

# INVESTMENT NOTE

11 DECEMBER 2023

## THE NEW NEW NORMAL



IZAK ODENDAAL

OLD MUTUAL MULTI-MANAGERS

It has become trite to call the world a very uncertain place. There are always unknowns, because the economic and political future is inherently unpredictable. Many scientists can make accurate predictions because the laws of nature allow them to. But in human affairs, there is always room for surprise. Nonetheless, there are several reasons why the next decade or so could be quite different from the preceding era, including interest rates, scarcity, geopolitics and technology. Exactly how different is where the uncertainty lies.

### EARTHQUAKE AND AFTERSHOCKS

Starting with interest rates and inflation. In the immediate aftermath of the Global Financial Crisis (GFC) of 2008, the term 'New Normal' was widely used to describe the global economy (the term was popularised initially by Bill Gross and Mohammed El Erian, then from PIMCO). It was a New Normal of paying off debt, low inflation, low interest rates, and persistently weak demand. In simple terms, there was too little spending and too much saving as households and firms focused on repairing their balance sheets. A few years later, Harvard economist and former Treasury Secretary Larry Summers would revive a 1920s term to describe what was happening: secular stagnation.

Then Covid came. And though it was a health event, from an economic point of view, it was much more like an earthquake. The economy's seismometer, usually fairly stable, went haywire as economic activity stopped, and then shifted rapidly and deeply. One obvious example is the ongoing embrace to remote work. No one could imagine giant office buildings standing empty several days a week, but now they do.

If Covid was the earthquake, inflation was the aftershock, followed by a surge in interest rates, another aftershock. Inflation seems to be fading in most countries and as a result, interest rates look set to decline next year. At any rate, that is what the market is pricing in. But do we return to the world of persistently low and stable



WEALTH

inflation and interest rates? What does the New New Normal look like?

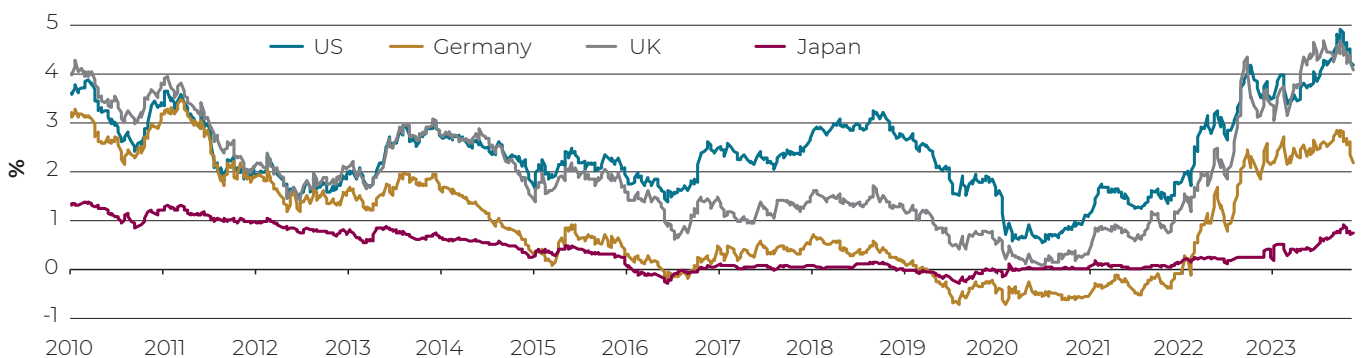
Some of the factors that resulted in low inflation and low interest rates remain, for instance ageing populations across the rich world (in fact, demographics is the one corner of social science where long-term trends can be forecast with reasonable certainty). But other disinflationary forces might have dissipated.

For instance, the post-GFC period was characterised by premature attempts to cut government debt levels, and therefore fiscal policy was too tight across the rich world. Monetary policy had to overcompensate, which is one of the reasons we saw zero interest rates and quantitative easing. Central banks were “The Only Game in Town” as the title of El-Erian’s 2016 book put it (the title of his forthcoming book, “Permacrisis”, pretty much sums up the current mood).

In contrast, the response to Covid saw a massive fiscal injection, particularly in the US. One of the reasons the

seismometer went wild was because, thanks to stimulus cheques, US household incomes rose, even as millions lost their jobs. This has never happened before. This was followed by billions more in support when energy prices surged in the wake of Russia’s invasion of Ukraine. Governments, led by the Biden administration in the US, are also ramping up investment in green energy and high-tech manufacturing. More muscular government interventions like these seem likely to become a more permanent feature and are potentially inflationary. They also raise new concerns over long-term debt levels. When government long bond yields were hovering between 1% and 2% on both sides of the North Atlantic, the market was practically begging for more borrowing to take place. Now that it is happening, yields might have to settle at higher levels even if they are below recent peaks. (However, should Western governments embrace austerity again, the impact will be disinflationary, and yields will fall).

**CHART 1: 10-YEAR GOVERNMENT BOND YIELDS %**



Source: LSEG Datastream

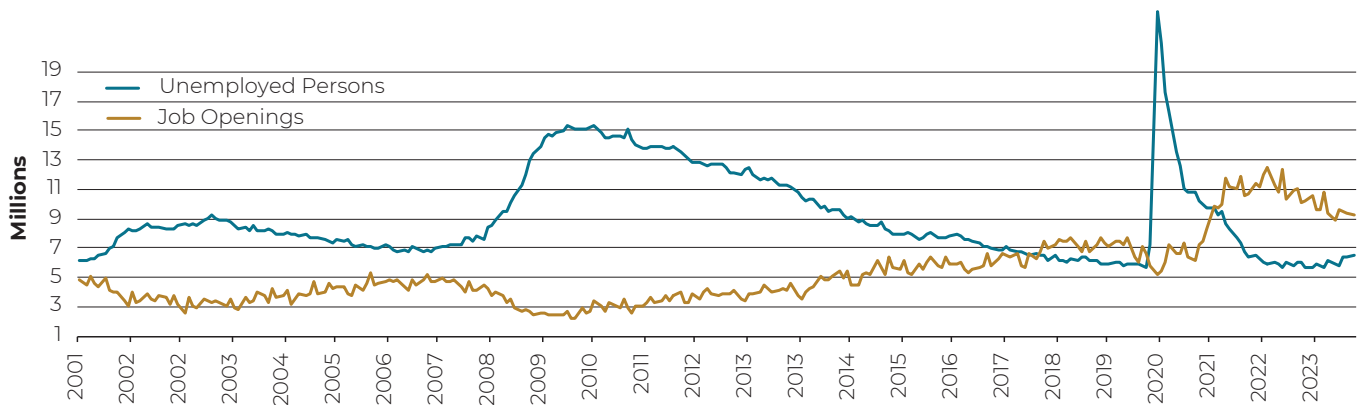
A slightly different way of thinking about it is that a lack of spending is not the problem anymore. The problem is increasingly supply constraints, not deficient demand, as was the case between 2008 and 2020.

Covid exposed the fragility of many supply chains and forced a rethink. For many years, companies could draw on an ever-expanding global productive base. Supply chains could be run as lean and cheaply as possible. In the New New Normal, companies must think carefully about having

diversified suppliers, and whether these are acceptable politically and geopolitically.

Labour shortages have also been a feature of the post-pandemic world in rich countries. Job openings still exceed the number of available workers, though the gap is not as extreme as 18 months ago. And since companies have struggled to get workers, often by raising wages, they are also likely to be more reluctant to let them go in a downturn.

CHART 2: JOB OPENINGS AND UNEMPLOYED PEOPLE IN THE US



Source: LSEG Datastream

## COLD WAR 2.0

There is no doubt that the geopolitical landscape has changed. There was a moment in the early 2000s when it looked like China, Russia, Europe and the US could get along and the world would enjoy growing prosperity and the spread of peace and democracy. That is no longer the case. We are in Cold War 2.0.

Henry Kissinger, the controversial but world-bestrident American diplomat who passed away recently at the age of 100, noted that the first Cold War was more dangerous, but the second is more complex. In the first Cold War, the US and USSR pointed nuclear missiles at one another. This is not quite the case in Cold War 2.0, but the enemies are deeply economically interlinked. Yes, war could break out

if China invaded Taiwan, but it is probably more mundane things we should worry about, namely the impact of the unpicking of these economic relationships. This is particularly true if we consider about how many poor countries became more prosperous because of globalisation (including China itself). What is the future path to prosperity for developing nations in this geopolitically fractured world?

The International Monetary Fund calls it 'slowbalisation.' It is not a reversal of globalisation, but one where considerations other than efficiency predominate. There will still be winners and losers, and huge volumes of cross-border commerce. But it will, according to the IMF, be a drag on global economic growth in the years ahead.

## I, ROBOT

Then there is technology, particularly the stunning advances in artificial intelligence. The AI optimists argue that it will transform economies and result in rapid productivity growth, something that was sorely lacking in recent years. The pessimists warn that a benign scenario is where AI destroys millions of jobs and destabilises societies, while the malign scenario is where robots one day rule over humans. The problem for outsiders is that even the experts in the field cannot agree on what lies ahead.

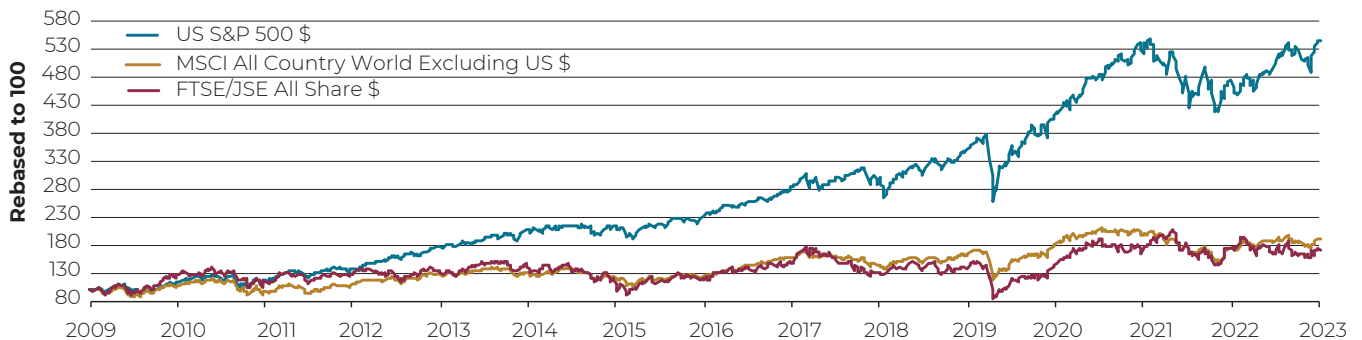
There are a few lessons from the past. New technologies have historically diffused through the economy slowly. As

exciting as a new technology might seem, the real productivity gains will only come once companies figure out how to apply it to improving everyday tasks. This can take years. This results in what consultancy Gartner calls the technology hype cycle. Massive excitement (usually coinciding with euphoric financial speculation) is followed by disappointment and disillusionment, before people gradually figure out how it can be used, and it eventually becomes part of daily life and contributing to productivity gains. In the first part of the cycle, fortunes are made by the inventors and lost by Johnny-come-lately speculators. In the latter part, the gains increasingly accrue to the users of the technology.

## AMERICAN EXCEPTIONALISM

This brings us to equity markets. The stand-out feature of the past decade, both before and after Covid, is the outperformance of US equities compared to the rest of the world, driven largely by giant tech companies. The grouping has morphed from the FAANGs (Facebook, Apple, Amazon, Netflix and Google) to the Magnificent Seven (Apple,

Alphabet, Amazon, Nvidia, Meta, Microsoft and Tesla), but remains dominant. As chart 3 shows, the US has far outperformed non-US equities in dollar terms since the GFC. South African equities performed in line with the rest of the non-US global market.

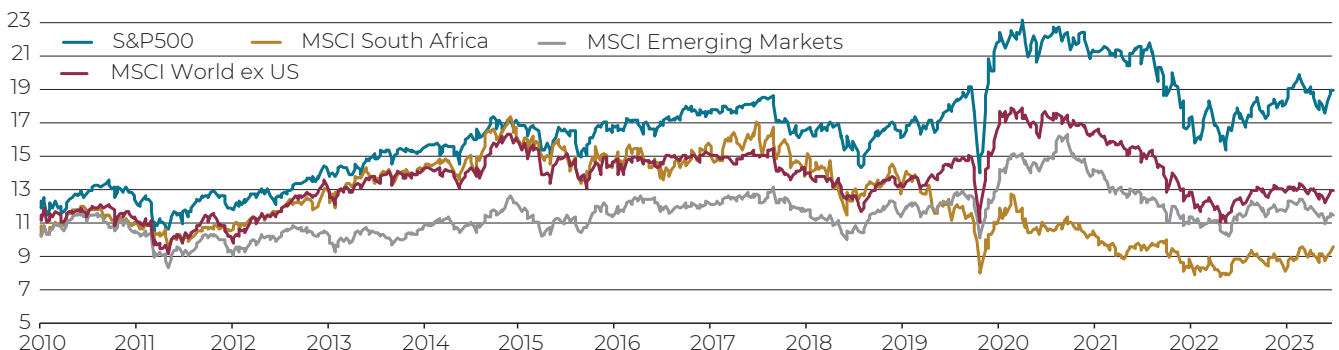
**CHART 3: US AND NON-US EQUITIES IN DOLLARS SINCE 2009**

Source: LSEG Datastream

The New Normal after the GFC was initially predicted to be a 'low return environment'. In one sense it was, since returns across global asset classes were lower than the pre-2008 boom. But then again, the pre-2008 returns were inflated by a massive expansion in debt as well as the one-off gain from China's rapid industrialisation. Post-2008 returns were not terrible everywhere, however. In particular, the US equity market had a strong run after a few initial wobbles, and since it forms 60%-plus of global benchmarks, the asset

class as a whole did well. It helped that valuations reset during the GFC, and investors could buy equities cheaply in most countries in 2009.

Where do we stand today? As chart 4 shows, valuations today are much more dispersed than a decade ago, where many markets were in the same ballpark in the low teens. Today US equities are expensive compared to their own history, and compared to other markets.

**CHART 4: FORWARD PRICE: EARNINGS RATIOS**

Source: LSEG Datastream

Whether American exceptionalism repeats in the years ahead is a big call. There is no doubt that it retains the edge in terms of leading technologies and remains the world's safe haven in times of anxiety. But the strong historical inverse relationship between starting valuation and subsequent long-term returns argues against such a repeat, and for increased exposure to the unloved, non-US corners of global equities (including South Africa and other emerging markets).

From a fixed income point of view, the fact that yields in developed countries are at levels last seen a decade (or more) points to much better future returns after a three-year bear market. As noted above, we should not necessarily expect yields to decline substantially, and returns will more likely come from income than capital gains.

In conclusion, does any of this crystal ball gazing help? Markets are incredibly efficient at discounting known

information and reasonably good at pricing in the outlook for the next few months or so, but as soon as the horizon shifts out, things become hazy. You can buy a 30-year bond – some countries even issued 100-year bonds, including, laughably, Argentina – but who knows what the world will look like even two years from now? That is why valuation is so important. Buying an asset with a margin of safety means it can deliver a decent return even in an uncertain macro environment. It also means that the investor who is a little bit more patient than the rest can outperform. When others are getting stuck in the news flow, the investor with a long-term horizon knows that most of it is just noise. And needless to say, diversification remains the investor's best defence in a world where old certainties are fast disappearing.

*This note returns on 15 January. Thank you for reading, and wishing you a safe and peaceful festive season.*

## EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	3 047.0	0.20%	0.76%	17.06%	14.12%
United States	S&P 500	US\$	4 604.0	0.20%	0.79%	19.90%	16.15%
Europe	MSCI Europe	US\$	1 943.0	0.67%	0.94%	12.18%	10.78%
Britain	FTSE 100	US\$	9 479.0	-0.98%	0.74%	5.15%	3.65%
Germany	DAX	US\$	1 560.0	0.13%	1.17%	16.56%	17.29%
Japan	Nikkei 225	US\$	222.9	-2.11%	-1.35%	11.99%	10.49%
Emerging Markets	MSCI Emerging Markets	US\$	975.0	-0.71%	-1.22%	1.99%	0.62%
Brazil	MSCI Brazil	US\$	1 687.0	-1.17%	-0.18%	15.63%	15.87%
China	MSCI China	US\$	54.2	-3.56%	-4.80%	-15.25%	-15.77%
India	MSCI India	US\$	885.6	3.04%	3.82%	14.86%	11.11%
South Africa	MSCI South Africa	US\$	381.0	-3.30%	-2.06%	-9.50%	-10.56%

## EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	73 791.0	-2.53%	-2.31%	1.02%	-0.91%
All Share	All Share (Total Return)	Rand	12 992.0	-2.43%	-2.21%	4.74%	2.82%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	31 704.2	-1.57%	-1.69%	3.06%	1.37%
TOP 40/Large Caps	Top 40	Rand	11 807.0	-2.97%	-2.76%	4.52%	2.55%
Mid Caps	Mid Cap	Rand	20 273.0	0.64%	0.42%	2.08%	0.44%
Small Companies	Small Cap	Rand	31 195.0	0.52%	1.24%	6.18%	6.50%
Resources	Resource 20	Rand	4 560.9	-9.52%	-7.43%	-20.60%	-23.84%
Industrials	Industrial 25	Rand	22 052.0	1.03%	-0.19%	16.47%	14.82%
Financials	Financial 15	Rand	12 051.0	-1.72%	-1.50%	13.70%	13.59%
Listed Property	SA Listed Property	Rand	1 770.7	3.23%	4.40%	4.65%	7.51%

## FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
IBOXX Global Government S&P Overall (USD Unhedged)		US\$	75.8	0.38%	0.64%	-1.51%	-3.28%

## FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	922.7	-0.35%	-0.47%	7.61%	9.00%
Government Bonds	BESA GOVI	Rand	909.6	-0.34%	-0.46%	7.58%	8.99%
Inflation Linked Bonds	BESA CILI	Rand	343.1	0.42%	0.33%	5.20%	9.80%
Cash	STEFI Composite	Rand	545.5	0.16%	0.18%	7.52%	7.95%

## COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	75.8	-3.85%	-6.37%	-11.81%	-0.21%
Gold	Gold Spot	US\$	2 005.0	-3.23%	-1.76%	9.92%	12.45%
Platinum	Platinum Spot	US\$	916.0	-1.82%	-1.51%	-14.63%	-9.49%

## CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	18.97	-1.65%	-0.61%	-10.24%	-9.56%
ZAR/Pound	ZAR/GBP	Rand	23.79	-0.38%	0.04%	-13.45%	-11.64%
ZAR/Euro	ZAR/EUR	Rand	20.40	-0.55%	0.63%	-10.69%	-11.14%
Dollar/Euro	USD/EUR	US\$	1.08	0.93%	0.83%	-0.93%	-1.85%
Dollar/Pound	USD/GBP	US\$	1.25	1.32%	0.41%	-3.57%	-2.77%
Dollar/Yen	USD/JPY	US\$	0.01	-1.28%	-2.20%	10.55%	6.04%

Source: I-Net, figures as at 8 December 2023

The Old Mutual Wealth Investment Note is published on a weekly basis to keep our clients and financial planners informed of what is happening in financial markets and the economy and to share our insights. Markets are often very volatile in the short term and similarly, economic data releases or central bank actions may cause concerns for investors. This does not mean that investors should take action based on the most recent events. It is better to be disciplined and remain invested in well-diversified portfolios that are designed to achieve long-term objectives. Our Strategy Funds are actively managed, with asset allocation changes based on valuations and in anticipation of future real returns, and not in response to the most recent market noise. The future is always uncertain and that is why our Strategy Funds are diversified and managed with a long-term focus.



## WEALTH

Old Mutual Wealth is brought to you through several authorised Financial Services Providers in the Old Mutual Group who make up the elite service offering. This document is for information purposes only and does not constitute financial advice in any way or form. It is important to consult a financial planner to receive financial advice before acting on any information contained herein. Old Mutual Wealth and its directors, officers and employees shall not be responsible and disclaims all liability for any loss, damage (whether direct, indirect, special or consequential) and/or expense of any nature whatsoever, which may be suffered as a result of or which may be attributable, directly or indirectly, to the use of, or reliance upon any information contained in this document.