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Quality: A Silk Purse Out of a Slow World

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In today's investment environment, investors are forced to deal with a tremendous amount of noise. This noise tends to foster shorter-term viewpoints and can be a distraction from the larger macroeconomic events that are likely to influence investment returns over the longer term. At Crawford, we attempt to step back and keep in perspective the hyper volatility of the present, giving thought to the larger themes that move more glacially over time. One such theme that needs attention is the possibility of a long-term decline in the growth rate of the global economy. This potential decline, if realized, will have significant implications for the way one should invest.

Between geopolitical fragmentation, rising tariffs, and aging demographics, it is possible that the high-octane global growth of the past decade will give way to a more subdued expansion going forward. While this shift brings challenges, it also underscores the enduring advantages of owning high-quality businesses, particularly those with strong balance sheets, durable earnings, and consistent dividend profiles. Current tariff disruptions only serve to highlight the ongoing troubles global economies are facing today.

The last decade aside, the world has been experiencing a long-term slowdown in growth rates that began in the 1970s, worsened after the 2008 global financial crisis, and is showing few signs of improving. Since growth is the foundation of economic progress, this looms as a very significant issue. Several structural shifts help explain why global growth has been decelerating. Before we get to the reasons, we want to point out that this does not mean our economy is ex-growth, nor does it imply an inability to generate attractive investment returns.

One major transition that is currently in the news is the transition from a manufacturing-driven economy to one dominated by services. While the service sector continues to expand, it generally offers fewer productivity gains. Unlike manufacturing, where automation, scale, and logistics improvements can rapidly boost output, services tend to be more labor-intensive and resistant to efficiency improvements.

Demographic changes also play a significant role. In the aftermath of World War II, the surge in birth rates fueled decades of economic expansion. A growing population created demand for housing, infrastructure, and consumer goods. Today, however, many developed economies are facing declining birth rates and aging populations. With shrinking workforces and smaller future consumer bases, businesses have fewer incentives to invest in large-scale expansion, particularly in economies where rising labor costs are not easily offset by productivity gains. This environment has, in many cases, led companies to prioritize financial engineering over physical investment. Share repurchases and dividend payments have taken precedence over capital spending, reinforcing wealth concentration and limiting the broad-based growth that characterized earlier periods of economic expansion. All of these factors are a reflection of a maturing economy.

There are ideas for reigniting growth, but each comes with caveats. Artificial Intelligence (AI) could boost productivity in sectors like healthcare and education, where gains have historically been difficult to achieve. But its impact and implementation timeline remain uncertain. Reindustrialization, including reshoring initiatives and industrial policy supported by tariffs, is another avenue. Yet it's important to recognize that the decline in domestic manufacturing stemmed from more than trade policy alone, and that many of today's high-growth industries, such as semiconductors, clean energy, and electric vehicles, tend to be capital-intensive but not labor-intensive. Immigration, too, could help sustain population growth and bolster the workforce, though it's politically charged. Fiscal spending has proven more effective, particularly in the U.S., where government investment has supported consumption and economic resilience. But this has its limits as the national debt is becoming an issue with investors as is the overall level of government spending in excess of tax receipts. Some advocate for more aggressive redistribution through higher taxation on the wealthy, though that approach comes with social and political hurdles.

Secular trends that are well-established tend to be powerful in shaping future outcomes. It is hard to imagine a shift back from services to manufacturing in the modern world. Demographics, once directionally set, move inexorably. Immigration, the lifeblood of a growing economy, is shut off for now, maybe to be revived later. These trends do not have to result in negative growth for the global economy, but they do point to slowing growth over time. The slower the growth, the more difficult it is for companies to succeed. In the face of these potential challenges, our investment discipline remains grounded in what we can control: owning high-quality businesses that generate durable earnings, returning capital to shareholders, and maintaining strong financial foundations.

It's obvious that in a slower growth environment, revenue growth becomes harder to achieve. That puts a premium on companies that can sustain and grow earnings without relying on the economy to provide a cyclical thrust to meet investor expectations. Our portfolios are intentionally composed of such businesses, those with pricing power, operational efficiency, and resilient demand profiles. We marry all these favorable characteristics with a conservative valuation profile. If cyclical tailwinds should begin to diminish, the consistent earnings generation of these holdings should stand out even more.

If earnings growth slows in lockstep with economic growth, dividends will become a larger component of total investment return and investors will increasingly look to dividends and other forms of capital allocation for income and stability. Our dividend-paying holdings are well-positioned for such an environment, not just because of their dividend, but because those dividends are backed by strong fundamentals and a commitment to return capital to shareholders.

Higher interest rates and slower growth make debt harder to service. In this world, leverage is not just a risk, it's a liability to valuation. Companies with strong balance sheets and low debt burdens, such as those favored by Crawford, are better positioned to weather volatility, fund organic growth, and maintain dividend payments without compromise. In fact, these companies may even benefit from a valuation premium as investors reassess balance sheet quality in a more capital-constrained environment.

At Crawford, our investment approach remains steadfast. In a world where growth may be slowing and capital is more expensive, we believe the case for high-quality businesses will be strengthened.