Global secular dynamics

June 2022

Titanic shifts in global secular dynamics threaten long-term returns

Asset owners are facing one of the most difficult investment environments in decades which will challenge long-term returns.

Macquarie Capital Head of Asian Strategy, Viktor Shvets, said investors were grappling with rising inflation not seen since the 1970s, geopolitical and social tensions that rival those of the 1960s, and the largest withdrawal of fiscal and monetary support in decades.

“That's a very complex set of problems we’re facing,” he said. “The next 12 months and quite possibly the next five to ten years will be one of the most difficult periods that investors ever navigate.”

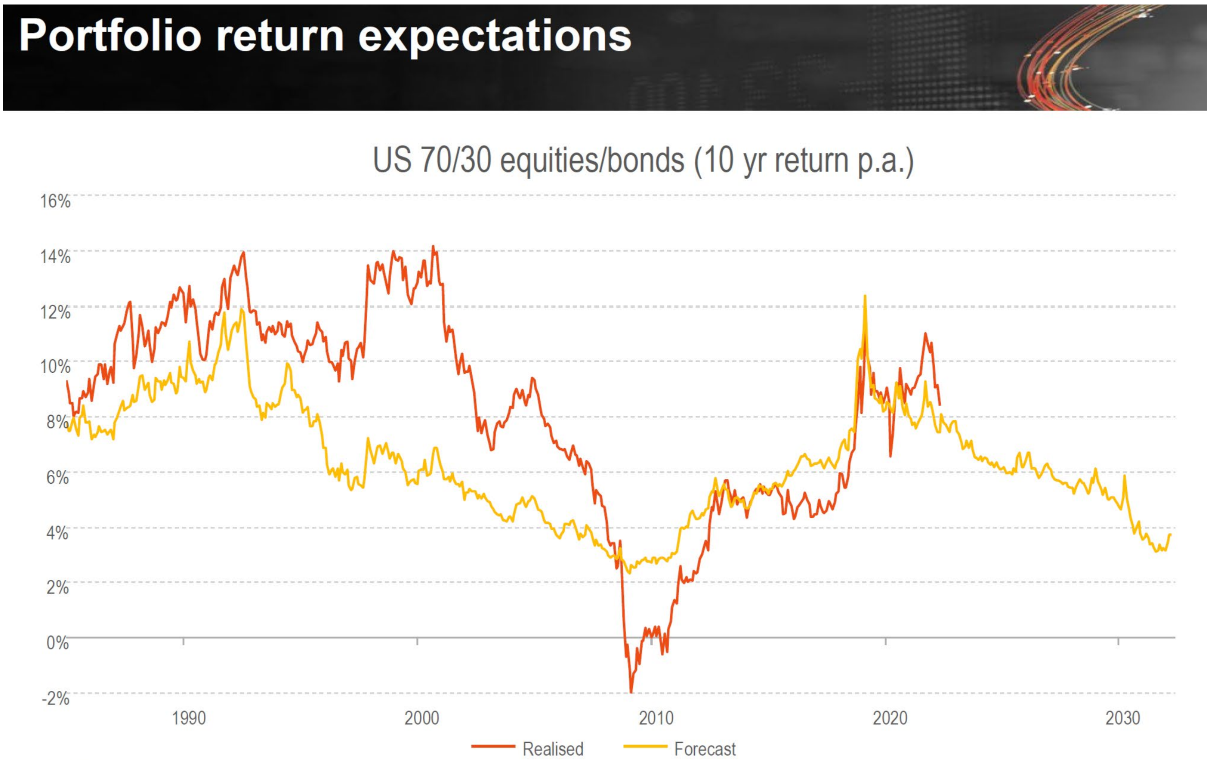
This environment tends to produce unpredictable black swan events that break down the normal distribution of returns. Investors are likely to see multiple violent changes in market conditions.

“Just as you worry about inflation it will disappear almost completely and just as you see disinflation it will come back.”

Frontier Advisors Director of Investment Strategy, Chris Trevillyan, said investors still needed to take on risk as they faced an environment of lower long-term returns.

“We've had a truly extraordinary last couple of years – I think we sometimes forget how drastically things have changed in such a short period of time,” Trevillyan said.

Inflation expectations and crude oil pricing have skyrocketed while this year bonds and equities underperformed at the same time – something that has not happened in recent decades.



Source: Refinitiv Datastream

He recommended greater portfolio diversification to counter such uncertainty.

“Don’t just rely on one particular area to try and provide that diversification. For example, not just relying on government bonds to provide that downside protection in the portfolio.”

Investors should think holistically from a total portfolio view about the impact of potential events. For example, most asset owners had minimal direct investments in Russia or Ukraine but the war has had a much larger impact on currencies and commodities.

AMP Capital Senior Economist, Diana Mousina, said the mini commodities boom and supportive government spending would underpin the Australian economy.

While inflation and wages growth in Australia was not as strong as the US, Australian households are far more sensitive to interest rates rises. About 30 per cent of mortgages will roll from fixed to variable rates in the next 12-18 months.

“Households here are very sensitive to interest rate changes so the RBA will have to tread very carefully.”

Households should be able to absorb interest rate rises to about 1.5 per cent but 2 per cent would be uncomfortable. In May and June the RBA quickly hiked rates by a combined 75 basis points, bringing the cash rate to 0.85 per cent.

“The key question is does the central bank want to get inflation down enough that it will engineer a huge downturn or recession?”

Shvets said investors should accept that some events are unpredictable and uncontrollable.

“One thing investors should not do is be swept around by news flow because we’re going to be getting conflicting messages, whether it’s inflation, commodity prices, or geopolitics,” he said.

He suggested focusing on productivity drivers, technology, commodities that will still be needed despite the energy transition (such as copper, nickel, cobalt, lithium), capital goods companies, and companies set to exploit new thematics such as robotics, automation, and alternative transportation.