Camdor GLOBAL ADVISORS
FINDING LASTING SOLUTIONS IN AN UNCERTAIN WORLD

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# Macro Matters: An Introduction

The world is a complex place, but our brain is only three pounds. We live in a dynamic ever more interconnected world that paradoxically bombards us with increasing amounts of information to absorb and yet also demands ever quicker decisions. The trick is to curate, to distil, and to reduce that complexity to something more manageable for our evolutionary constraints.

This quarterly column assesses at a high level a reduced selection of key buckets of macro risk, particularly relevant for liability driven investors, and with a view to their evolution over the next 12 months. We also delve into more detail on specific dynamics that bear further thought. These often cross multiple buckets reflecting the interconnectedness of our world today. Importantly, this is not an isolated point in time exercise but rather a regular updating to aid assessment and inform action.

**Dr Bob Swarup**
Principal & Founder

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# Key Macro Risks

Key Risk 01

## Geopolitical & Socio-political

**Impact = Medium to high**

Probability ↔

Post Brexit, Britain has regained some political equilibrium after a bout of being run by Twitter and 24 hour news channels. There is a sense of complacency creeping in about muddling through, but economic data will worsen over coming months as the lack of business investment plays through. The socio-political fractures meanwhile remain just beneath the surface for many parties. The focus now shifts to Europe where we are seeing the first compromises born of brinkmanship now that the exit genie is out of the bottle. Italian banks were first, Spanish austerity is set to fracture next. Religious tensions are also reshaping the socio-political landscape for the first time in centuries. In the US, behind the schadenfreude and soaring sales of Trump pinatas, a clear shift towards isolationism is emerging. TPP is off the table and both parties are now seeing a growing internal battle for their future souls (and direction). In Asia, the Permanent Court of Arbitration ruled against China in the long-running South China Sea dispute, which exacerbates regional tensions. We also note Russia has now pulled out of peace talks with Ukraine.

Key Risk 02

## Financial Markets

**Impact = Medium to low**

Probability ↓

Markets have stabilised in recent weeks, as central bankers reiterate dovishness. The BoE has restarted QE and the Bank of Japan is set to expand its buying list further as it runs out of government bonds to purchase. Regardless of moral hazard, these will sustain financial markets. Additionally, the further suppression of the yield curve only makes risky assets more attractive than ever. But there are divergences and fragilities appearing. The US is finding it hard to justify its dovish stance given recent data and political overtones. The pricing mechanism in financial markets is now dead (what's the right multiple for Apple?), which means these are all sentiment trades. That fundamentally changes the nature of volatility – generally low but with unexpected spikes. And on the ALM front, liabilities outmarch assets given their longer duration, creating more pain and a greater hunger of yield. We also note that the return of QE threatens to further strain the leaching of quality collateral from the system. Given the proliferation of LDI and derivatives more generally coupled with changing regulation (e.g. EMIR), liquidity here can only worsen.

Key Risk 03

## Economic

### Impact = Medium to high

Probability

Social tensions today are rooted in poor economic outcomes for people. Brexit was another example of the sense of disenfranchisement and economic apartheid prevalent across advanced economies today. That will worsen in the near-term.

The UK has seen a significant decline in business investment as companies wait for the next steps to become clear. QE may provide some breathing space but the economy also needs structural change, particularly given the deficit. There is a very high probability of a technical recession. Brexit also likely accelerates the process of rebalancing already underway as financial institutions shrink their balance sheets and the property market absorbs higher (taxation) costs of ownership. That takes time and involves going down first before going up again (hopefully). Europe also has pain in the offing as banking balance sheets come under strain, and upcoming elections in France and Germany next year create likely a lack of tangible political commitment to economic reform. On the global stage, we note the decline in trade growth – not just a slowdown. For those in commodities, demand is set to weaken further. And in the US, productivity growth has entered its longest downward patch in almost 40 years.

Key Risk 04

## Other

### Impact = Medium to high

Probability

Migration is becoming the dominant narrative in European politics. Its confluence with worries about global security and the rise of terrorism means that the politics of division is once again acceptable and palatable. Upcoming elections in France and Germany will test how deep this runs within their societies. We expect strong gains for populism and nationalism, which will tinge the political debate going forward, much as has already happened in the US. Both are historically negative for growth and trade, accentuating the new paradigm of Deglobalisation 2.0 that we observe. As noted last time, we except the world to become very familiar with the term ‘climate refugee’. Africa is facing severe challenges both climate wise and economically, and we expect a growing wave of migration from there into Europe. The debate will also tinge future Brexit negotiations and should not be ignored as a potential derailer/blocker of key terms. On the tech front, technology continues to be the future of the world economy, for most people. The rush of M&A deals being struck recently within the technology space, along with the success of Go Pokemon, has further fuelled this belief. But the sharing economy is also currently creating a downward pressure on wages. US wages showed a sharp deceleration in wage growth in Q2 (though there remain inflationary pressures in the pipeline).

# Highlighted Risk - Deglobalisation 2.0

The world is getting smaller. That has been the unbidden meme of at least the last half century.

Since the end of the Second World War, the world has become more interconnected. Multilateral organisations such as the World Bank; free trade agreements; a global financial infrastructure; the rise of vast pools of savings – pension funds, insurers, SWFs etc. – with an international palette of investments; the advent of the internet – all these have fuelled an unstoppable juggernaut of growth for over 60 years, benefiting all of us economically and socially.

Today's meme is globalisation and free trade is its evangelical mantra. It is an accepted foundation of society. But the narrative has become worn and no longer fits the facts. Globalisation is dead and we are starting the journey back. The world arguably today is in the midst of a new meme in the making – deglobalisation - as people turn their backs on an interconnected world economy and societies turn iconoclastic.

Globalisation may be defined as the economic state where trade across nations (exports and imports) is growing faster than GDP. By implication, people interact more, transact more and create more wealth through their exchanges.

In contrast, deglobalisation may be defined as the alternate state where trade grows less than GDP. Countries become inward focused, international trade declines as a proportion of GDP and growth slows down as economic opportunities shrink.

Even a cursory look at history reveals a clear cycle of globalisation and deglobalisation from the 19th century onwards, as global trade began to expand under the twin influences of colonialism and the Industrial Revolution.

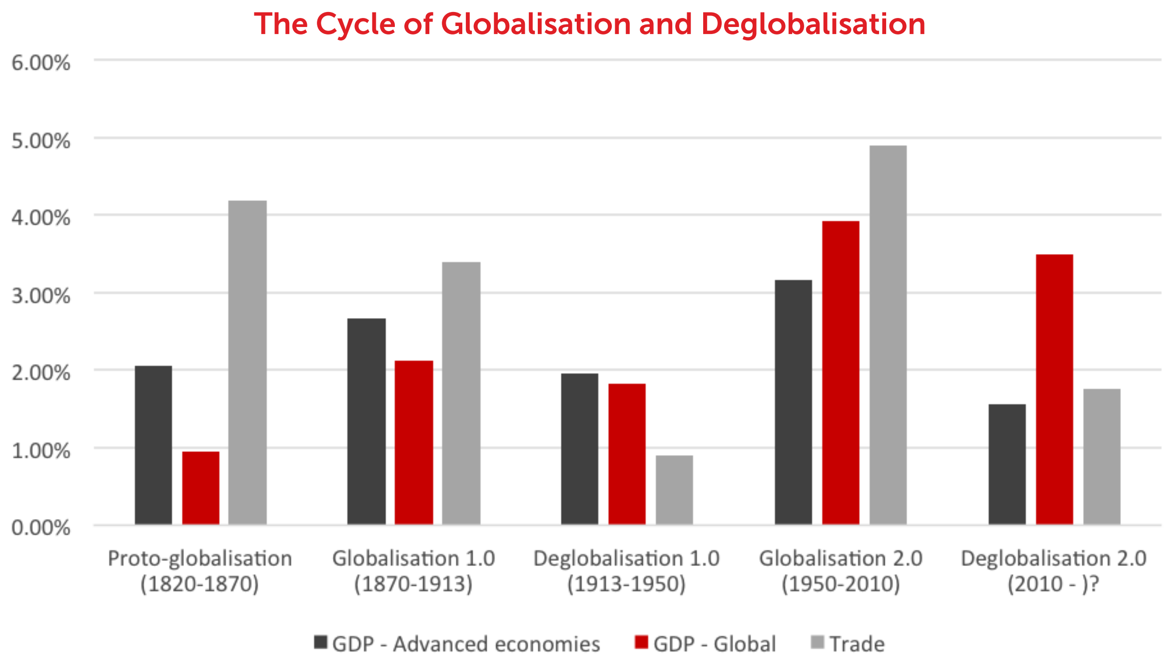


*Figure 1: The different phases of globalisation and deglobalisation over the last two centuries (Sources: Maddison, World Bank, Max Roser, CPB Netherlands, Camdor Global).*

Clear phases can be delineated if we examine GDP growth vs trade growth.

- **Proto-globalisation (1820-1870):** Rapid global trade growth as Western Europe and its offshoots (e.g. the US), spread their model of state-sponsored capitalism globally.
- **Globalisation 1.0 (1870-1913):** Empire building became the norm. Trade was aided further by rapid advancements in automation, transport, communications and the growth of an international financial system. But rapid economic change also led to volatile bouts of economic obsolescence and unemployment. A complex financial system introduced regular booms and busts, leading to worries over financial stability.
- **Deglobalisation 1.0 (1913-1950):** The incipient tensions of limited growth and unequal outcomes coupled with a huge overhang of (largely war) debt stoked a wave of nationalism, protectionism and populism. Domestic priorities dominated, trade fell away and a collective failure to tackle deeper structural issues resulted in the debacle of the 1930s.
- **Globalisation 2.0 (1950-2010):** Since then, we have been on a tearaway expansion with unparalleled growth of both global trade and GDP. It has been a golden age where the world embraced free trade, multilateral bodies, coordination of policies, the rise of superstates and technology.
- **Deglobalisation 2.0 (2010 - ?):**

In our opinion, Globalisation 2.0 ended in 2010. And the data indicates that we are now seeing the unveiling of 'Deglobalisation 2.0'. This likely began around the turn of the decade, as the last financial crisis crystallised the growing sense of disenfranchisement and disillusionment amongst large swathes of the world's populations. A toxic mix of suppressed wages, divisive politics, and an explosion of debt have all combined to destroy the allure of globalisation for many.

This is now more than a sense of ennui. Around the world, politicians are responding to shifting moods amongst their voting public. Trump is in the ascendant in the US, Sanders' acolytes have become the Tea Party of the Democrats, and the whole debate has moved to a more protectionist stance, perhaps best encapsulated by the recent U-turn on the Trans-Pacific Partnership (TPP) by Hilary Clinton – once a key supporter who called it "the gold standard in trade agreements" – as she prepares to fight the presidential election.

In Europe, Brexit is another step in this journey and the bailout of the Italian banks another, both the first of a likely soon to be familiar narrative across Europe. And in Asia, even China is struggling with the after-effects of too much debt-fuelled growth and suppressed wages.

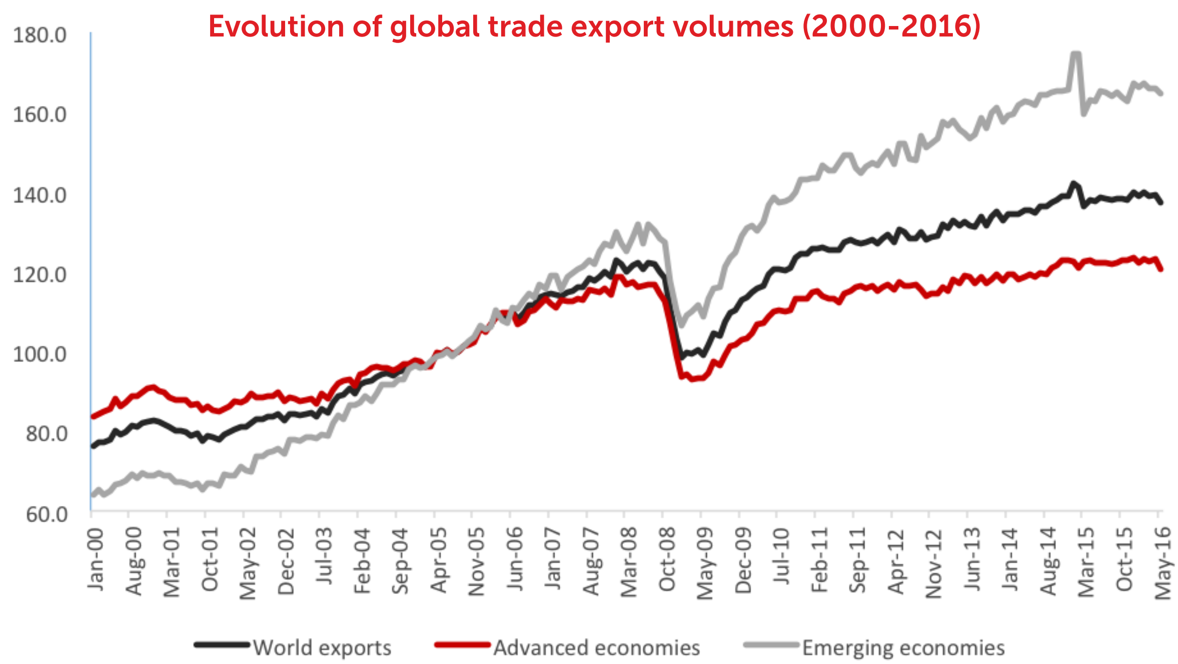


*Figure 2: Evolution of global trade volumes globally, for advanced economies and for emerging economies, all indexed to 2005 (Source: CPB Netherlands)*

The impact on raw data is troubling. Global trade is no longer slowing down but actually has come to a grinding halt, even a decline, according to the most recent data from the CPB World Trade Monitor. Since its peak in January 2015, it has fallen -3.4% through to end May 2016. Analysis by Global Trade Alert[1] lays the blame not at the door of commodity price falls, but shifts in trade policy. Protectionism in 2015 was up 50 per cent on 2014, with over 80 per cent of the measures coming from G20 members. The deleveraging of banking balance sheets has also played a role. Cross border lending is falling, as banks reduce their balance sheets whilst also retreating from periphery to core activities in response to state pressure.

Policymakers have blinded themselves to this emerging trend and the associated risks associated. Current monetary policies such as quantitative easing cannot change this dynamic. In the absence of structural change, their corrosive impact on savings and minimal impact on global growth only inflames the rhetoric of social disenfranchisement. The 'elite' are increasingly at risk as new parties more sensitive to these shifting sentiments spring up with populist messages. Their effects are well documented in history - autarky, protectionism, economic naivety and a rush to grab what remains of the economic pie.

Redistribution is not the answer. Trade growth is and policymakers would be wise to think hard about how to nurture it amongst these headwinds.

[1] Global Trade Plateaus: The 19th Global Trade Alert Report', Simon J. Evenett and Johannes Fritz

# About Camdor Global Advisors

Camdor Global Advisors is an independent economic and strategy advisor to pension funds and other institutional investors. Our principals have many years of real world, hands-on experience in investment strategy and risk management across multiple asset classes and for multi-billion portfolios.


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## About the Principals

### Dr Bob Swarup...

...is a respected international expert on macroeconomics, investment strategy, alternatives, risk management and regulation. He is the founder of Camdor Global, an advisory firm that works with leading institutions and investors around the world on strategic investment, risk management and business issues.

Bob was formerly a partner at Pension Corporation, a leading UK-based pension buyout firm, where he ran alternative investments, was Chief Risk Officer and oversaw thought leadership. Bob also served as Senior Investment Advisor to the UK Pensions Regulator; on the Advisory Board of Adveq, a leading Swiss PE firm; the Board of CatCo, a $2bn reinsurance hedge fund that he helped seed in 2011; and on numerous other boards and industry bodies.

Bob is a Fellow of the Institute of Economic Affairs and a Senior Visiting Fellow at Cass Business School. He holds a PhD in cosmology from Imperial College London and an MA (Hons) from the University of Cambridge. Bob has written extensively on diverse topics, with his work appearing in the Financial Times, Economist, Guardian and others. His published books include the internationally acclaimed bestseller Money Mania, examining over two millennia of financial crises (Bloomsbury, 2014) and ALM for Financial Institutions (editor, Bloomsbury Information Publishing, 2013) on meeting the challenges for asset-liability management going forward.

## Daniel Schrupp...

...is a seasoned investment professional and a former insurance company senior executive. Prior to CG Advisors, Dan was Chief Investment Officer at Lucida plc, a UK insurer focused on the pension buyout and bulk annuities markets. At Lucida, Dan was in charge of investment strategy, portfolio management of internally managed funds and selecting and overseeing third party managers. Dan successfully led Lucida into alternative credit asset classes including leveraged loans, private debt, ABS and infrastructure debt.

Prior to Lucida, Dan was a Senior Portfolio Manager at Aozora Bank where he managed a $4.5 billion portfolio of U.S. and European leveraged loans. Prior to Aozora, Dan spent 13 years as an investment banker focusing on corporate finance at Salomon Brothers Inc., Brown Brothers Harriman & Co., and CIBC World Markets. Dan has a bachelor's degree in economics from Yale University and a Masters of Business Administration from the Tuck School at Dartmouth College.

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