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GLOBAL STRATEGY THOUGHTS FOR 2021: REFLATIONARY REPAIR

US capitalism was built on large societal divisions, but sometimes such becomes intolerable and the majority of the population revolts. In this case, the virus accentuated the income divide and engendered even greater angst. However, during the past four years, the majority fought back in different ways and ended up fighting each other, while the wealthy prospered more than ever, with high-skill workers reaping gains while lower-skill workers struggled and were often displaced, especially after the virus. Now, with the election in Georgia, the wealthy and corporations will likely be negatively affected, especially regarding taxation, but this could be offset by increased economic and corporate revenue growth related to stimulus measures and the vaccine-led re-opening of the global economy.

Inflation hurts low income citizens the most because they allocate nearly all their income on daily necessities and rent. This tenet is often cited by central bankers and politicians for economic prudence, but in the current situation, central banks consider employment an even more important criterion, and hope that economic and price reflation will create jobs. Meanwhile newly empowered Democratic politicians are emphasising large fiscal spending, including infrastructure, social welfare policies and minimum incomes in order to help low-income citizens. While there is some debate about such, it seems that the Democrats will be able to pass major fiscal stimulus relatively soon using the “budget reconciliation” process that was used in most other major fiscal bills in the past few decades.

Such should greatly offset the weak virus-burdened underlying economy. Interest rates are being subdued by central bank purchases and multifaceted fears among bond investors, although some of these fears seem to be fading as inflation is rising faster than expected and bond market-derived intermediate-term inflation expectations are rising rapidly. Indeed, the CPI is already above pre-virus levels. Furthermore, the fact that the Saudis are cutting oil production, despite oil prices in USD terms nearly returning to pre-virus levels, is also likely related to the weaker USD, as the oil price in euro terms remains far below pre-virus levels. Any fear of continued such actions would be quite inflationary. Indeed, coupled with a weaker USD, rising food prices and distribution expenses, the US CPI could well approach 4% YoY in the 2Q and substantially exceed 3% throughout the 2H. Of course, part of this is due to a low base-year effect, but even on an annualised six-month basis, the CPI will likely be, unless there is a massive deceleration in measures of housing rent, 3% or higher throughout 2021, and even 4% in some months. Near year-end, the Fed may signal the tapering of purchases, but it would have to do so quickly in order to restrain inflation in 2022. Thus, a significant headwind to reflation may be bond yields rising much faster than expected.

Clearly, the political situation is very disturbing in the US, which seems to be more divided than ever, but it is calmer now in Europe. Japan and China are fairly calm too, as usual. The Middle East is even more a powder keg than usual, but President-elect Biden put the Iran nuclear deal’s authors in command of the State Department, so there is hope for greater peace. It would be immensely unwise for Iran not to compromise on many issues so that its people can prosper.

Japan, Europe and a good portion of the rest of the world will also likely experience inflationary economic growth, as oil prices and housing prices continue to rise. Of course, if the USD is weak, inflation may be somewhat curtailed in other countries, but we estimate that Japan will be very active in preventing yen strength and Europe will resist euro strength to some degree too. As societal divides are lower in most of the rest of the developed world, fiscal stimulus programs such as major increases in guaranteed income levels are unlikely to be common outside the US, which may curtail inflationary fears.

Interestingly, for all the factors that are changing rapidly, very many others remain in a long-term uptrend. ESG investment themes, including alternative energy and technological improvements, are accelerating further. Assets in ESG and new technology-related funds have continued to hit record levels and this shift in preferences is likely to shape the investing landscape for decades to come. With the support of increased regulatory focus, ESG will promote many new forms of beneficial economic growth.

Also, the global diversification of supply chains will likely continue. We have long believed that this adds to economic growth globally, perhaps with somewhat decreased efficiency, but also providing increased robustness and reliability. ASEAN will continue to be a major beneficiary of this trend, but it will be interesting to see how much the Biden Administration emphasises on-shoring. Meanwhile, Chinese companies will continue to benefit from the country's establishment of its own massive internet system and promotion of new hi-tech industries.

So, although the world remains full of twists and turns and burdened by the virus, there are many reasons to be positive about societal and economic repair via reflation, but the most positive factor of all will be the widespread distribution of vaccines in 2021.

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