

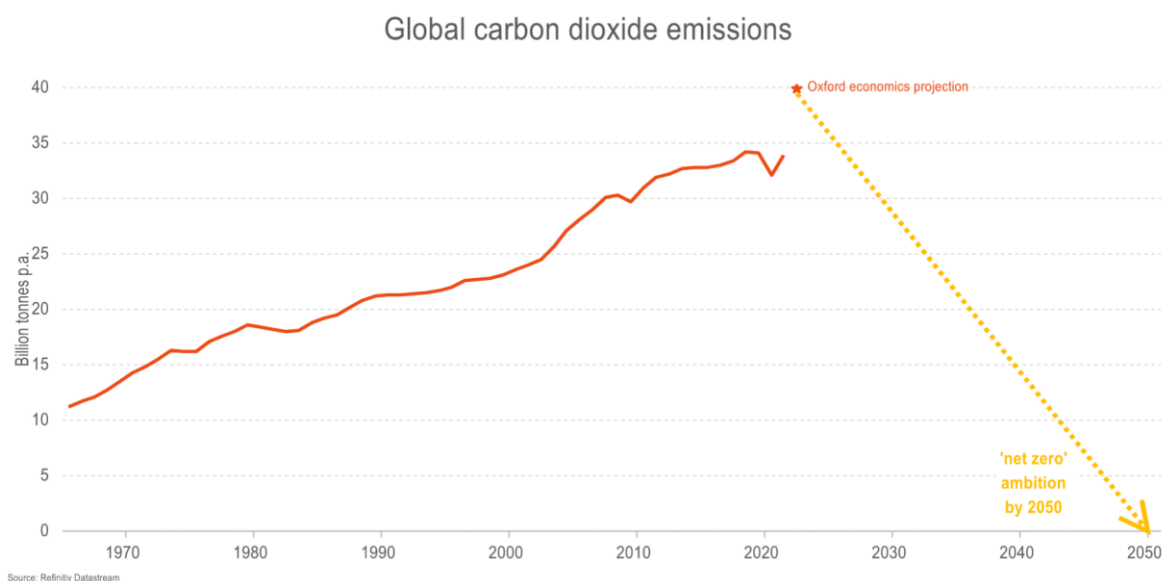
Uncertainty continues to shape global secular outlook

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The central challenges of climate change, ageing demographics, and ongoing geo-political tensions continue to create investment headwinds for asset owners.

“There are quite a few negativities out there – a number of factors that could well put upward pressure on inflation and downward pressure on growth,” Chris Trevillyan, Director of Investment Strategy, Frontier Advisors, said at the 2023 annual conference.

He said the 2050 net zero emissions target is looking increasingly ambitious with CO₂ emissions at record highs and renewable energy a small sliver of world energy consumption.

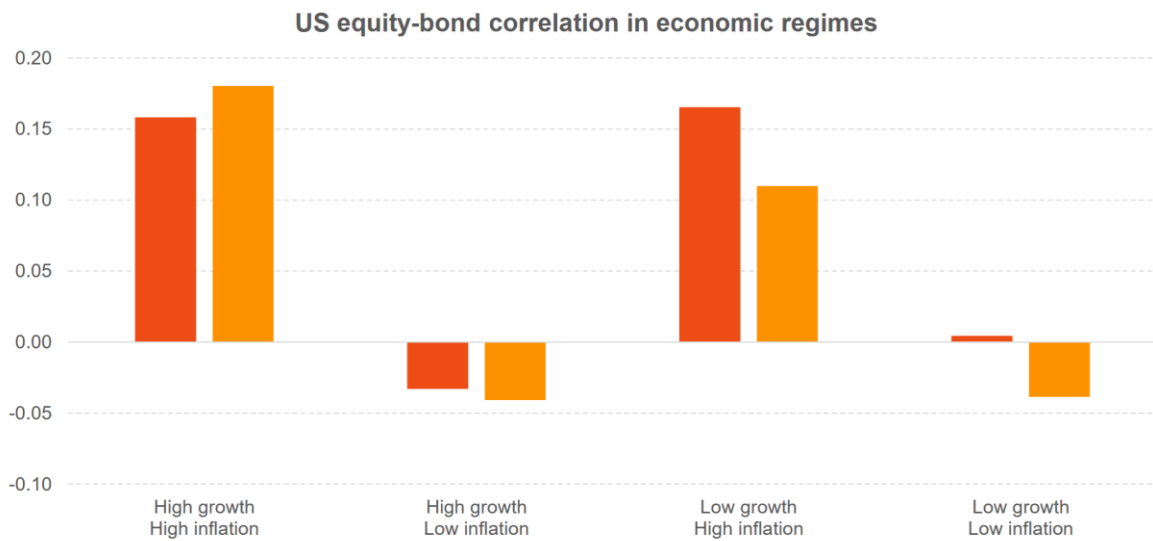


“A huge amount of investment is going to be required,” Trevillyan said. “There’s going to be some big increases in costs, impacts on growth – this is something that investment strategy needs to be incorporating.”

While India’s population will continue growing, China’s population has now peaked. Meanwhile, US workforce participation rates for those aged 55 and above have failed to rebound back to pre-pandemic levels, giving an insight into the impacts of an ageing population.

“Some of the big dividends from population growth that we’ve seen over the past century are unlikely to continue going forward.”

From an investment perspective, high inflation environments tend to create a positive correlation between equities and bonds, eroding their traditional diversification benefits.



A basic 70:30 equities-bonds portfolio is now forecast to deliver nominal five per cent annual returns over the next decade, higher than three per cent a year ago, but still at relatively low levels.

However, Trevillyan said an improvement in productivity growth, which could be driven by artificial intelligence or an energy technology breakthrough, could help spur growth and moderate inflation.



Geopolitics: security over economics

Geopolitical policy was now being driven by security rather than economics, according to Amber Rabinov, Head of Macro Research, AustralianSuper.

Countries were focused on strengthening defence security (including cyber defences), improving resilience (such as reducing dependence on certain countries for raw materials, energy and supply chains), and sustainability (including tackling climate change).

“From a macro perspective, what does the primacy of security over economics create? It creates an inflation bias,” Rabinov said.

In this environment, cost considerations are often subordinated to other requirements, creating major capital investment demands.

“Central banks may need to accept a higher level of core inflation due to supply side economics rather than excess demand.”

She said asset owners needed to consider how regulation may change given the days of policy liberalisation and a laissez-faire approach are over.

Trevillyan said there remained a great deal of uncertainty about future geopolitical changes, which underlined the need for diversification. Markets have also reacted in unexpected ways to recent geopolitical changes, such as the Trump 2016 election win or Brexit, although currencies have performed in line with expectations.

“So potentially think about currencies as one option, and maybe think about derivative positioning – options with currencies and things like that – so not taking on one single bet but trying to find some diversification risk management.”

US political landscape a major factor

The 2024 US election looms as another event that will shape the geopolitical landscape.

Andy Blocker, Global Head of Public Policy and Strategic Partnerships, Invesco, said he expected the election to again be fought between President Joe Biden and Donald Trump, who still has about 40% of the Republican primary despite currently fighting a second indictment.

“In a weird way, the Democrats really want Donald Trump to be the nominee because, even though he looks pretty invincible in the primaries, he is unlikely to win the general election.”

The election outcome could prove crucial given the fractured and un-cooperative relationship between the Democrats and the Republicans.

“The political landscape in the United States is getting more and more perilous,” Blocker said. “The polarisation of the country continues. I think it's really driven by us being able to choose our own news sources.”

He said politics took precedence over policy with strong anti-China sentiment among the US public creating one of the few issues supported by both parties. He said the US is committed to long-term allies such as Australia, especially as a bulwark vis-à-vis China.

Blocker also said equity markets needed to recognise that the US Fed has shown no signs of cutting interest rates any time soon. In addition, the massive multi-trillion dollar fiscal stimulus following the pandemic is over.

“If there is a mild recession or even deeper, there's no help coming from the federal government. There's no fiscal response at least until after 2024.”