Beyond the Election: What Doesn't Change Will Be a Lot More Than What Does

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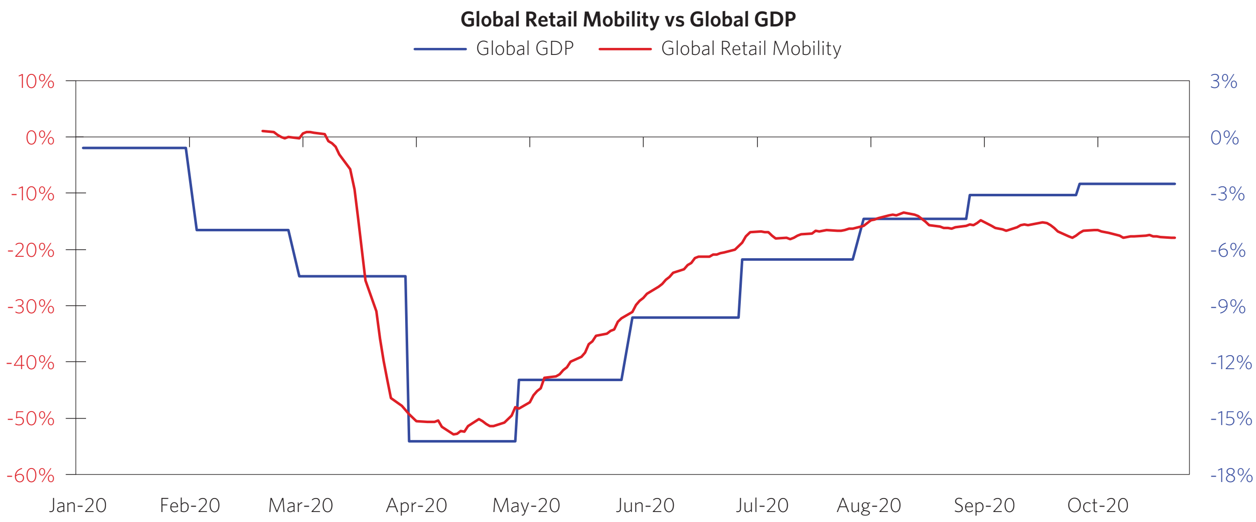
While the election is very important across many dimensions, it's also worth keeping in mind that the dominant forces which are now shaping economic/market conditions will remain the dominant forces. We see the following conditions as the primary determinants of future economic/market outcomes:

1. **The impact of the virus** is likely to be big for another year or more on the overall level of spending and income as well as on differences in the level of spending and income across sectors and economies.
2. **We will still be in an MP3 world** where fiscal policy, supported by monetary policy, will be the primary lever for managing the economy, and the need for wise lever pulling will be substantial. That brings with it the uncertainty of the political decision-making process as well as differences across countries in the ability and willingness to take action over time.
3. **The world will be awash in liquidity**, with monetary success (i.e., reflation) leading to ever-increasing piles of cash which steadily lose real purchasing value.
4. **Abundant liquidity will continue to seek out storeholds of wealth** that protect against the risks of those assets most impacted by lower levels of income and spending as well as the devaluation of money resulting from MP3 policies.
5. **While these conditions are most prevalent in the West, they are not so prevalent in the East**, thus creating a step change in the secular shift of economic power from West to East. We expect global capital to move similarly over time.

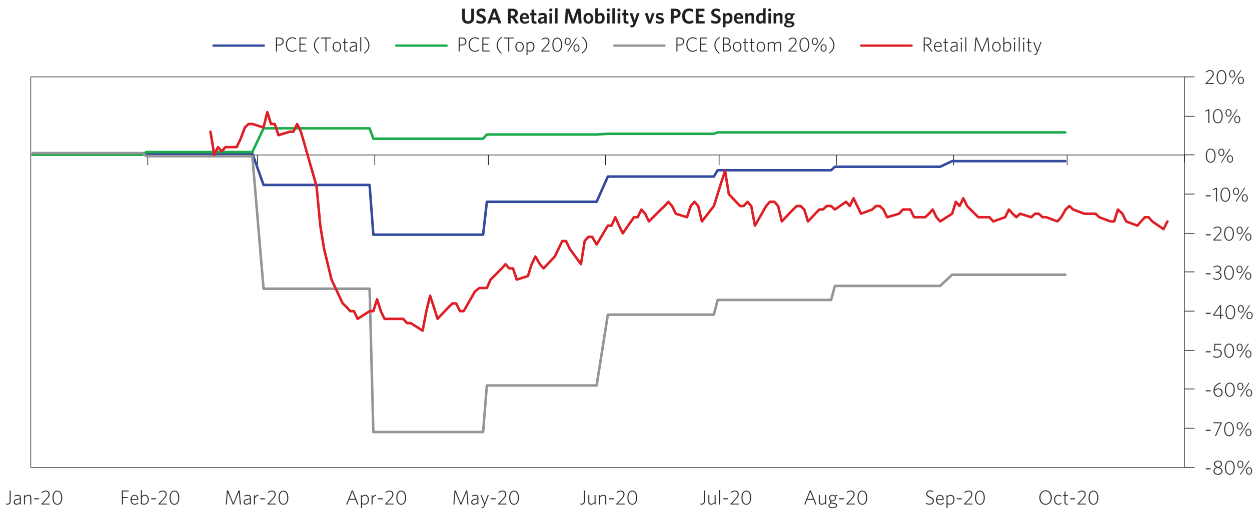
Taking a snapshot of where we are with respect to each of these key forces:

1. There is no omniscient way to see social distancing or its impact on spending in action, but one proxy is mmobility data. By this proxy, it is clear that social distancing has a big impact on spending, that it impacts spending on some things a lot more than others, and that mobility has flatlined at about 20% down relative to its level at the beginning of the year.



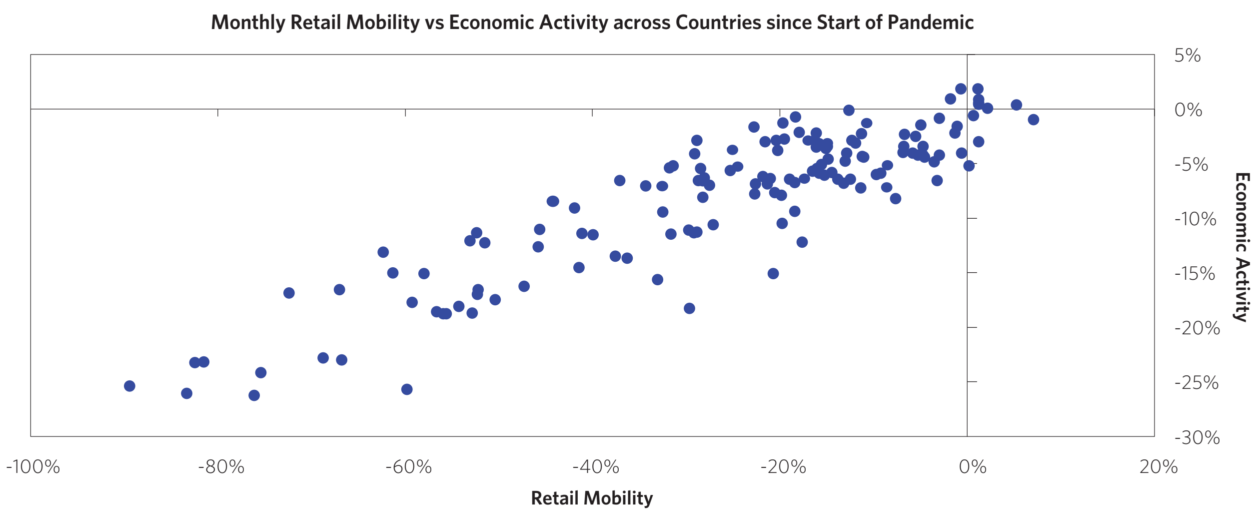
Source: Google Mobility

And zooming in on different types of consumer spending, we can see that the types of spending that the virus has depressed the most (like travel and leisure) remain 40% below peak, with limited prospects for improvement as long as the threat of the virus remains.



Source: Google Mobility

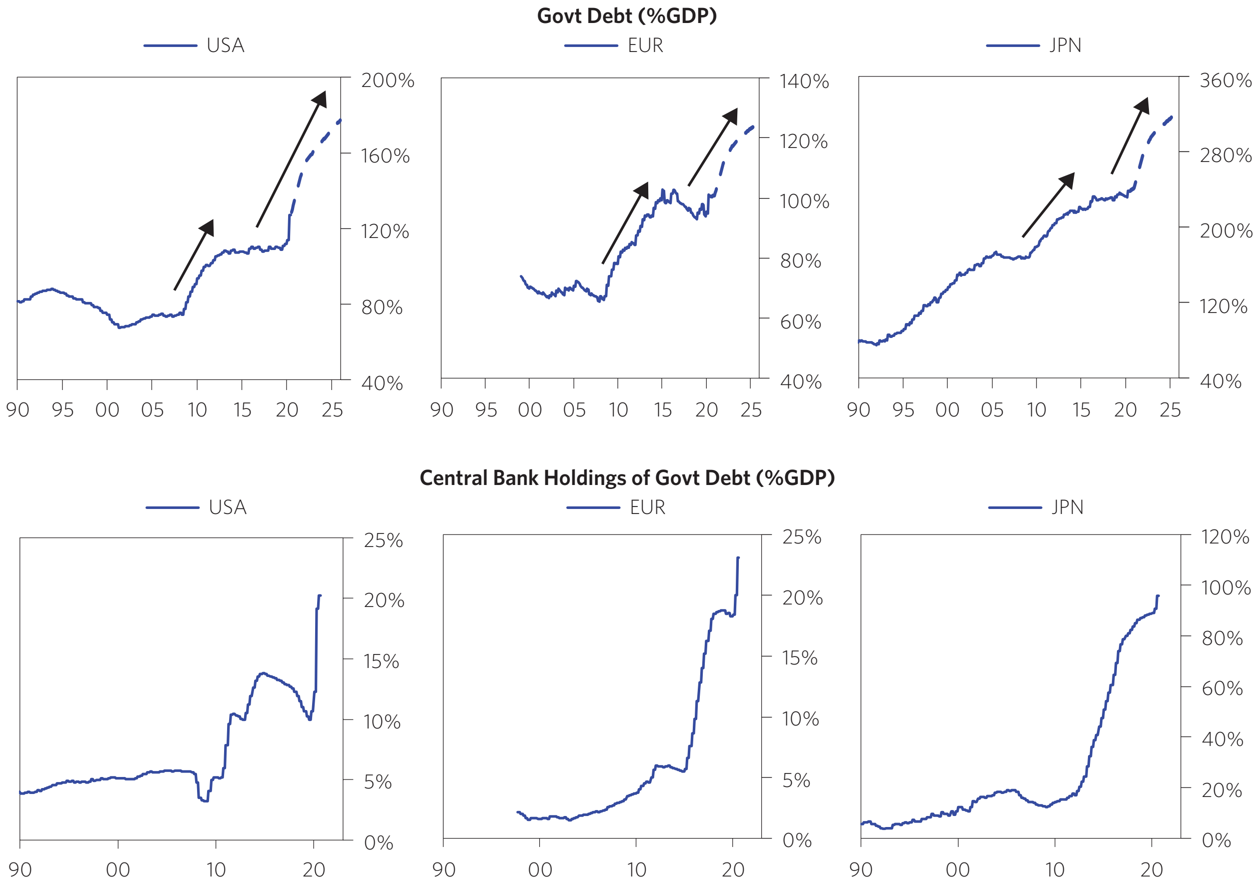
To date, differences and degrees of social distancing have been among the clearest indications of how the virus is impacting spending across countries, as illustrated below. The degree of the fiscal response rounds out the picture.



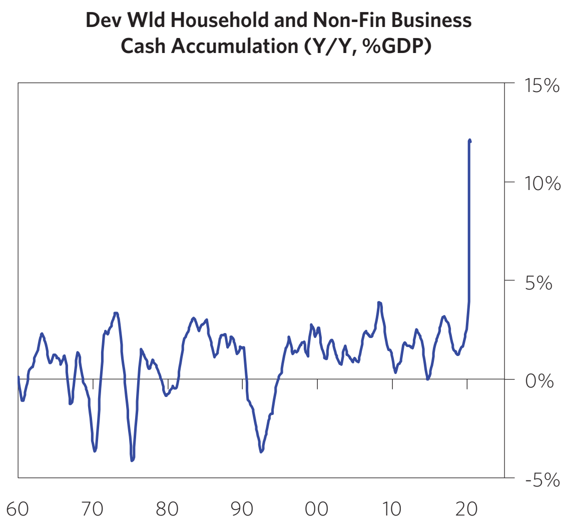
Source: Google Mobility

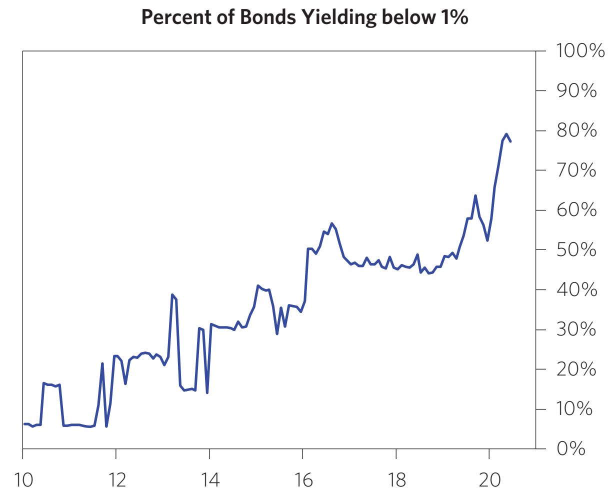
2. We are now firmly ensconced in a world of MP3—coordinated fiscal-monetary stimulation aimed directly at supporting spending, with central banks monetizing fiscal deficits. While different policy makers will take different routes to get there, the pressure will be to provide enough stimulus to alleviate both the near-term economic pain of the virus and the long-term burden of very high debts. As shown, government debt levels have exploded, with much of that debt landing on central bank balance sheets.

Massive Government Stimulus Funded by Central Bank Printing



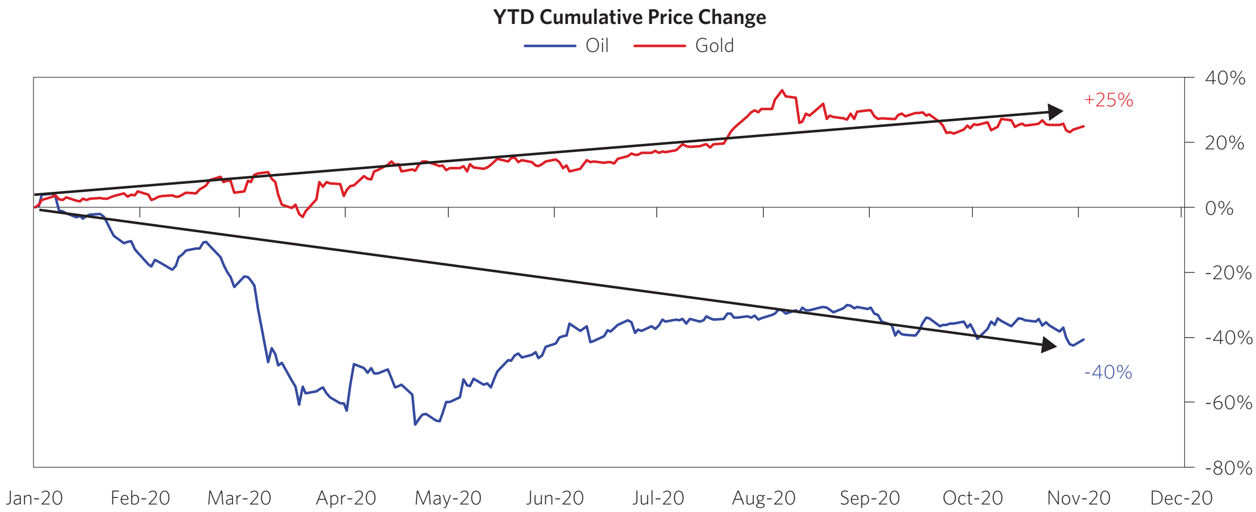
3. The world will still be awash in liquidity, with piles of cash losing real purchasing value. The chart on the left below shows the buildup of cash that has occurred, as households have thus far saved a good deal of the transfers they've received from the government, and businesses preemptively borrowed at the start of the crisis but haven't had to deploy the funds. On the right, we show just how widespread the condition of low returns at both the short *and* long end of the yield curve is.





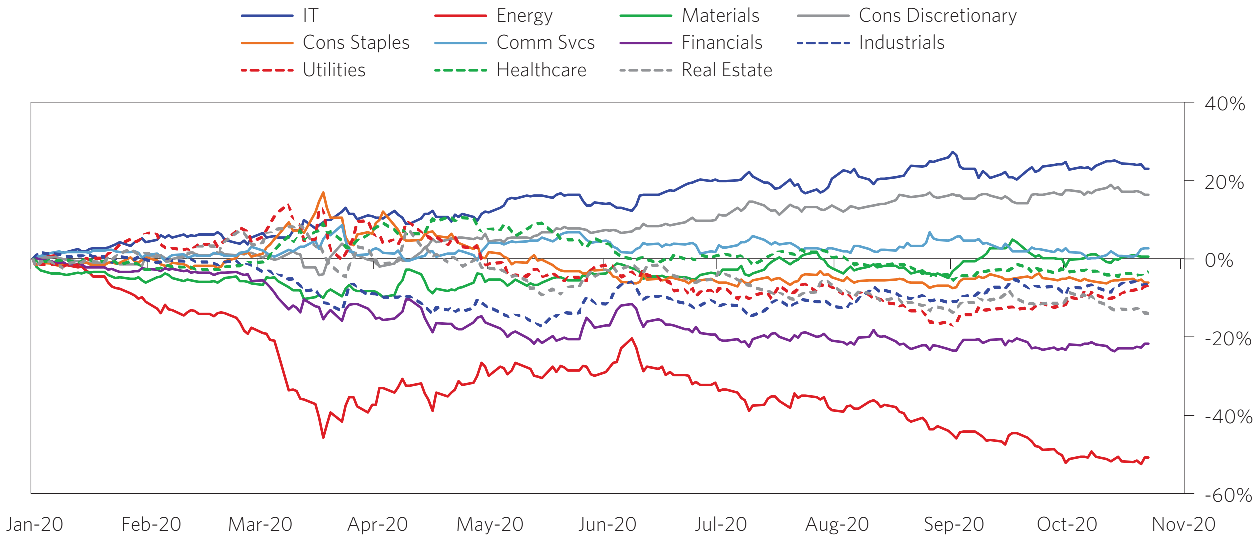
4. Abundant liquidity will continue to seek out storeholds of wealth which protect against the risks of assets most impacted by lower levels of income and spending as well as the devaluation of money resulting from MP3 policies. We are seeing highly divergent outcomes at every level you can think of (asset classes, sectors, companies, countries, and individuals) between those more vulnerable to the key cross-cutting pressures at work and those that are more insulated or have even benefited.

One of the clearest examples of the divergent pressures from the collapse in demand versus the expansion of liquidity and its movement into storeholds of wealth is the divergence between oil prices and gold prices. Spot oil is a very short-duration asset whose price is heavily influenced by current demand, particularly the demand for travel, which has been hit especially hard by the pandemic. As an example, note the extreme move of the spot oil price to $20/bbl in April when demand collapsed (with short-duration WTI futures falling sharply below zero during that time). On the other hand, gold is a long-duration storehold commodity not used much for immediate consumption and better thought of as a currency whose value is in relation to fiat money. With the actual and expected production of fiat money going strong this year, and without much exposure to the collapse in demand, gold prices in money terms rose, but really, the value of money in gold terms fell.



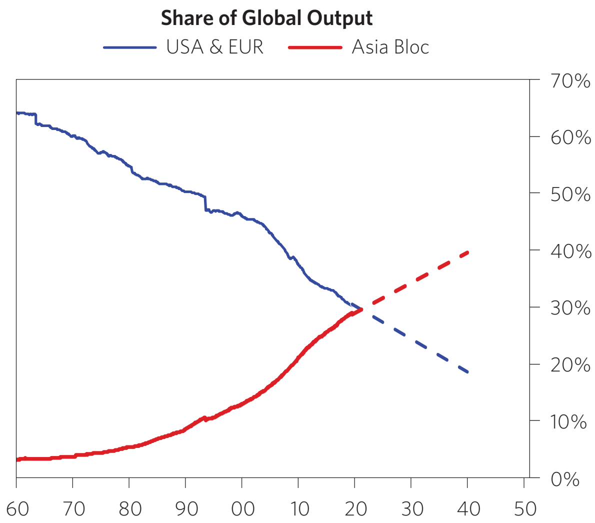
Another example is the sectoral dispersion in the stock market. Taking the US as an example, the top-performing technology sector has functioned as a type of storehold of wealth given wide profit margins, low debt, and the related ability to get to the other side of the economic contraction unscathed. Meanwhile, the energy sector is down by almost 50% due to the collapse in global demand, and banks are down 20% due to the related potential for credit losses and the margin squeeze from zero interest rates. These divergences belie the roughly "unchanged" price of the equity market in aggregate, which is hardly representative of any of the parts.

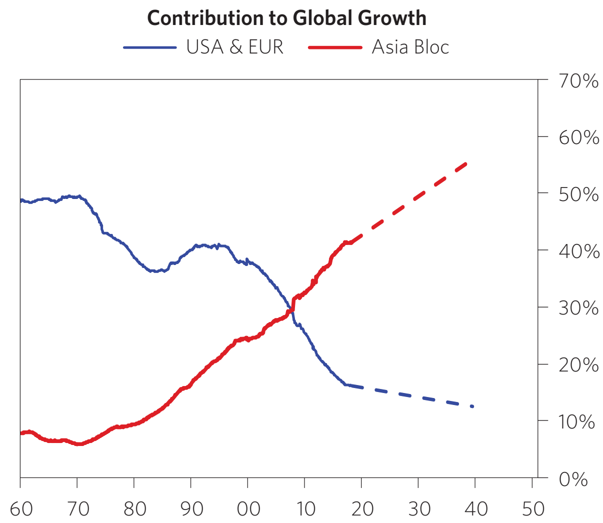
YTD Cumulative Sector Returns Diff Mkt



5. These conditions are particularly true in the West and Japan, but not so much in China and the rest of Asia. This latter region has been the best in the world at containing the virus while limiting the loss of economic activity. As a result, there has been less need for fiscal relief funded by monetization, on top of the fact that these countries are investors/savers that run persistent current surpluses—meaning they are not reliant on foreign capital. Today, China is one of the only countries in the world to have fully recovered to pre-pandemic levels of economic activity, and the only major country with a bond yield that isn't flirting with the zero bound.

   All this is creating a step change in the secular shift in the global balance of economic power from West to East. Already, China and the surrounding Asia bloc (including Hong Kong, Korea, Malaysia, Singapore, Taiwan, and Thailand) account for as much global output as the US and the Eurozone combined as well as the majority of global growth. This trend is on course to continue given secular productivity prospects, and we expect that over time, global capital will follow suit.


Share of Global Output
USA & EUR
Asia Bloc
70%
60%
50%
40%
30%
20%
10%
0%
60
70
80
90
00
10
20
30
40
50


Contribution to Global Growth
USA & EUR
Asia Bloc
70%
60%
50%
40%
30%
20%
10%
0%
60
70
80
90
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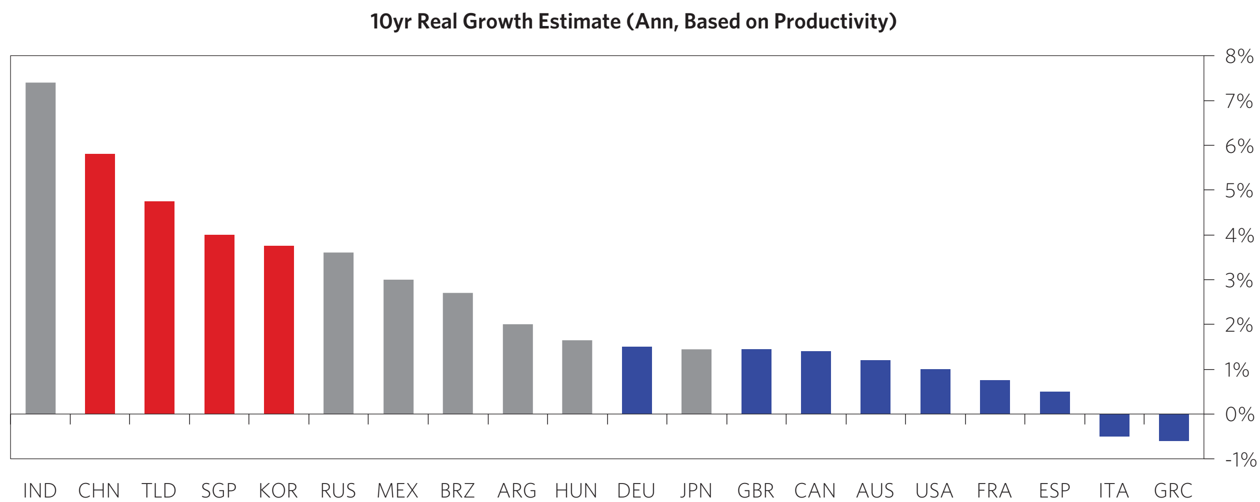
10
20
30
40
50


10yr Real Growth Estimate (Ann, Based on Productivity)
8%
7%
6%
5%
4%
3%
2%
1%
0%
-1%
IND
CHN
TLD
SGP
KOR
RUS
MEX
BRZ
ARG
HUN
DEU
JPN
GBR
CAN
AUS
USA
FRA
ESP
ITA
GRC