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The New Political Paradigm

Lars Kreckel, CFA – Global Equity Strategist,
Asset Allocation



Agenda

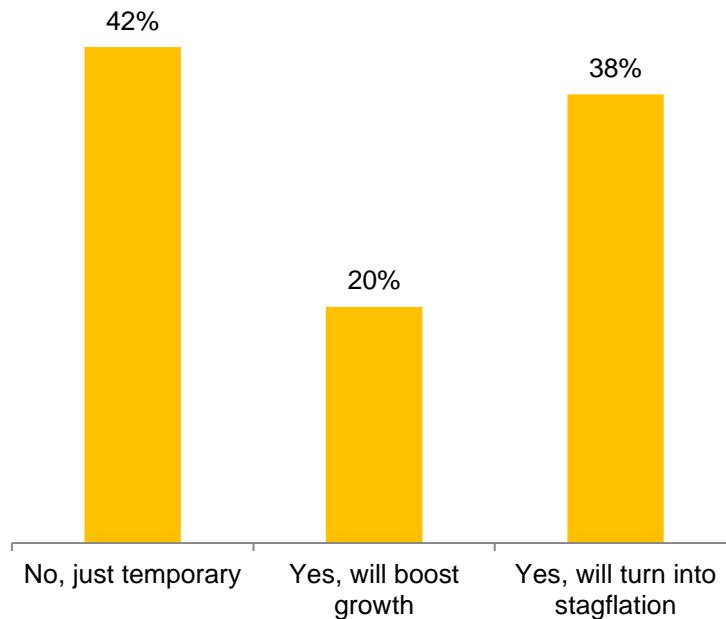
1. Why are people so angry?
2. What can be done about it?
3. What will be done about it?
4. Asset Allocation – don't predict, prepare



Why this matters

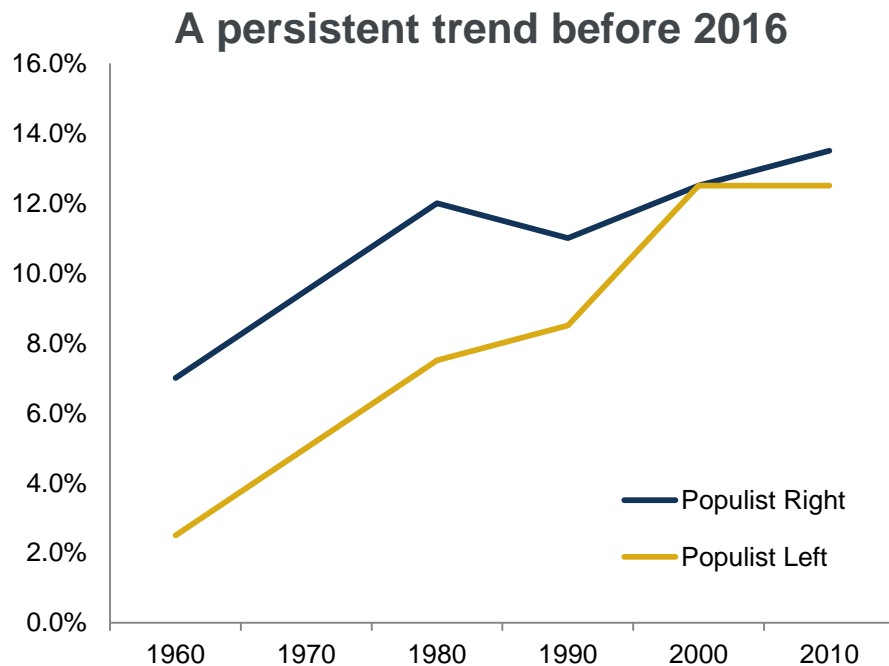
- The New Political Paradigm
- ...drives markets
- ...creates winners and losers
- ...is here to stay
- ...will likely get stronger
- ...is not consensus

Are Trump and Brexit the beginning of 'de-globalisation'?

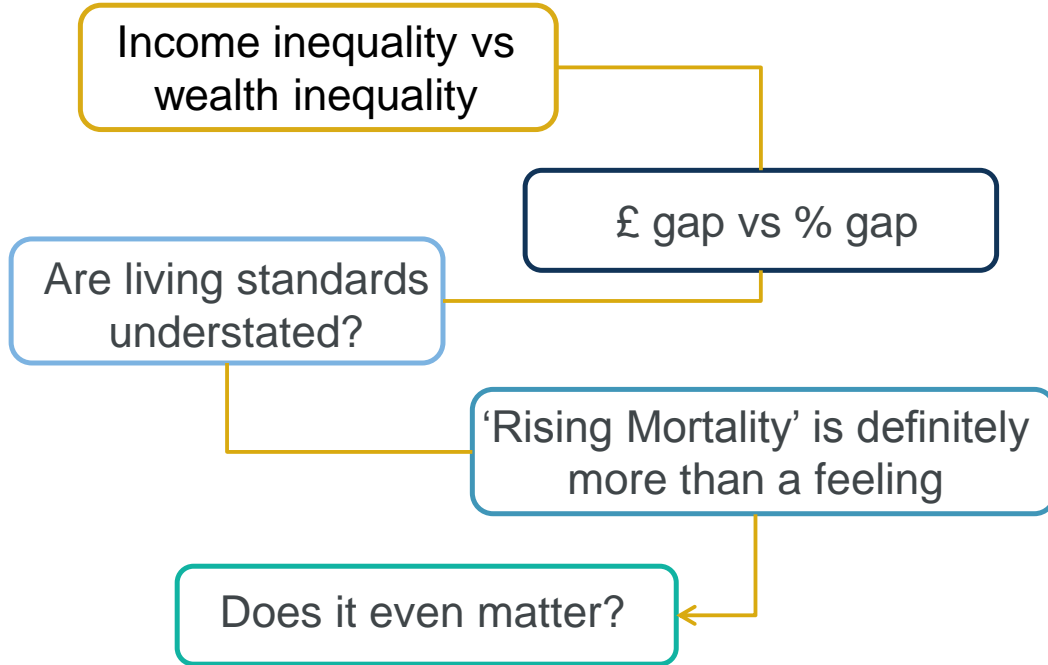


Why are people so angry?

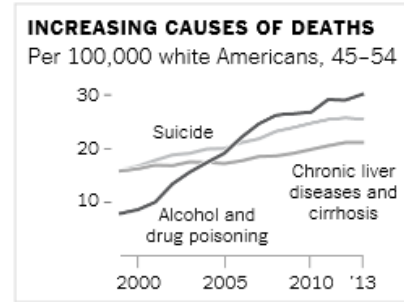
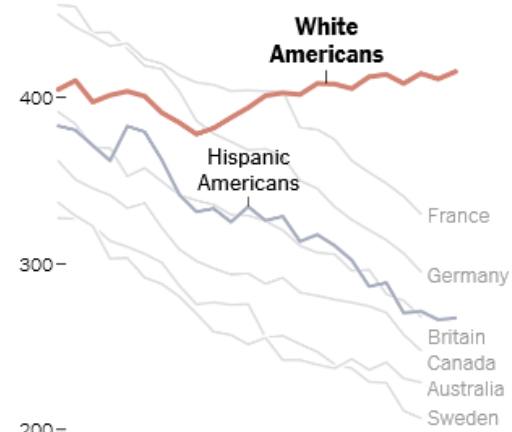
- Trump and Brexit are symptoms, not causes
- Populist parties are on the rise across the West
- The trends are not new, but 2016 was when it started to matter
- A simple question without simple answers



More than a feeling?

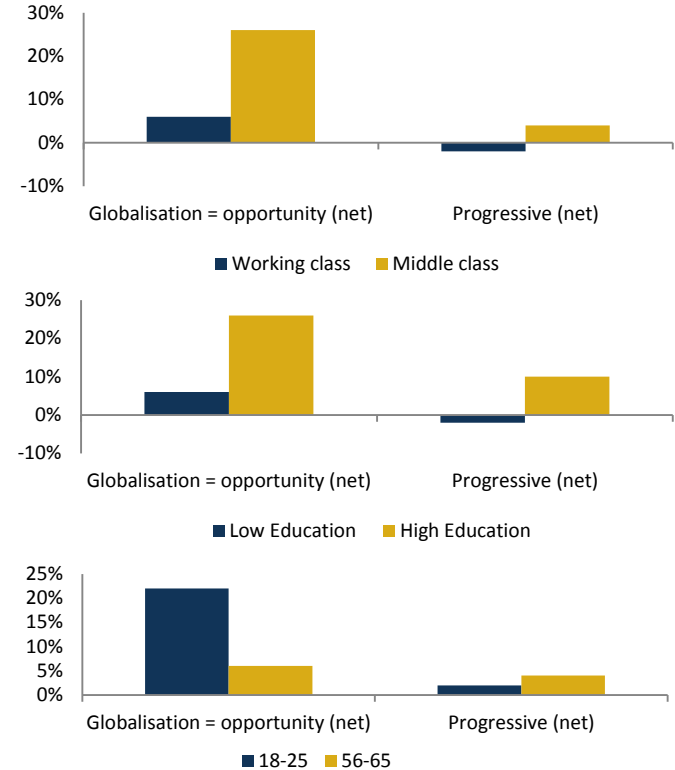


DEATHS per 100,000 people aged 45-54



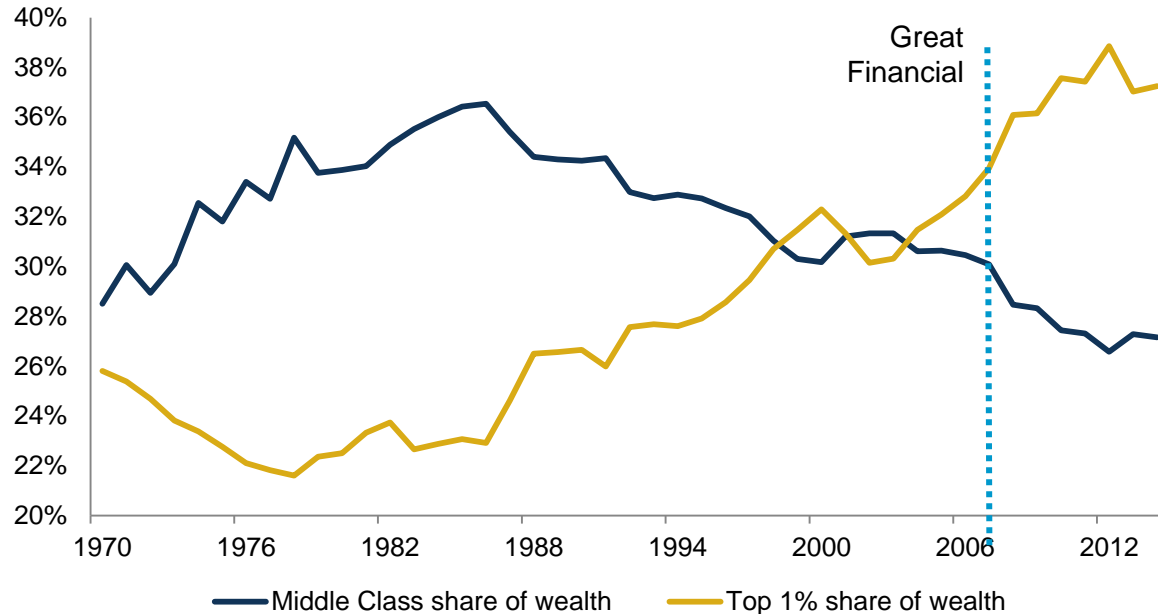
Shifting values, globalisation

- Excessive and quick shift to progressive values; advanced by the liberal elite against the will of ordinary people
- Progressive vs Traditional values
- Globalisation makes a bigger pie, but divides it up to create winners and losers
- Survey says: it's fear not values
- Values don't explain the fear of Globalisation. Age, class and education do.



QE and bank bailouts

'by the rich, for the rich'



Reinforced the view of inequality; the elites are looking after themselves

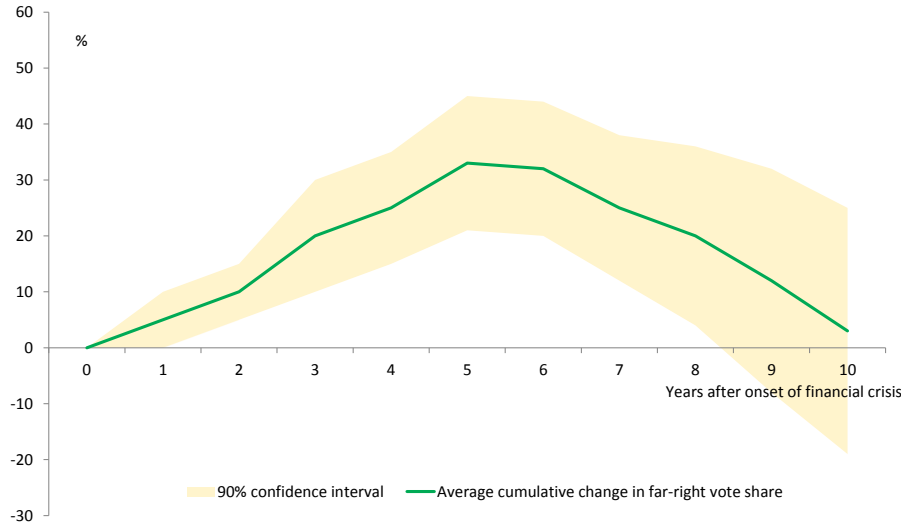
...while ordinary citizens are left to fend for themselves



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History points to a hard right turn after financial crises

Share of the vote for the far-right



On average, after financial crises...

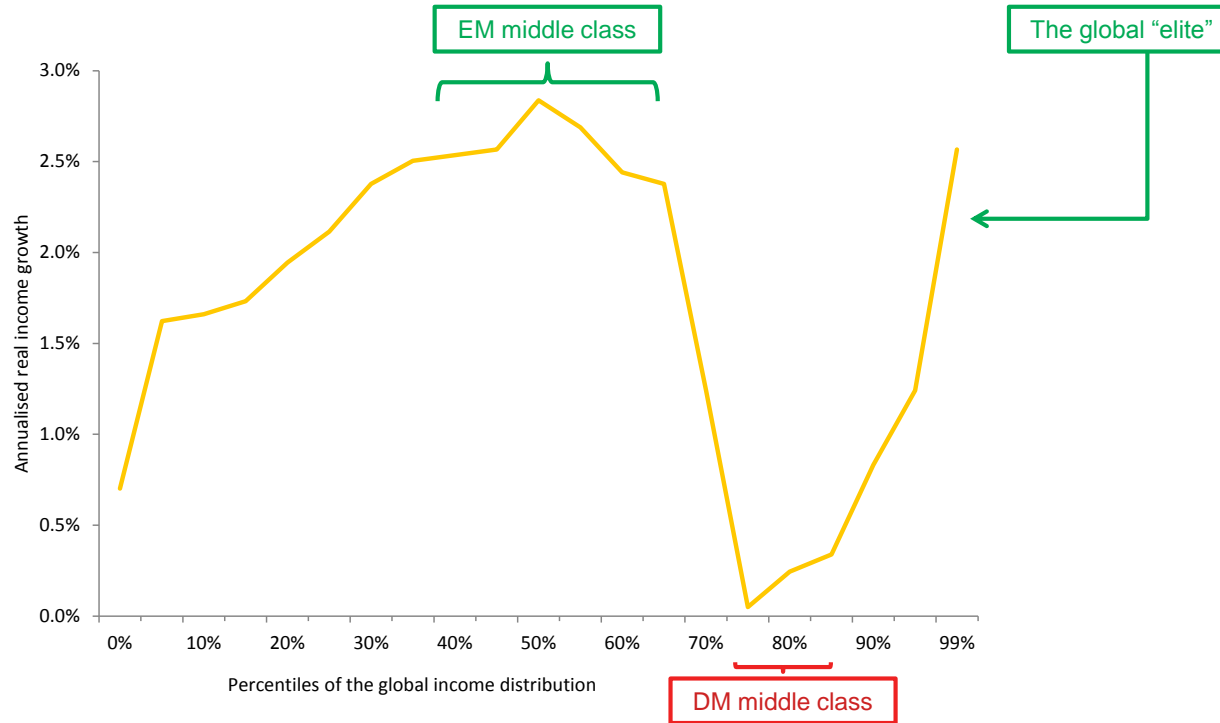
- Share of vote for the far-right increases
- Political polarization increases
- Street protests (riots, strikes & demonstrations) increase

Average 35%(!) pick-up in vote share for the far right, peaking five years after the onset of financial crisis

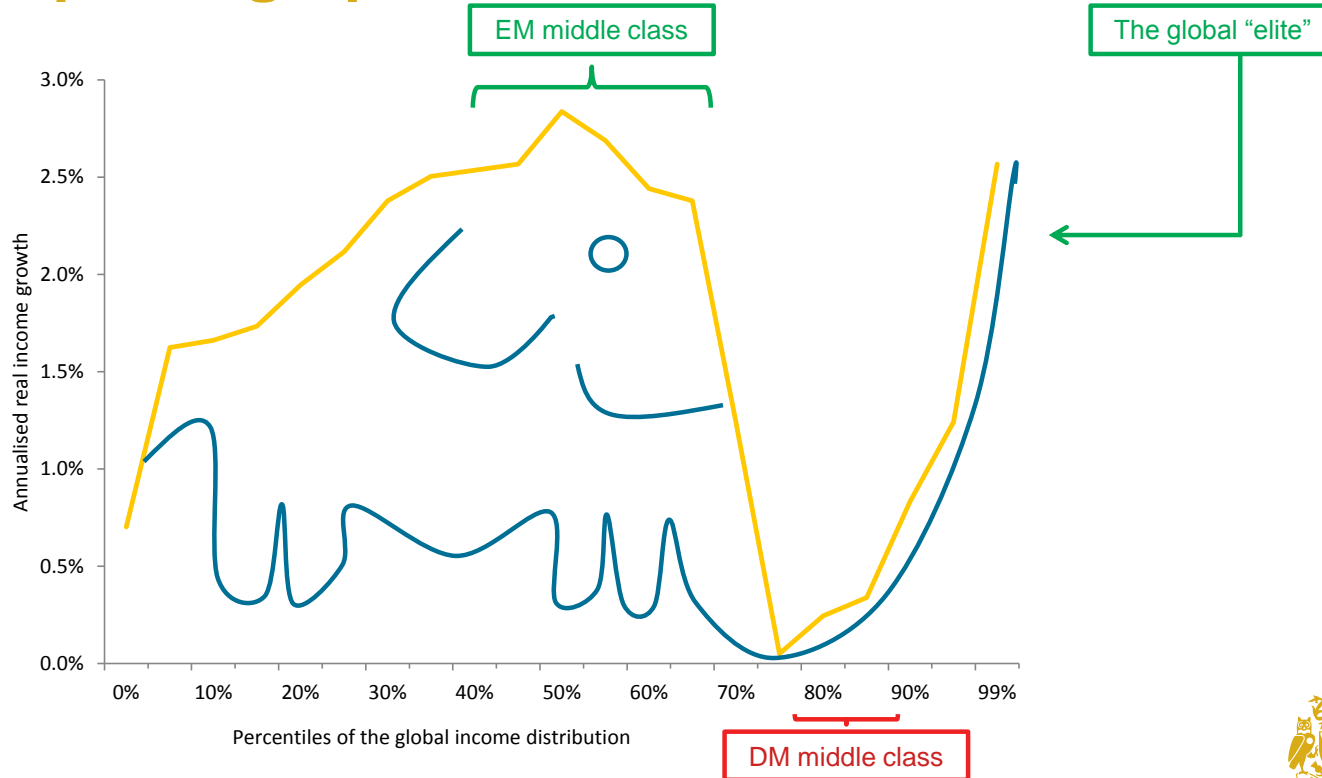


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Inequality, the Elephant graph



The Elephant graph



Automation

'Manufacturing decline' or 'Manufacturing job decline'?



America is producing more than ever...

...but with fewer and fewer people



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Automation – only the beginning



WAYMO

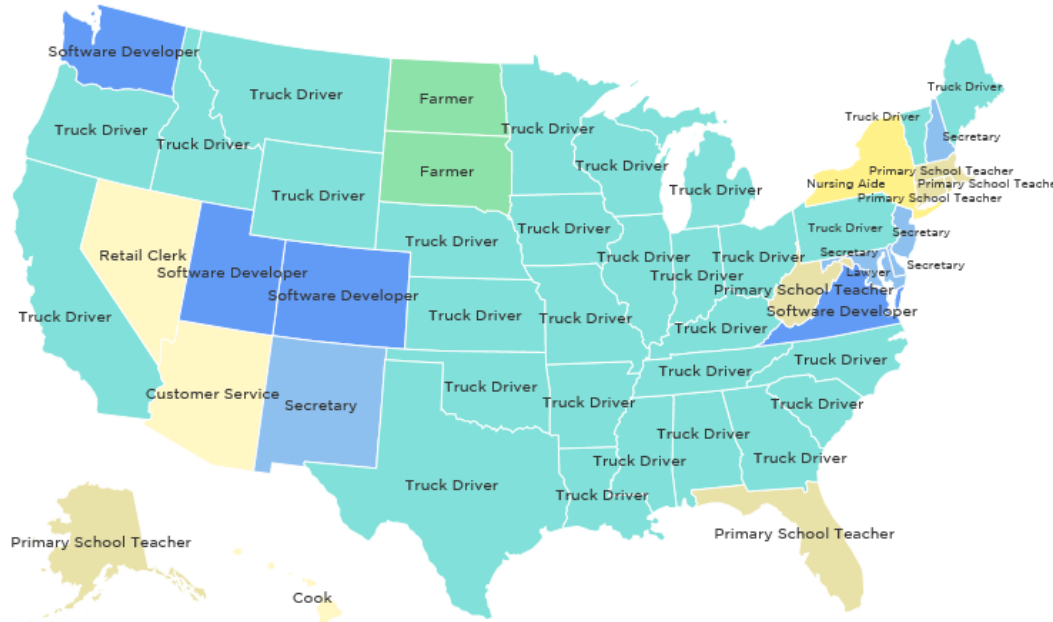
CAFEX

amazon go



MOMENTUM
MACHINES

The most common job in each US state - 2014



In the US there are:

168,000 transit bus drivers

181,000 taxi drivers

505,000 school bus drivers

600,000 Uber drivers

2,500,000 truck drivers

8,000,000 retail salespeople & cashiers

14,000,000 restaurants workers

A total of **146,000,000** jobs



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Institutional degradation

Degradation by a thousand cuts

Same pattern across countries

'6 in 10 believe search engines over human editors'

'53% don't regularly listen to anyone with whom they often disagree'

'4x more likely to ignore information that supports an opposing view'

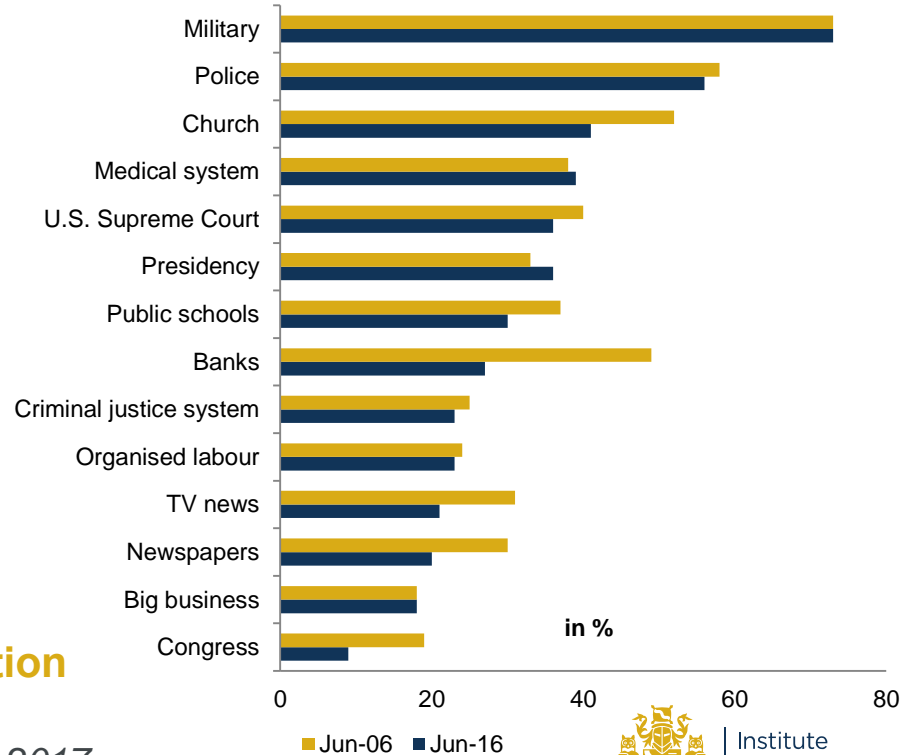
'Peers are as *credible* as experts'

'In 1960 70% of Americans trusted the government, today it's only 18%'

"The third line of my work is the deconstruction of the administrative state."

Steve Bannon, February 2017

Pew research



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Elite anxiety

Survival Condo Project

- Luxury Survival Condos in an old Atlas Missile Silo
- \$1.5m - \$4.5m
- 70 people can live completely 'off-grid' for more than 5 years
- Sold out, second project underway

New Zealand citizenship: e.g.
Peter Thiel

'It's a very odd thing. You're seeing the people who've been the best at reading the tea leaves – the ones with the most resources, because that's how they made their money – are now the ones most preparing to pull the rip cord and jump out of the plane.'

Robert Johnson

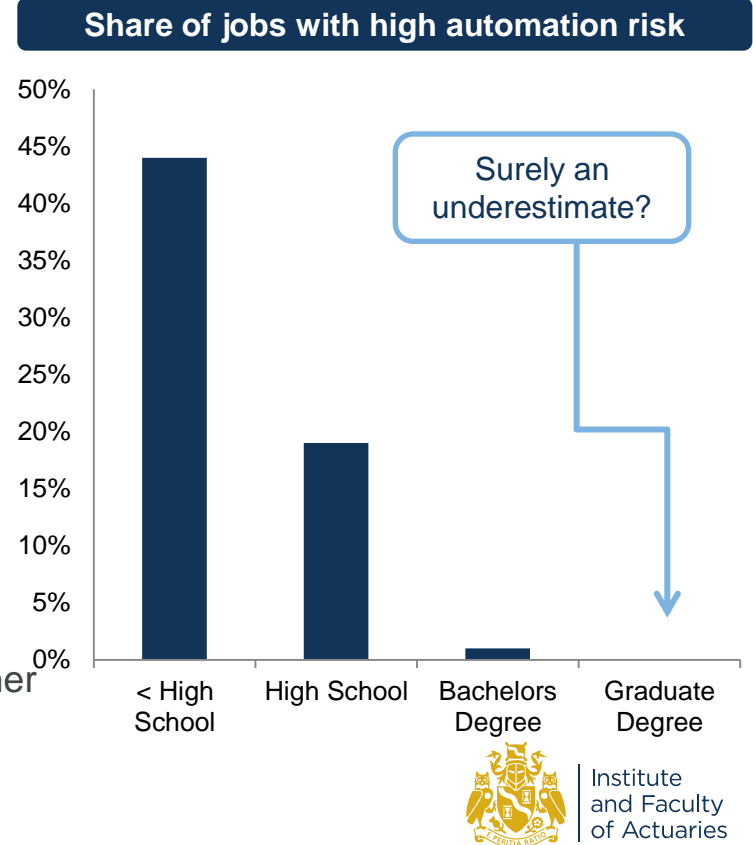
Survival Condo Project



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Solutions – more education?

- Education ticks a lot of boxes
- More education = less risk from automation
- More education = less risk from globalisation
- More education = lower appeal of Populist parties
- The college earnings premium has continued to grind higher



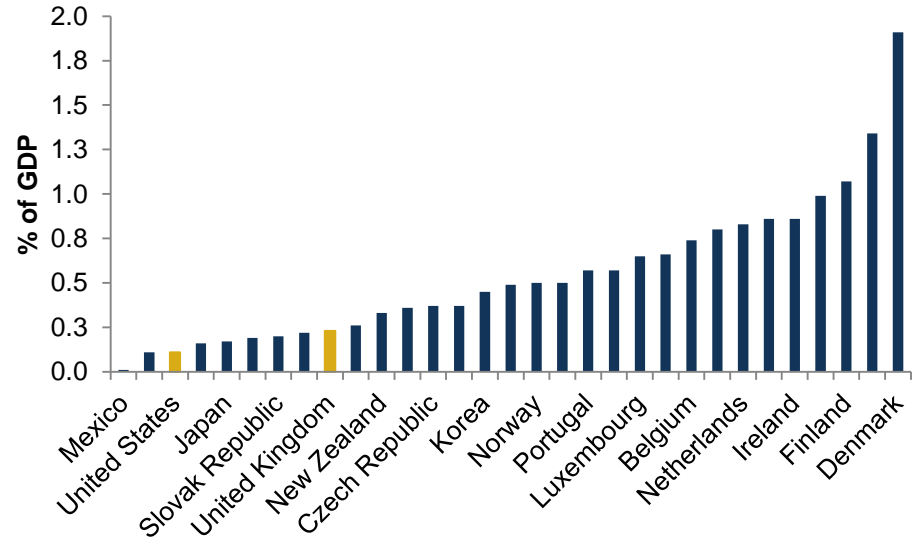
Solutions – social safety net?

US spending on ALM programs has halved (in % of GDP) since the 80's

Social Security Hammock or money well spent?

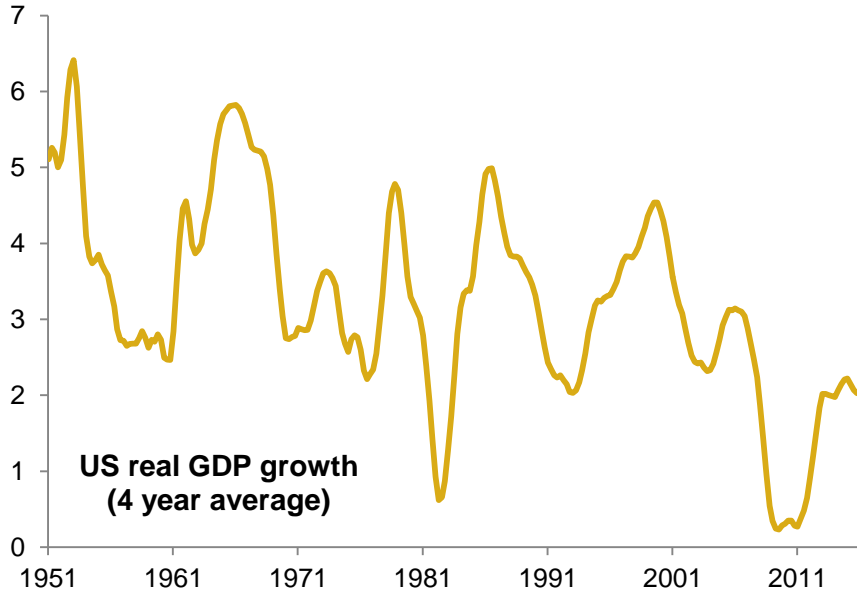
Can this explain the lack of social tensions in the euro crisis?

Public expenditure on Active Labour Market Programs



Solutions – more nominal growth?

The great slowdown



“To get the economy back on track, President Trump has outlined a bold plan to ... return to 4% annual economic growth”

WhiteHouse.gov

- LGIM estimates that trend growth in the US is **1.5%**
- The Federal Reserve estimates it is at **1.8%**
- The CBO estimates **2.0%**
- House Republicans estimate **3.0%**
- Steven Mnuchin, Treasury Secretary is “...aiming for **3% annual growth or higher**”



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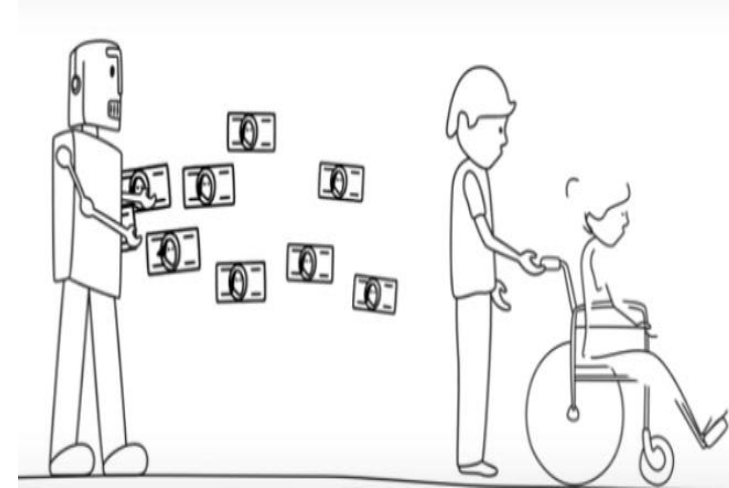
Solutions – more redistribution?

A new approach to resource allocation

Universal basic income?

Robot tax?

Redistribution to save Capitalism



“There is a pretty good chance we end up with a universal basic income, or something like that.”

Elon Musk, November 2016

“If a robot comes in to do the same thing, you’d think that we’d tax the robot at a similar level.”

Bill Gates, February 2017



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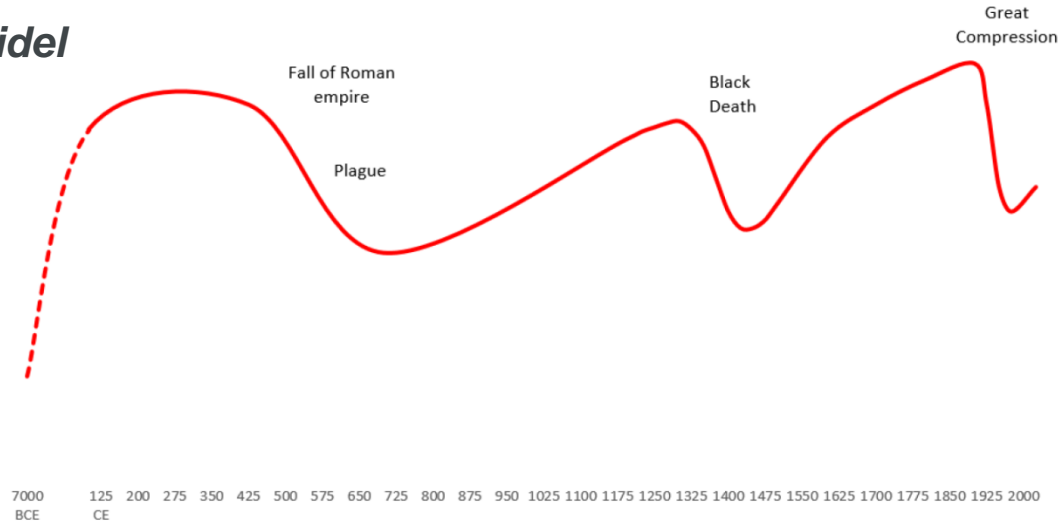
Solutions – Don't look at history for inspiration

“Violence has been the single most important means of levelling wealth and income inequality in human history.”

Walter Scheidel

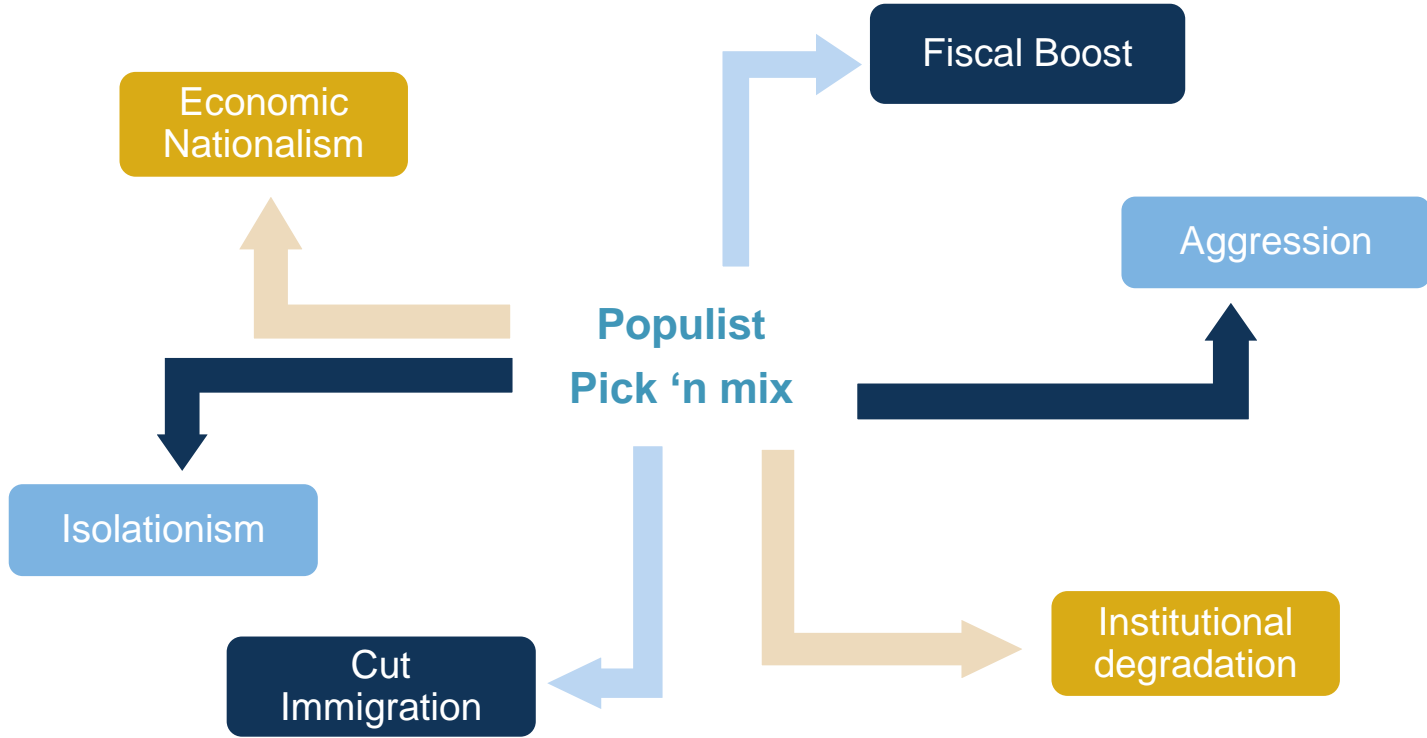
- Mass mobilisation war
- Revolution
- State collapse
- Pandemics

Inequality trends in Europe in the (very) long run



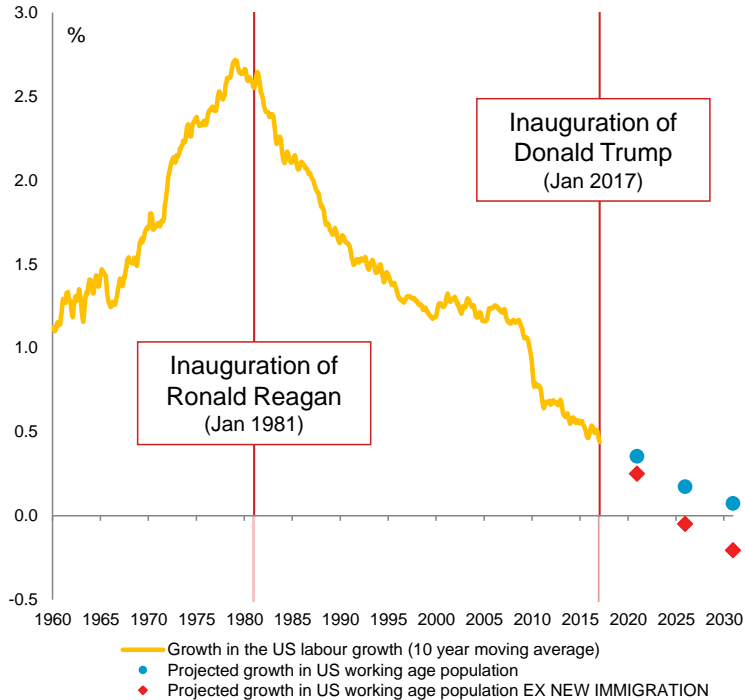
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How will policymakers respond?

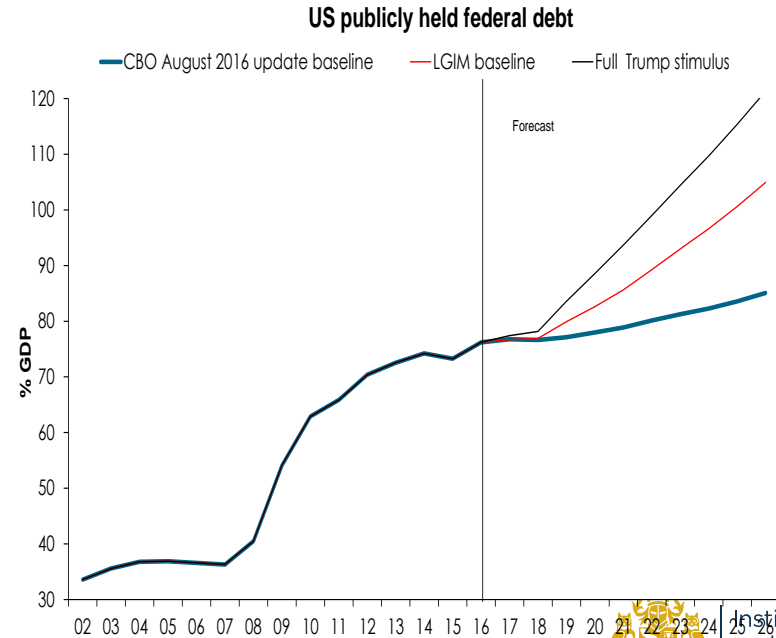


President Trump is trying to fight the demographic tide

The demographic tailwind has disappeared



US publicly held federal debt

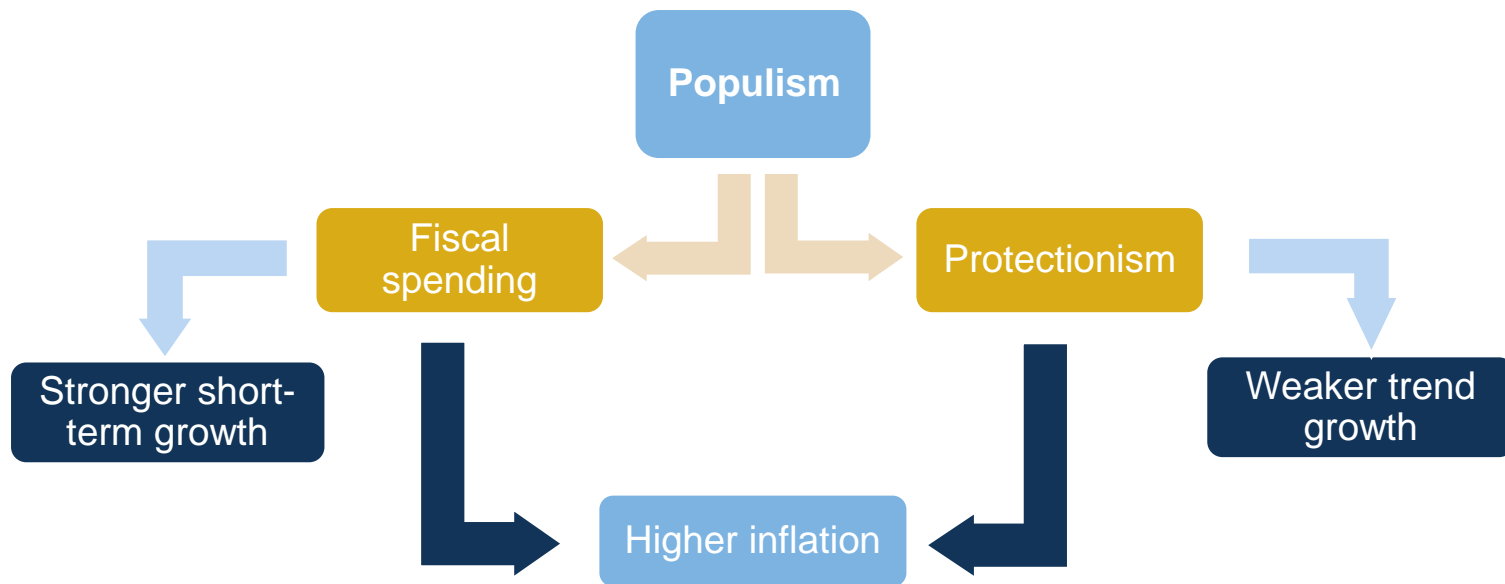


New Political Paradigm matrix

	Economic nationalism	Fiscal boost	Cut immigration	Political risk	Isolationism	Total
Equities	●	● ●	●	●	●	●
Bonds	●	● ●	●	●	●	● ●
Credits	●	● ●	●	●	●	●
Inflation	●	● ●	●	●	●	● ●
USD	●	●	●	●	●	●
Commodities	●	● ●	●	●	●	●



Inflation impact of populist shift clearer than growth impact



“An ideology that pits a virtuous and homogeneous people against a set of elites and dangerous ‘others’ who are together depicted as depriving (or attempting to deprive) the sovereign people of their rights, values, prosperity, identity, and voice”

Albertazzi & Duncan (2008), Twenty-First Century Populism

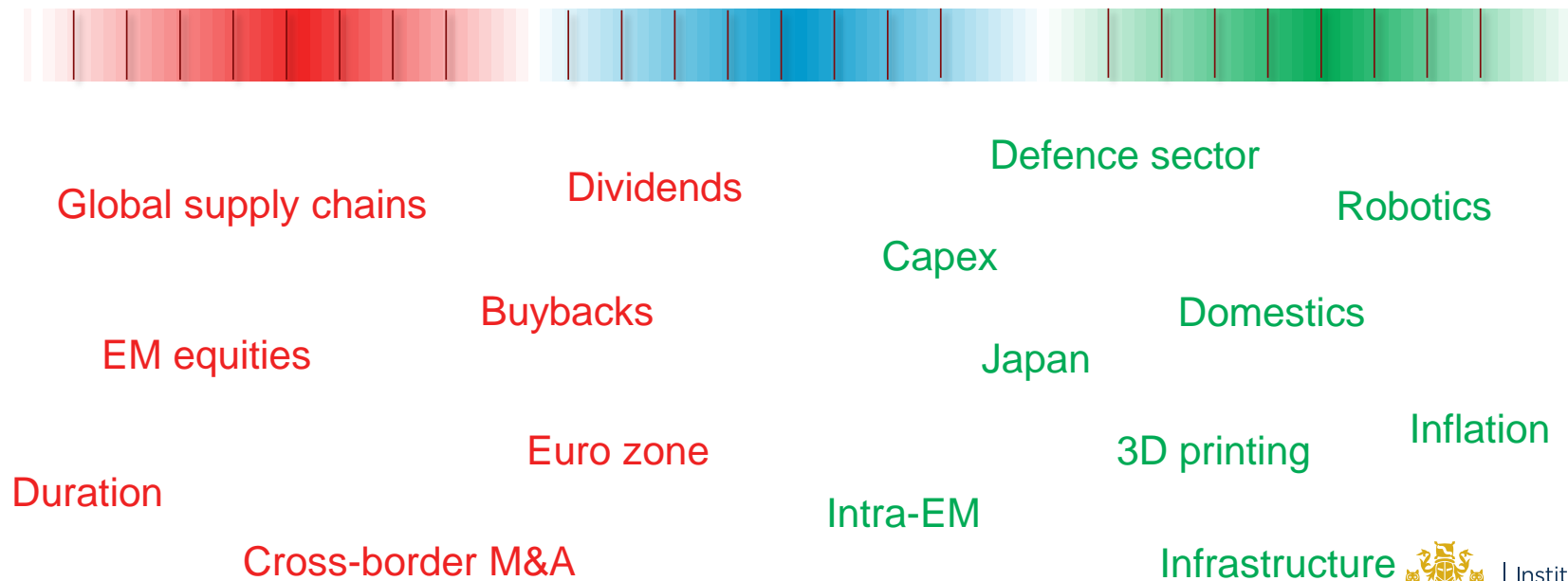


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A more granular look at Winners and Losers

Losers / Less of

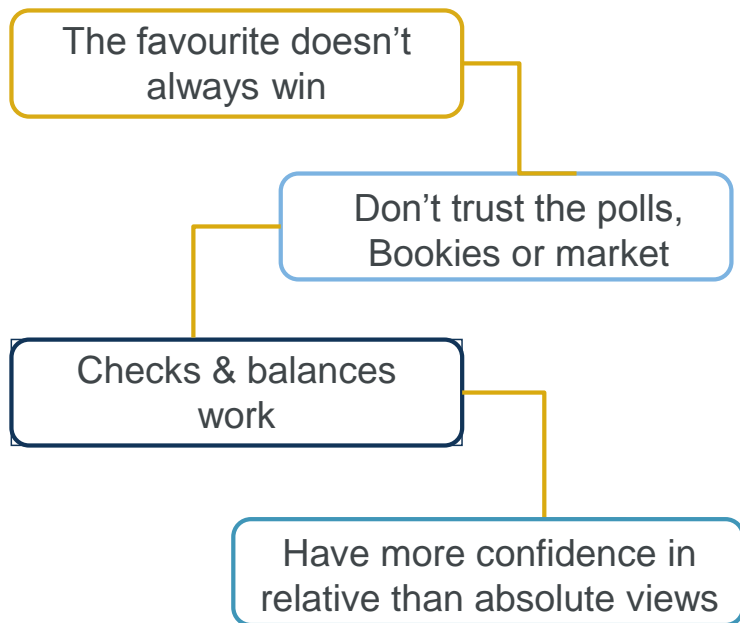
Winners / More of



Political risk – A never ending story...



Lessons from 2016



1 GBP and MXN both rally (c. 4%) going in to the event in anticipation of Remain/Clinton

2 GBP and MXN both collapse (c. 10%) faced with the reality of Leave/Trump



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Don't predict, prepare

French election scenario planning

	Macron/Fillon	Le Pen	Hamon
EMU Equities	●	● ● ●	●
Other Equities	●	● ●	●
UK Sovereign	●	● ●	●
US Sovereign	●	●	●
EU Sovereign	●	● ●	●
UK Investment Grade	●	●	●
EU Investment Grade	●	● ● ●	●
Global High Yield	●	●	●
EM Debt, lcy	●	● ●	●
GBP/EUR	●	● ●	●
USD/EUR	●	● ● ●	●



Thought leadership

September 2016 Time for coordinated policy to revive growth?  Follow us @LGLIM #Fundamentals

FUNDAMENTALS

Time for coordinated policy to revive growth?

With global growth remaining subdued and increasing signs that monetary policy is reaching its limits, the calls for fiscal easing and more policy coordination are growing louder.



In this edition of Fundamentals, LGM Economist Magdalena Polon takes a look through the lessons of history and presents the case for greater coordination between monetary and fiscal policy.

THE PERCEPTION OF MONETARY POLICY BEING AT ITS LIMITS IS GROWING

Global growth has remained sub-par. Inflation and inflation expectations, meanwhile, have been hovering near historical lows (especially in the developed economies) and well below targets set by central banks. This is despite exceptional and prolonged easing by the major central banks, highlighting the limits to monetary policy's ability to revive growth and stave inflation following the global financial crisis.

There are a few reasons why the prolonged easing has not been more successful. These include a fall of the 'neutral' rate below zero (so below most policy rates), lower investment and risk appetite, and higher precautionary savings making rate cuts less effective.

Tight fiscal policy is likely given its negative impact (see **Figur. 1**). As short-term interest rates are already higher, tightening fiscal policy therefore, likely prolonged the euro area.

November 2016 When I'm 64  Follow us @LGLIM #Fundamentals

FUNDAMENTALS

When I'm 64

US trend growth has probably halved to around 1.3% due to an ageing population. Although reported GDP growth is modest by historical standards, it's enough to tighten the labour market. This implies a drag on profitability and a cyclical rise in inflation.



In this edition, LGM Economist James Carroll considers what an ageing population implies for the tightness of the US labour market.

It is 50 years since the Beatles wondered what happened when they're 64 ("When I'm Sixty-Four"). Since then the US economy has grown by an average of 3% per annum. But there is a sharp difference between the last decade (1996) and the previous four (2006). We have previously suggested that statisticians are underestimating output and overestimating inflation for digital services ("Bean Counters? Fundamentals", March 2016). But this doesn't change the fact that nominal growth is historically weak, hindering the ability of firms, households and governments to pay off debts. It seems demographics are to blame.

Demographics affect GDP growth in two ways: the number of people willing to work and their productivity. As people age they are less likely to work, particularly as they approach 'retirement' age. Moreover, academic research suggests most people's productivity peaks in their late 20s. So a very young or very old population is less productive than a middle-aged one.

BABY BOOMERS ARE RETIRING
The US birth rate peaked in the late 1950s. These workers are dropping out of the labour force as they reach retirement. The natural change in the labour force (school leavers minus retirees) was running at 1.25 million per year between 2000 and 2010 (just under 1% of the labour force), but is close to zero at present.

The growth in the labour force at the moment (and therefore driven entirely by immigration, a political hot potato) if current immigration trends continue, the labour force should grow by just 14% in coming years, almost 110% less than the four decades prior to the financial crisis.



macromatters.com



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