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HEARD ON THE STREET

Worry Over Inequality Occupies Wall Street

Gulf Between Haves and Have-Nots May Hurt Economy

By JUSTIN LAHART

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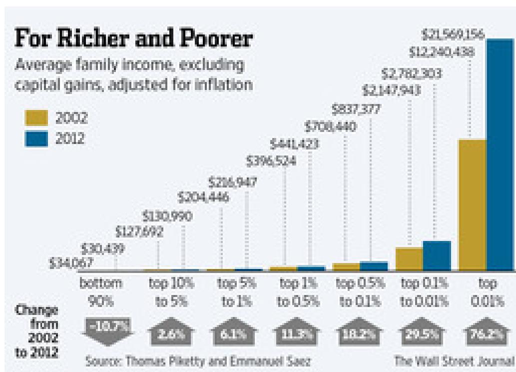
Even if they have found the widening gulf between America's haves and have-nots troubling, inequality isn't something fund managers have worried about professionally. That may be changing.



Over the years, the only way inequality has really mattered to investors has been as a factor when considering stocks. If the rich are getting richer, companies that cater to them have better prospects. Goldman Sachs Group, for example, recently conducted a survey that showed optimism among high-income consumers relative to low-income ones at a high and pointed investors toward companies like department-store operator Nordstrom and luxury-bag maker Tumi Holdings.

Lately, though, some big investors have worried increasing income and wealth gaps threaten the economy's ability to expand. They also fret that public anger over it, which Democrat Bill de Blasio tapped in his successful run for New York City mayor, is creating dangerous political tensions.

Bill Gross, manager of the world's largest bond fund by assets at Pimco, in a recent note said he believed increases in inequality had made the U.S. less productive. "Developed economies work best when inequality of incomes are at a minimum," he wrote. Several fund managers at a Heard on the Street conference last month also voiced concerns, among them Kynikos Associates founder James Chanos, who worried people have less incentive to participate in the economy if they have concluded "the game isn't fair."

When inequality increases as a result of, say, corruption, it clearly causes economic harm. But for the U.S., where much of the increase in inequality results from market mechanisms like changing pay patterns for skilled workers and rising global competition for lower-skilled jobs, its effects are more ambiguous.

Recent work by economists Thomas Piketty, Emmanuel Saez and Stefanie Stantcheva comparing the performance of advanced economies since the 1960s suggests increases in the share of income the top 1% of the population receives relative to the bottom 99% are at most only slightly negative for growth. What that analysis can't tell is what high levels of inequality like today's might mean. Tax-receipt data collected by

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U.S. income in 2012. The only year in the past century when their share was bigger was 1928, at 19.6%.

Worse, this is occurring as average incomes have stagnated. Inflation-adjusted, median U.S. family income fell 6% in 2012 from 2002, according to the Commerce Department. Meanwhile, net worth for the median family in the top 10% by wealth was a record 24 times more in 2010 than for the median family overall, according to the Federal Reserve.

Former Morgan Stanley equity strategist Gerard Minack notes the U.S. Gini index, a gauge of income disparities that is also at a record, tracks with measures of political polarization. So he worries inequality could give rise to more political dysfunction that risks damaging the economy.

Another concern is that rising inequality creates financial instability. Raghuram Rajan, the economist now heading India's central bank, has posited that the credit bubble in the early part of the last decade was a consequence of inequality. In his telling, stagnating incomes led middle- and lower-income families to borrow excessively to raise standards of living.

But if inequality has risen to a point in which investors need to be worried, any reversal might also hurt.

One reason U.S. corporate profit margins are at records is the share of revenue going to wages is so low. Another is companies are paying a smaller share of profits on taxes. An economy where income and wealth disparities are smaller might be healthier. It would also leave less money flowing to the bottom line, something that will grab fund managers' attention.

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