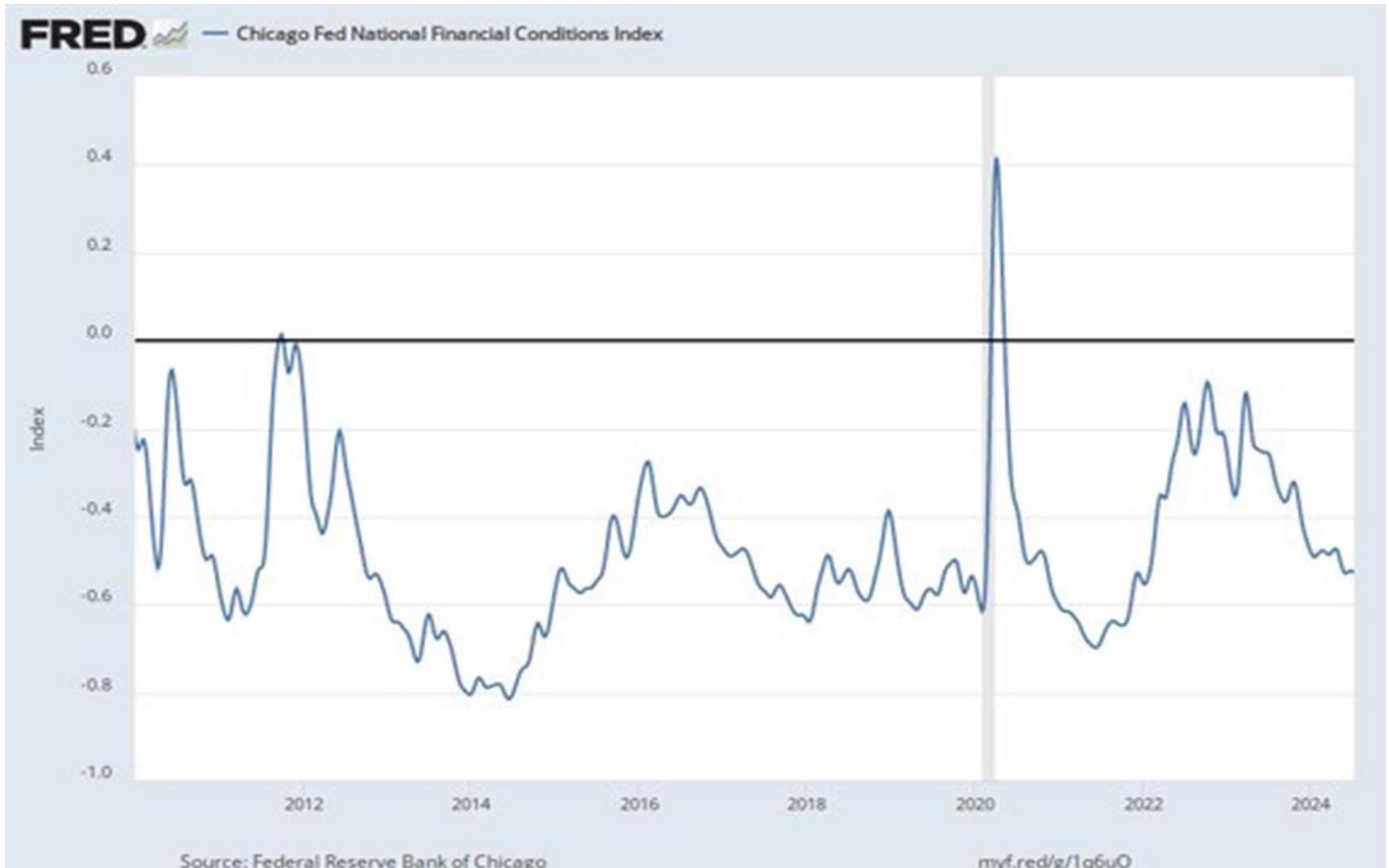
SURPLUS/DEFICIT AS A PERCENTAGE OF GDP
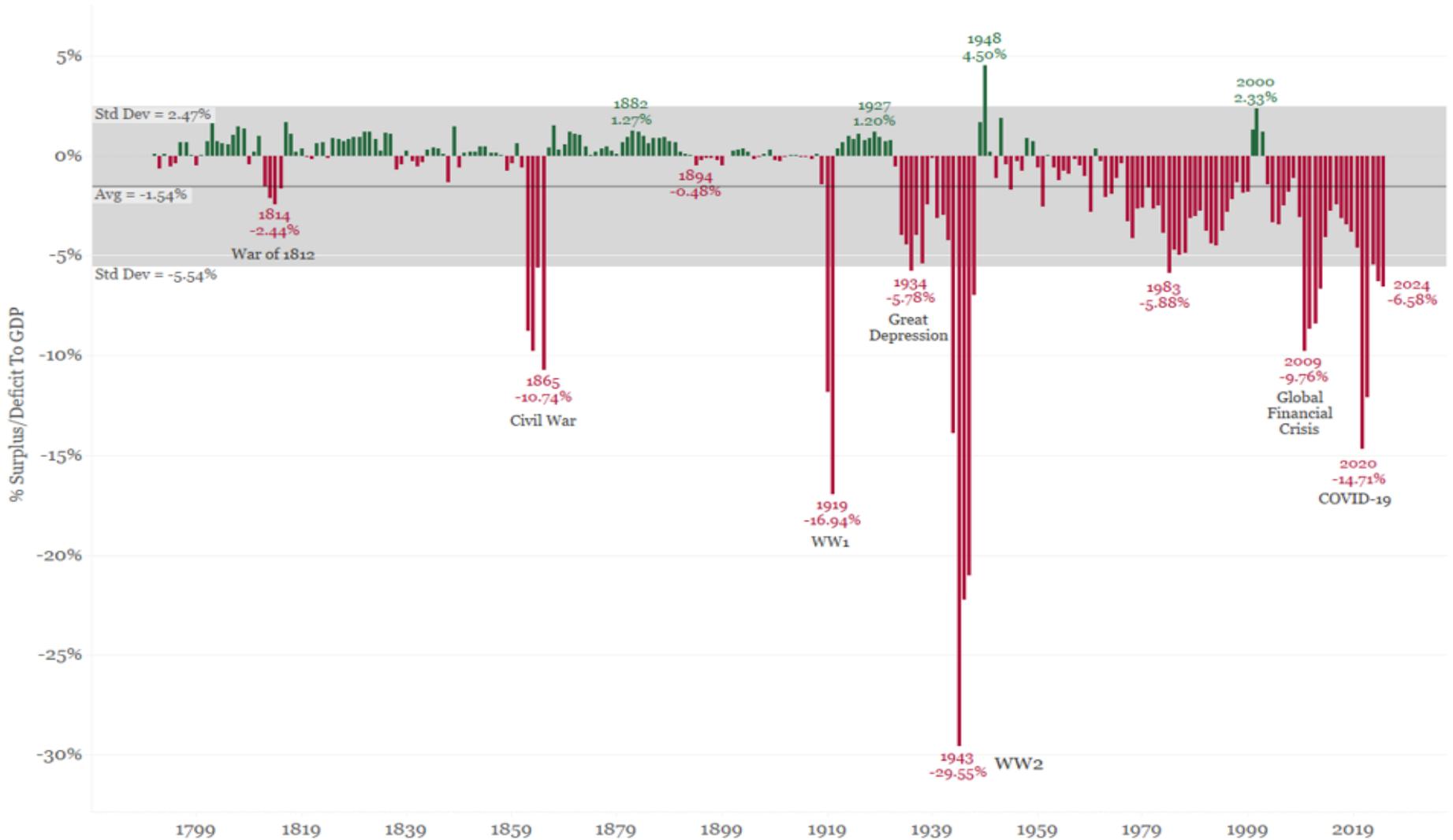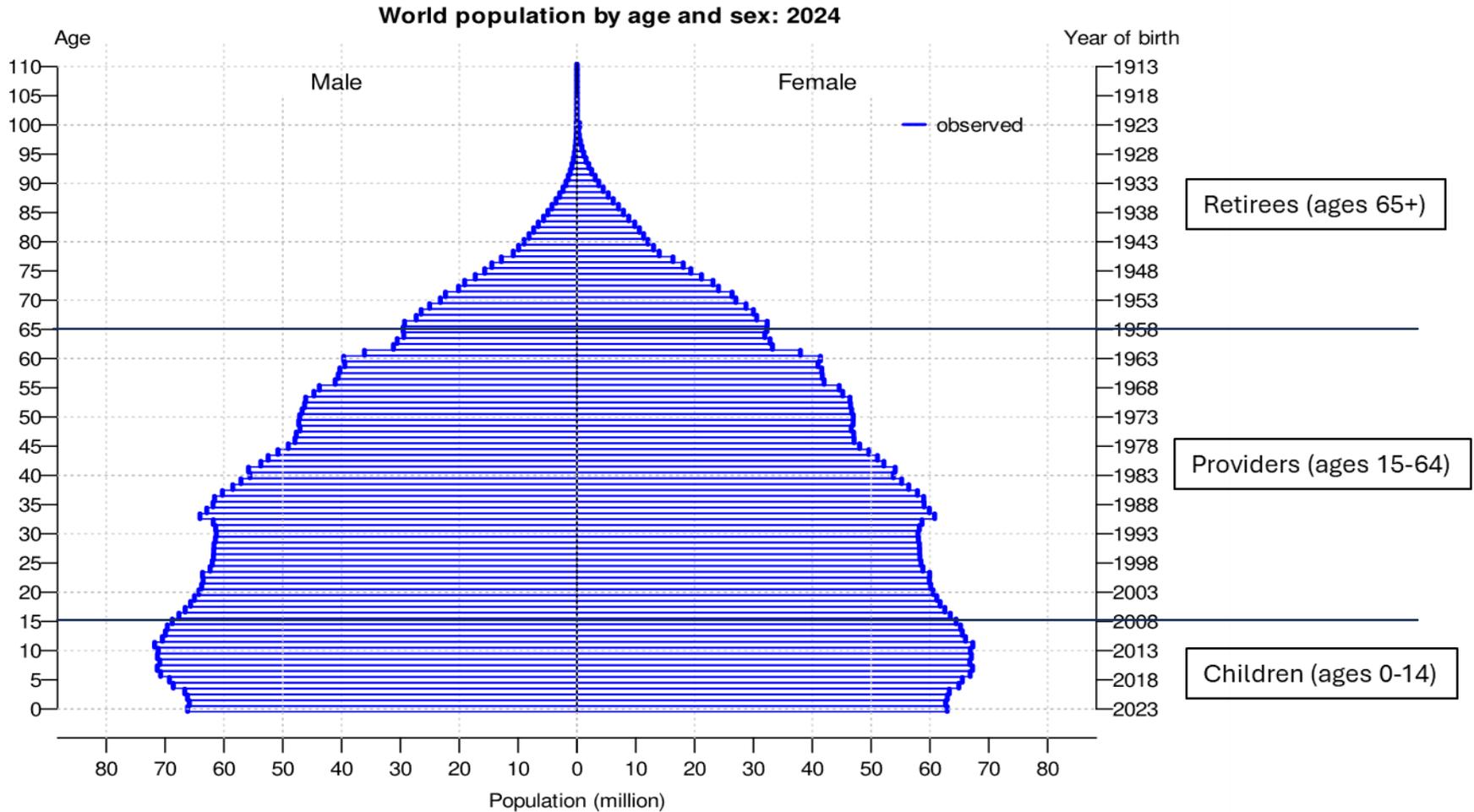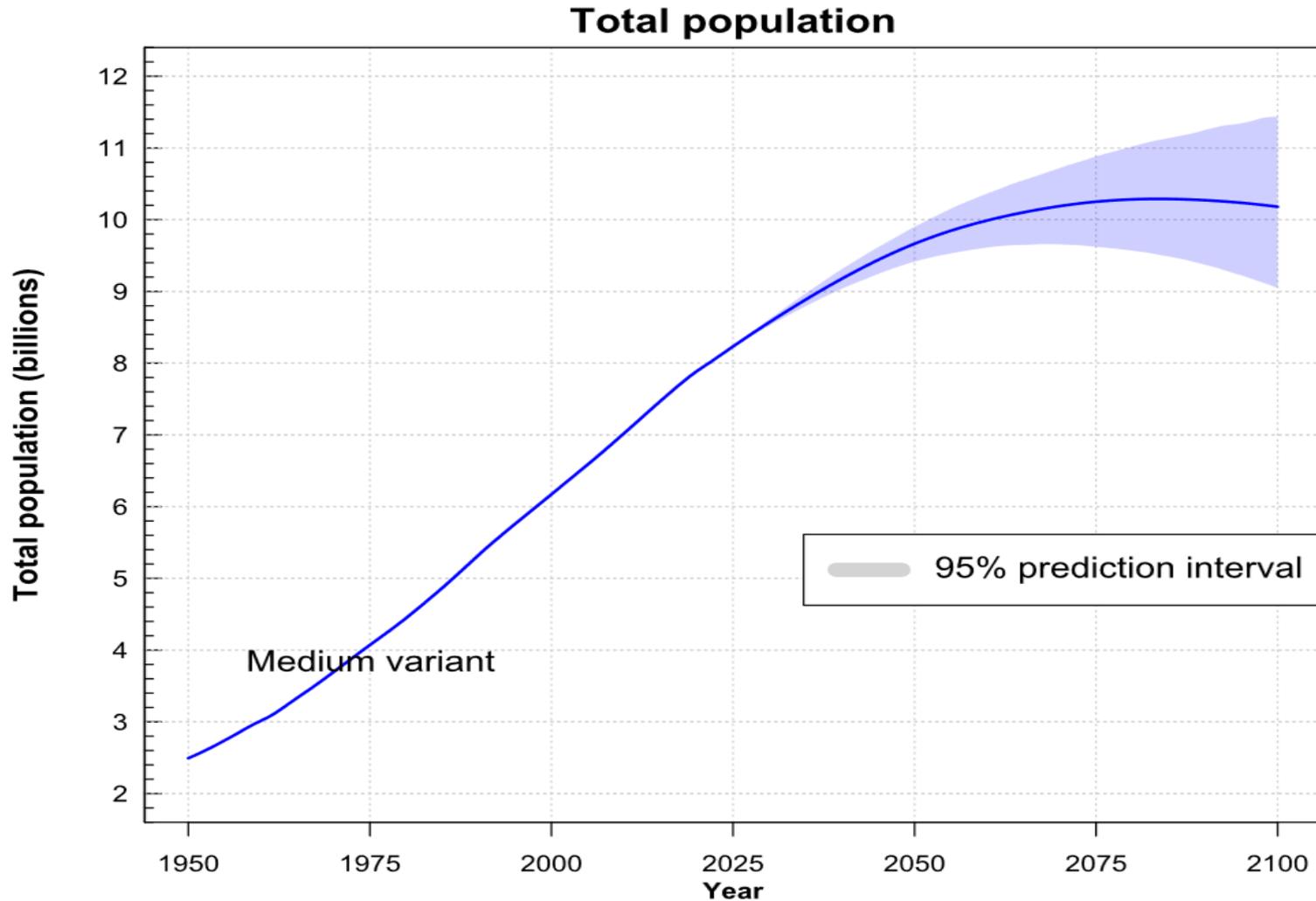
EXPECTATIONS

- The State Investment Office does not make explicit forecasts of economic variables or investment market returns:

  - Shorter-term forecast are notoriously hard to make and, even if done accurately, markets frequently don't respond "the way they should", relegating the reason for making the forecasts to "moot" status

- We do, however, review current economic conditions, trends in economic conditions, financial market conditions, valuations and general market outlook to get some sense of probabilities of broad outcomes. On that basis:

  - Recession has a somewhat higher-than-normal probability over the next year, though forecasters (and we) have thought that for 18 months now

  - The Fed has been signaling a first interest rate cut in the near term, if inflation behaves itself

  - We are curious about this inflationary cycle. Historically inflation comes in two waves. If we are to have two waves, the first is clearly over and the second would start showing up over the next six months or so

  - Typically, when the stock market gets as highly valued as it is presently and as narrow and concentrated as it is, a correction occurs. Could it be 10%? 20%? Coincide with a recession and be 30%?

- Due to massive inflows and the time it takes to get invested in the private markets where most of the permanent funds have large exposure, the funds are positioned well for rougher markets with material excess cash and bonds in current asset allocations.
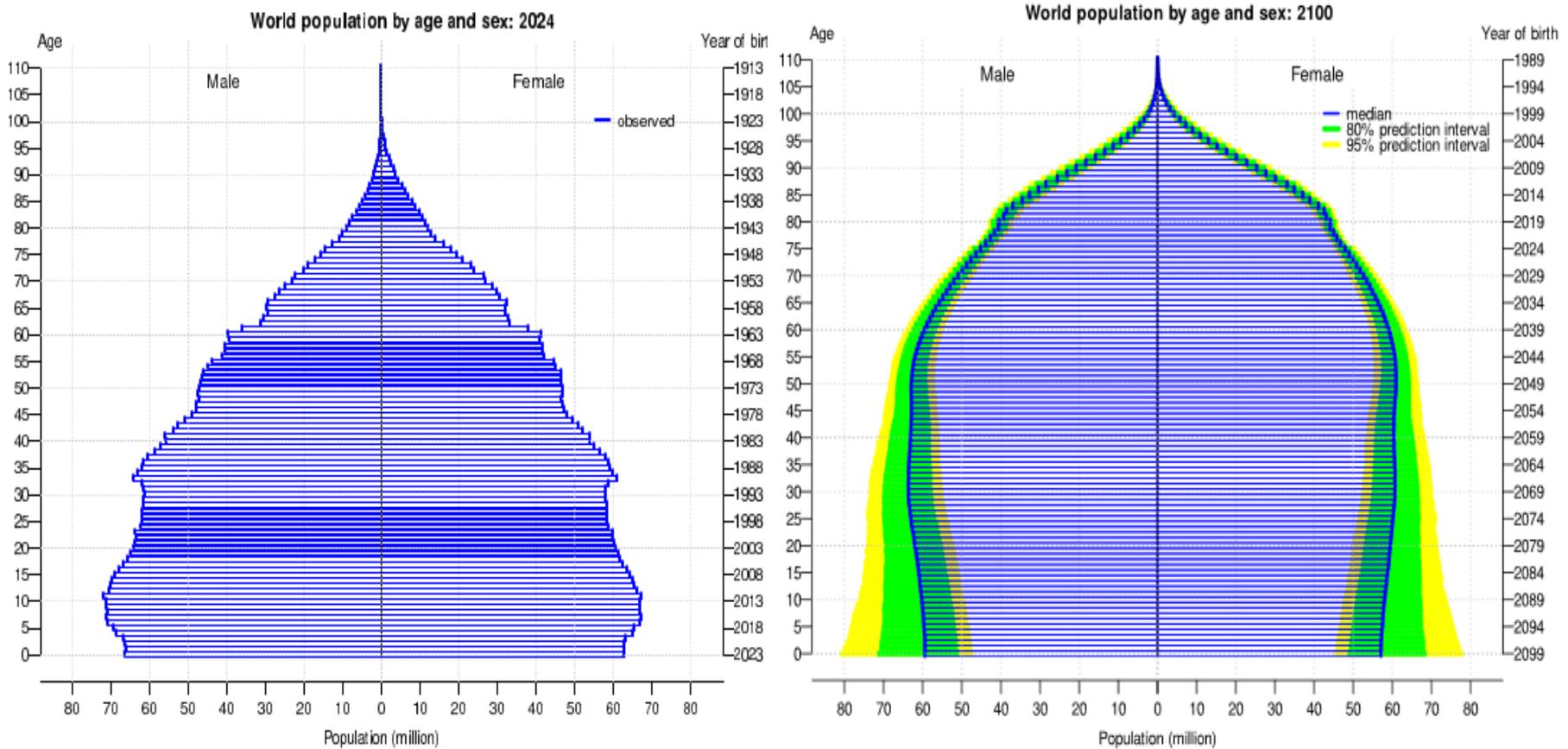
DEMOGRAPHIC VIEW OF WORLD POPULATION PYRAMID

World population by age and sex: 2024

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United Nations, DESA, Population Division. *World Population Prospects 2024*. http://population.un.org/wpp/

DEMOGRAPHIC VIEW OF THE WORLD: 1950-2100

Total population

WORLD DEMOGRAPHIC ISSUE #1: AGING

|	Total Population	Avg Age	Retirees		Children		Providers		Dependency	
			Number	%	Number	%	Number	%	Ratio	Providers per Dependent
2024	8 161 973	33.4	833 481	10.2%	2 016 801	24.7%	5 311 691	65.1%	53.7%	1.86
2034	8 823 785	38.0	1 133 164	12.8%	1 929 351	21.9%	5 761 270	65.3%	53.2%	1.88
2044	9 389 874	42.1	1 412 570	15.0%	1 961 689	20.9%	6 015 615	64.1%	56.1%	1.78
2054	9 813 252	45.4	1 700 558	17.3%	1 957 466	19.9%	6 155 228	62.7%	59.4%	1.68
2064	10 081 403	47.8	1 927 615	19.1%	1 894 149	18.8%	6 259 639	62.1%	61.1%	1.64
2074	10 240 485	49.5	2 121 153	20.7%	1 850 474	18.1%	6 268 858	61.2%	63.4%	1.58
2100	10 180 161	51.0	2 435 203	23.9%	1 681 182	16.5%	6 063 776	59.6%	67.9%	1.47

# DEMOGRAPHIC ISSUE #2: LOW INCOME COUNTRIES GROWING FASTER THAN HIGH INCOME COUNTRIES

Low Income Countries — Total population

High Income Countries — Total population
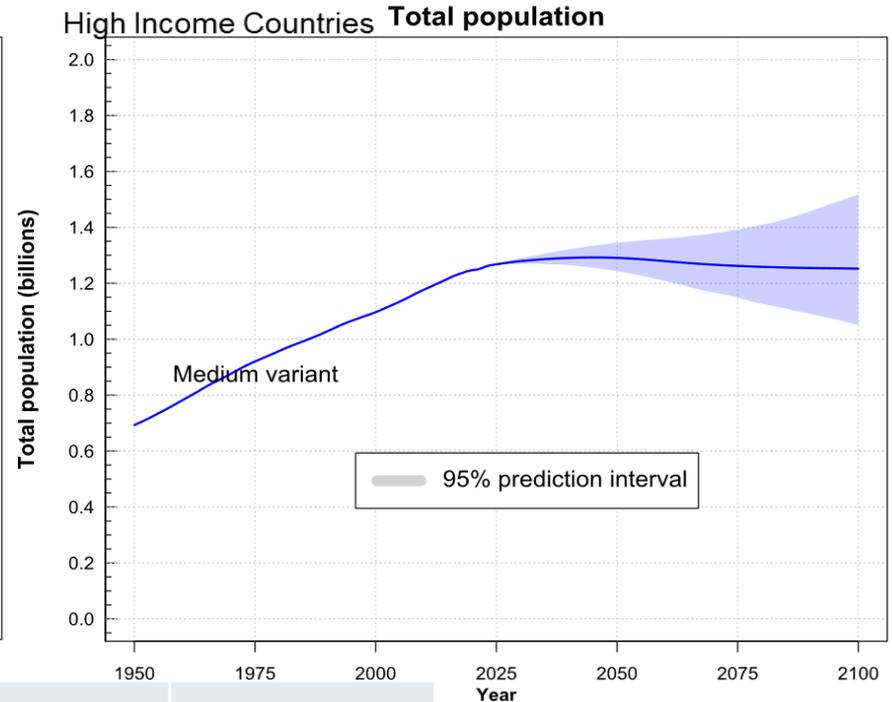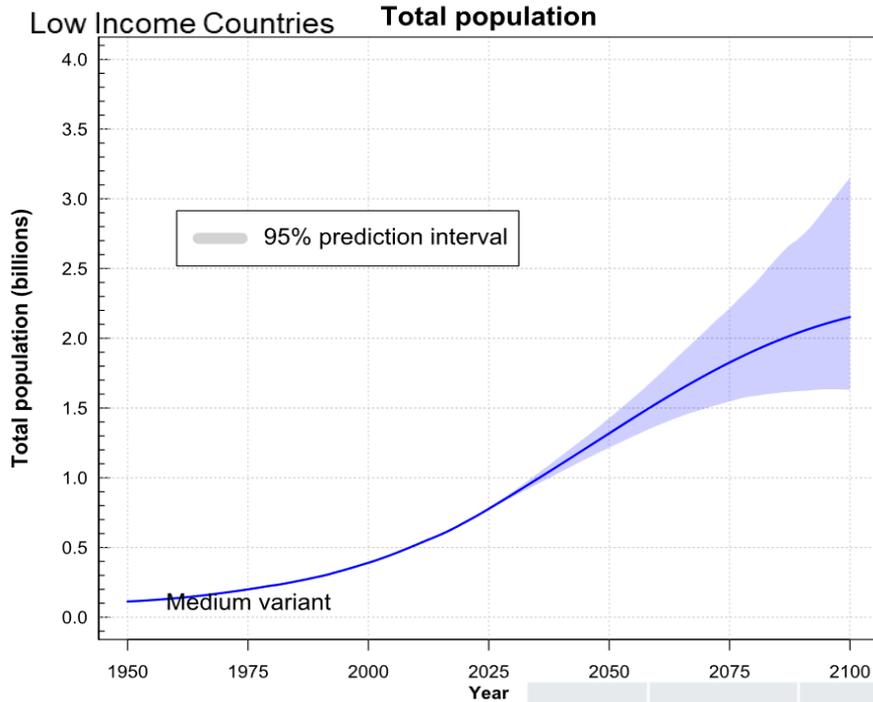
	Total	Low Income Countries		High Income Countries	
	Population	Population	%	Population	%
2024	8,161,973	756,668	9.3%	1,265,183	15.5%
2034	8,823,785	967,526	11.0%	1,284,972	14.6%
2044	9,389,874	1,185,604	12.6%	1,292,272	13.8%
2054	9,813,252	1,406,044	14.3%	1,287,185	13.1%
2064	10,081,403	1,618,085	16.1%	1,273,420	12.6%
2074	10,240,485	1,808,626	17.7%	1,262,827	12.3%
2100	10,180,161	2,151,930	21.1%	1,252,364	12.3%

DEMOGRAPHIC ISSUE #3: MAJOR ECONOMY POPULATION PENDING DISASTERS

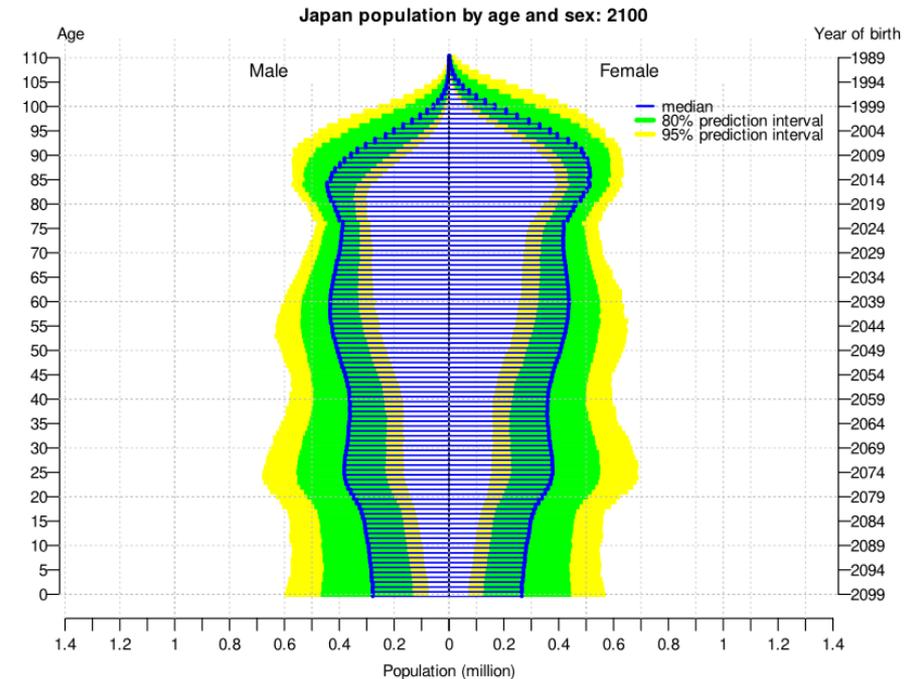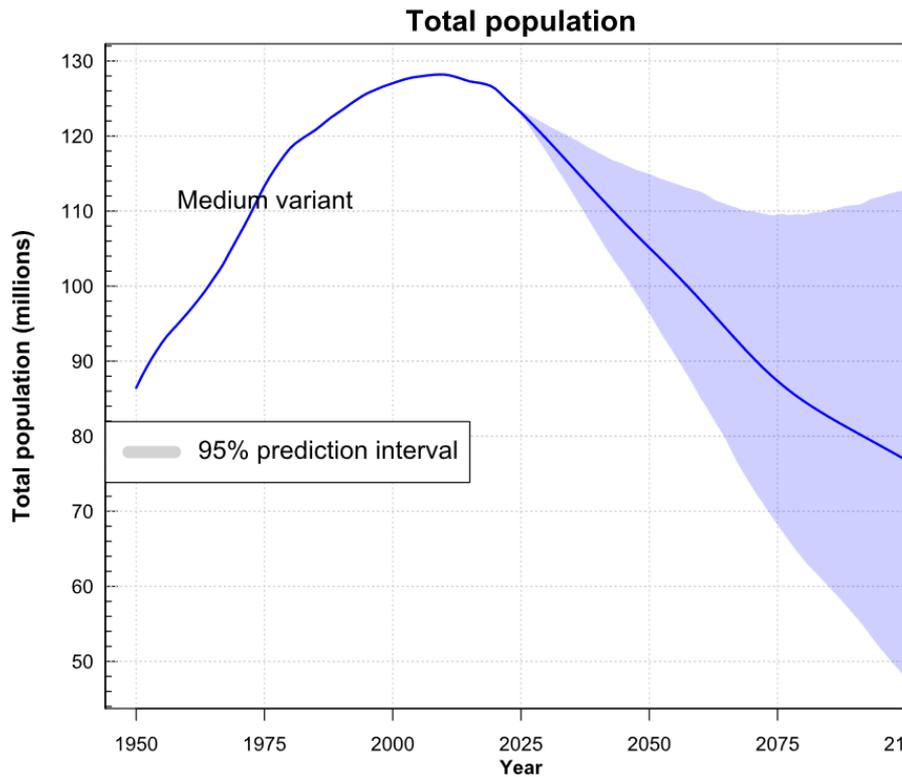## China: Currently the 2nd Largest Economy at $17.9T
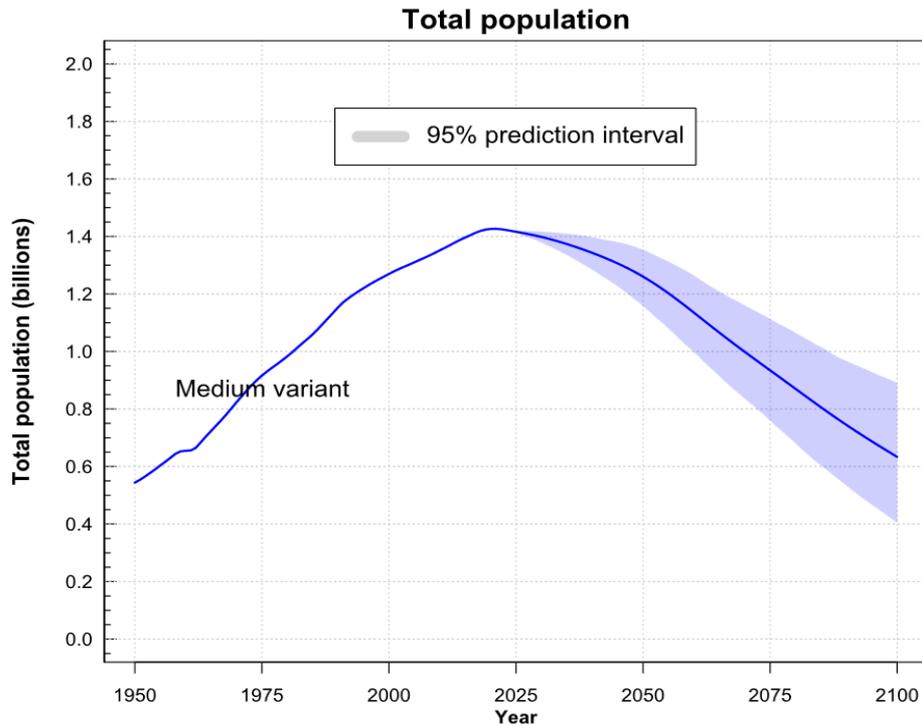
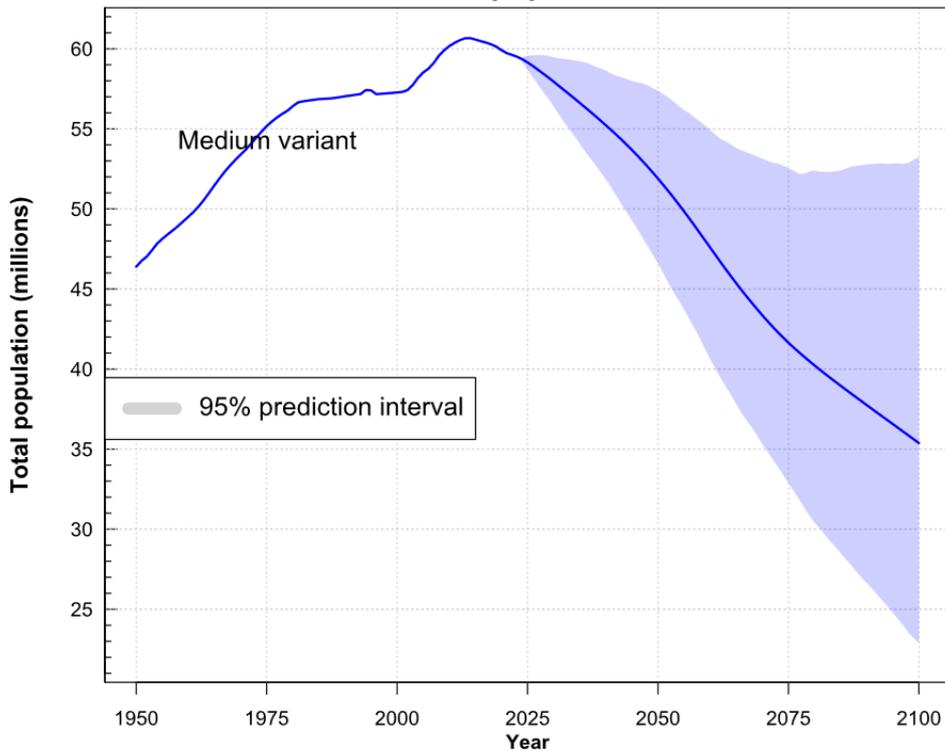There are 215 million aged 75+ in this chart
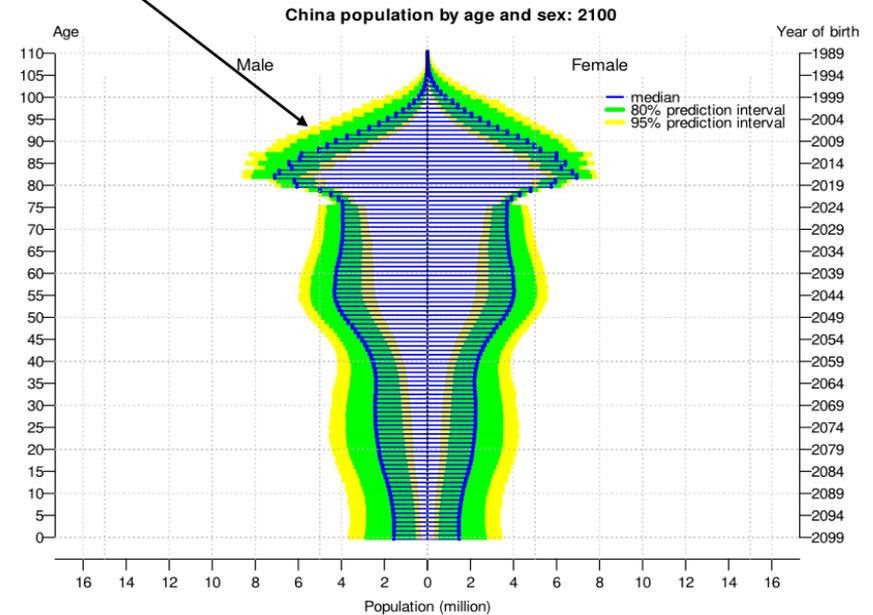
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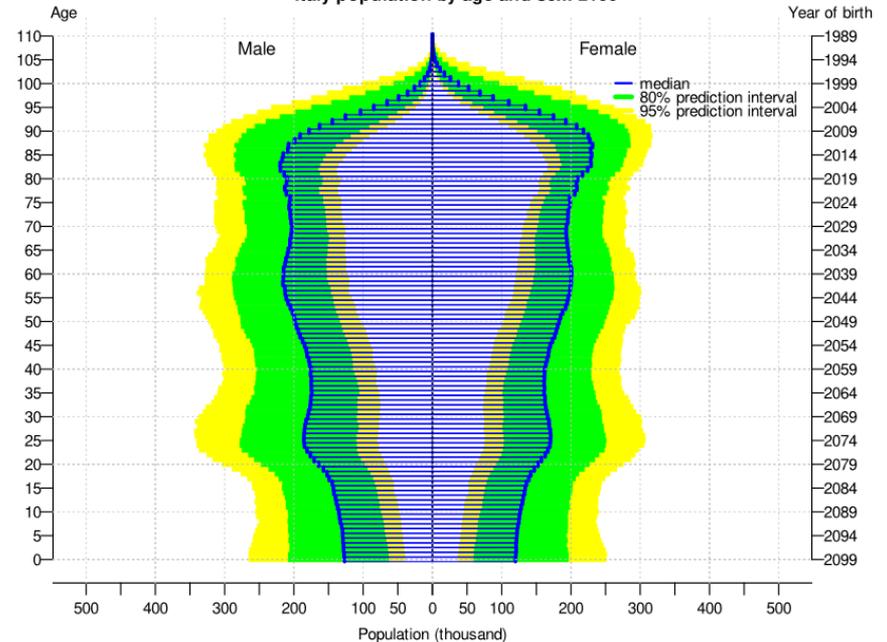United Nations, DESA, Population Division. *World Population Prospects 2024*. http://population.un.org/wpp/

DEMOGRAPHIC ISSUE #3: MAJOR ECONOMY POPULATION PENDING DISASTERS

Japan: Currently the 3rd Largest Economy at $4.2T

DEMOGRAPHIC ISSUE #3: MAJOR ECONOMY POPULATION PENDING DISASTERS

Italy: Currently the 10th Largest Economy at $2.0T

DEMOGRAPHIC VIEW OF THE UNITED STATES
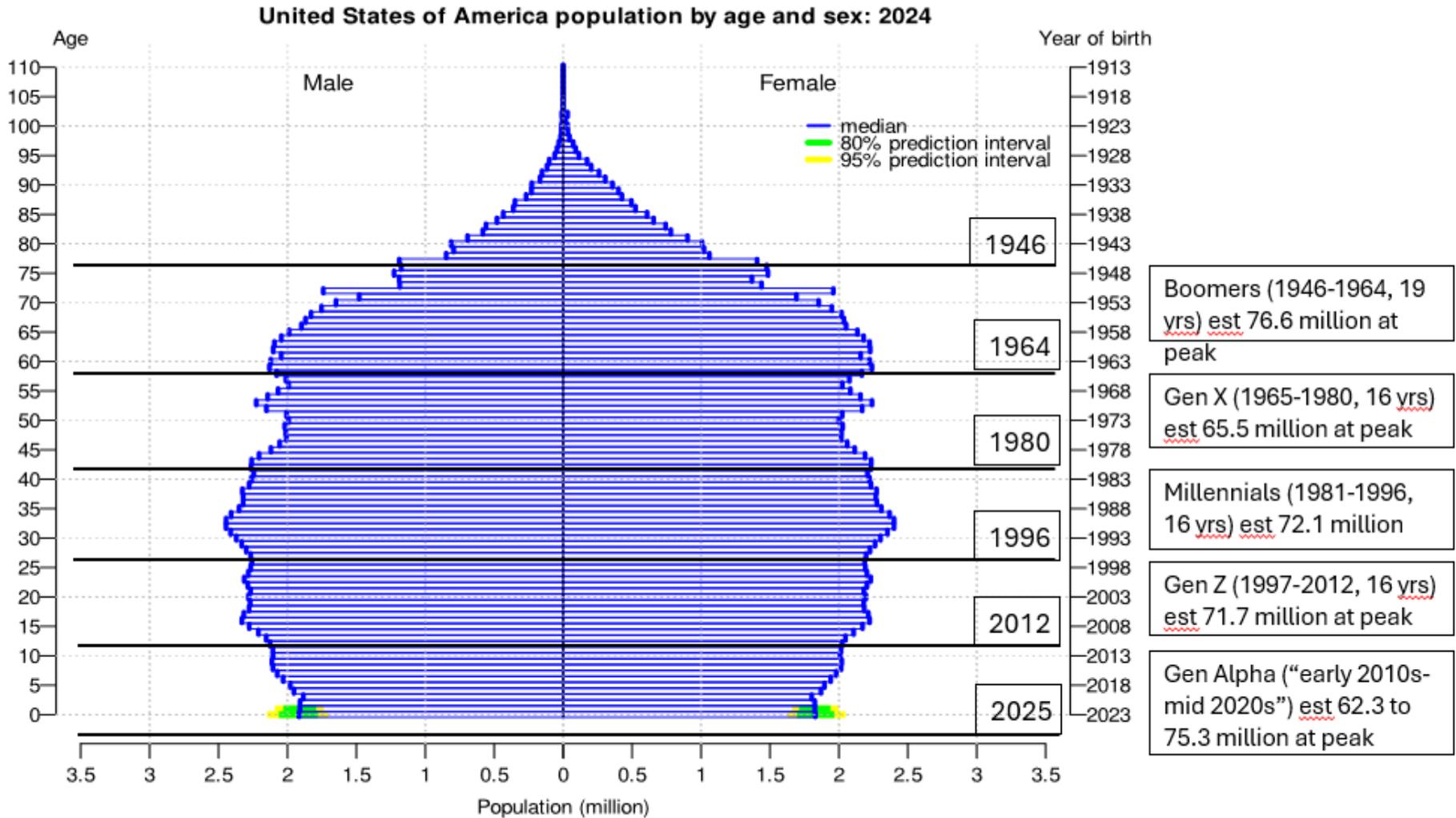

United States of America population by age and sex: 2024

Boomers (1946-1964, 19 yrs) est 76.6 million at peak

Gen X (1965-1980, 16 yrs) est 65.5 million at peak

Millennials (1981-1996, 16 yrs) est 72.1 million

Gen Z (1997-2012, 16 yrs) est 71.7 million at peak

Gen Alpha ("early 2010s-mid 2020s") est 62.3 to 75.3 million at peak
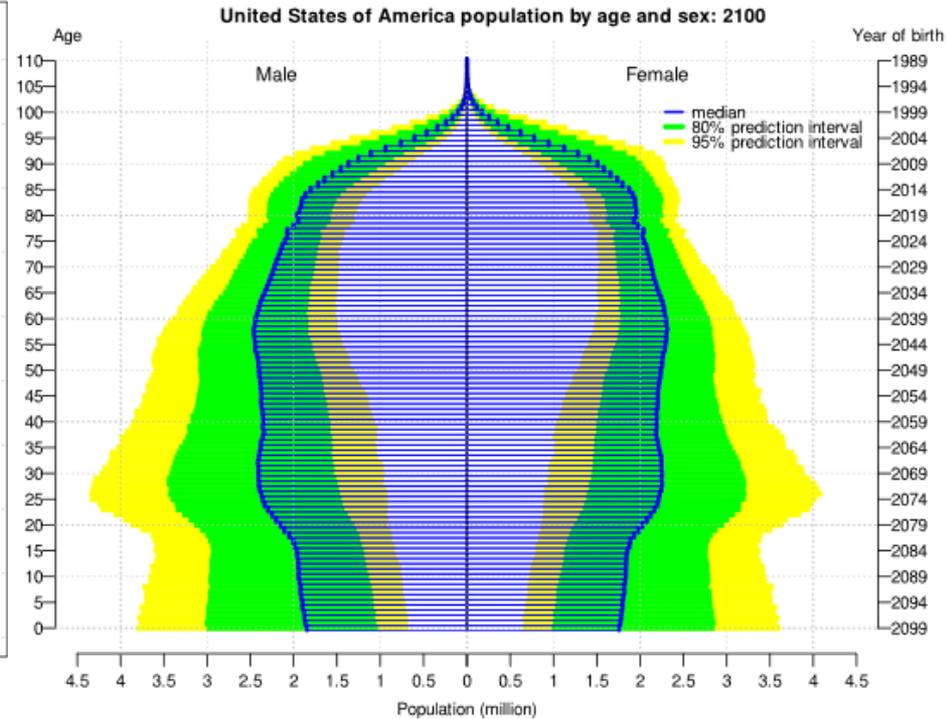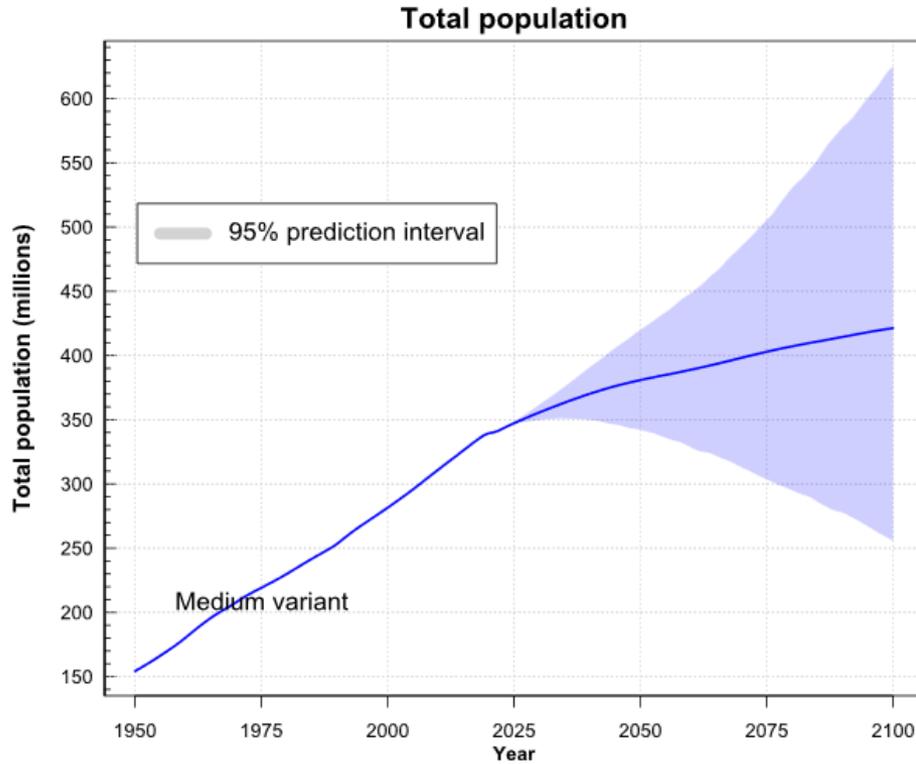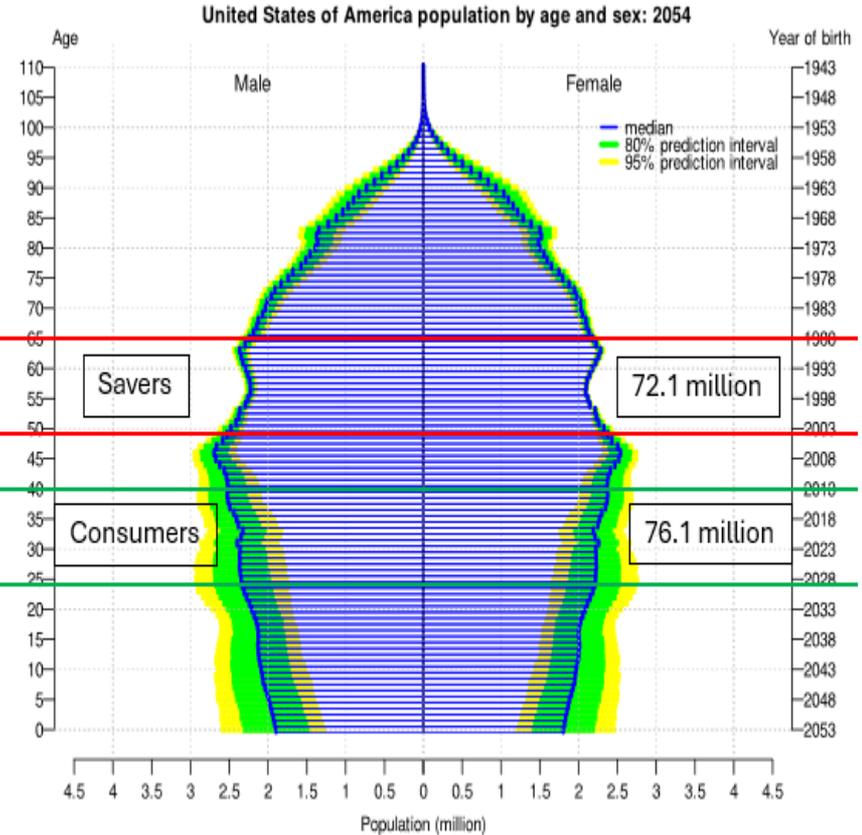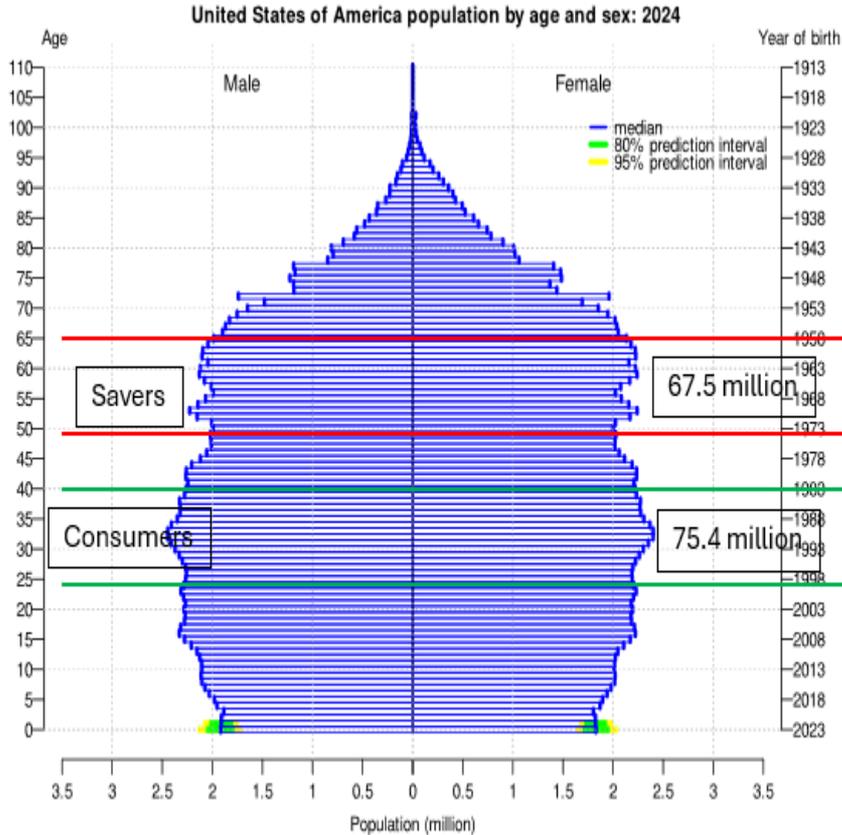
FUTURE DEMOGRAPHIC VIEW OF THE UNITED STATES

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United Nations, DESA, Population Division. *World Population Prospects 2024*. http://population.un.org/wpp/

U.S. ISSUE #1: SAVERS VS. CONSUMERS

United States of America population by age and sex: 2024

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United Nations, DESA, Population Division. *World Population Prospects 2022*. http://population.un.org/wpp/

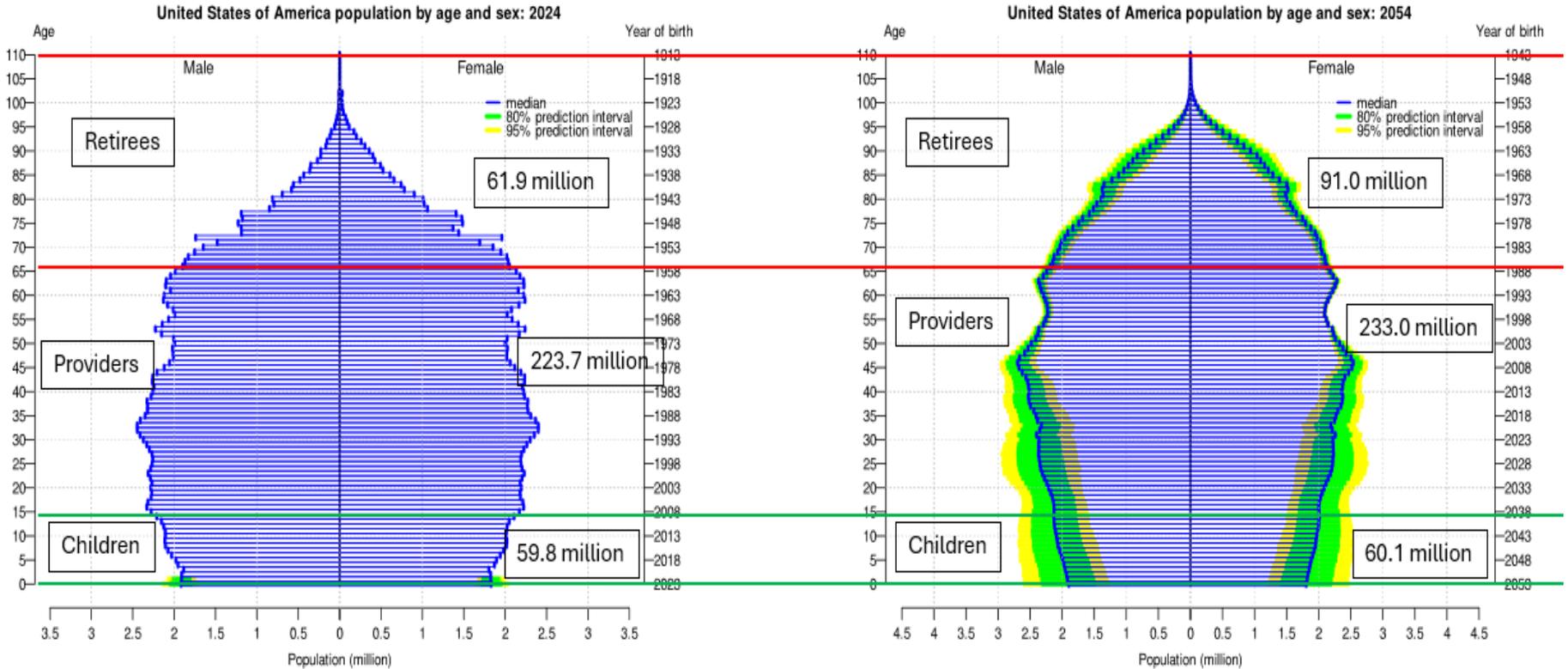United States of America population by age and sex: 2054

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United Nations, DESA, Population Division. *World Population Prospects 2024*. http://population.un.org/wpp/

Year	Consumers	Savers	C to S Ratio
2024	75 454	67 541	1.12
2034	77 011	66 386	1.16
2044	80 145	71 940	1.11
2054	76 070	72 118	1.05
2064	76 751	76 228	1.01

U.S. ISSUE #2: DEPENDENTS VS. PROVIDERS

2024 Dependency Ratio: 54.4%
(1.84 providers per dependent)

2054 Dependency Ratio: 64.8%
(1.54 providers per dependent)

Year	Dependency Ratio	Providers per Dependent	Children	Retirees	Providers
2024	54.4%	1.84	59 844	61 931	223 652
2034	59.2%	1.69	57 572	76 971	227 259
2044	62.2%	1.61	60 016	83 806	231 207
2054	64.8%	1.54	60 140	90 974	233 032
2064	66.2%	1.51	58 747	97 617	236 080
Growth Rates:			-1.9%	36.6%	5.3%

SUMMARY NOTES

- The world population continues to grow, though at a much-reduced rate than even the near past.
  - Presently at 8.1 billion, the global population is expected to climb to 10.3 billion around 2085 and then begin a decent.
  - Population growth will be stronger in lower income countries and week-to-declining in higher income countries.
  - Several countries, a number with larger populations and some of the largest economies in the world stand to lose a significant percentage of their populations (one-third to more than half) due to aging, poor fertility performance and weak immigration through to the end of the century.

- The world population is aging and the rate of aging is on the increase.
  - Dependency ratios are rising with more than all of the increase coming from an increased percentage of retirees.
  - This has economic implications regarding allocation of financial resources, labor, taxes and more.

- The United States is better off than most of the developed world demographically and holds several other advantages:
  - We can feed ourselves and export food
  - We can provide for all of our own energy
  - Our largest trading partner, Mexico, has excellent demographics and a demographic profile which fits well with our own
  - The U.S. is an attractive country to immigrants