‘Monitoring should be an integral part of the fund selection process’

Jeroen Vetter, Viewpoint **pages 10-11**

come Jim Leaviss noted on his Bond Vigilantes blog: “An increase in borrowing today by consumers and governments is merely stealing growth from the future.”

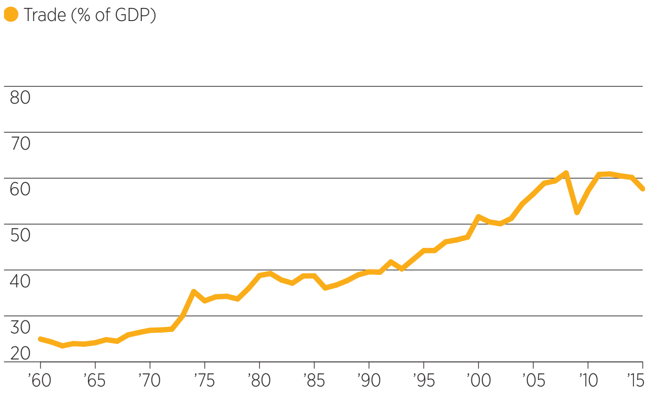
Political football

Regardless of the policies pursued by Donald Trump or a prospective nationalist leader in a European country, political risk will undoubtedly increase, as by definition is the case when the status quo is being challenged. Since the start of the second world war, it hasn’t been more difficult to predict the future than it is now.

“This increased political risk means there will be a greater risk premium in many sectors,” says Wade, who believes we just have to get used to politics driving asset markets.

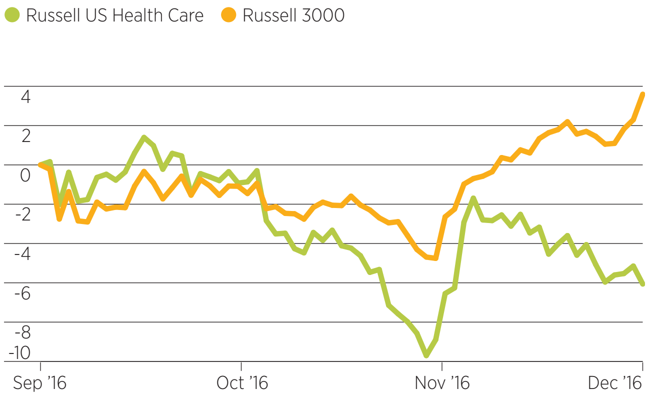
“The healthcare sector in the US has for example become a sort of political football,” he adds. US healthcare stocks nosedived in the run-up to the presidential election as Hillary Clinton, who had said she wanted drug producers to cut prices, looked likely to win. After Trump’s victory, the sector made a strong recovery as the Republican candidate had vowed to abolish Obamacare. When

Growth of trade from 1960 – 2015
% of global GDP



Source: WTO

US healthcare sector
index performance



Source: FE Analytics

‘GLOBALISATION HAS HELPED COMPANIES TO GROW PROFITS A LOT MORE THAN IT HAS GROWN WAGES’

Keith Wade
Chief economist,
Schroders

Trump then backtracked from this promise and suggested he could introduce drug price caps, stock prices slid back again (see ‘US healthcare sector’ graph above).

Uncertainty means it will also be more difficult to predict future returns. Such an environment is negative for assets with long duration, be it bonds or equities, says Williams. “Therefore it seems appropriate to prioritise those companies with capital projects on short payback periods over those with higher internal rates of return that stretch off further into the future,” he adds.

A combination of populist fiscal policy and protectionism will also fuel inflation, another red flag for long-duration assets. “This could lead to a derating of company valuations and to a trade away from bond proxies to cyclicals,” says Wade.

Short-duration assets and companies with low investment needs could therefore be relative benefactors of deglobalisation. But overall, the effect will be negative. “A retreat in globalisation probably won’t improve people’s lives,” says Williams. But protectionism would have an unintended consequence that could prove beneficial in the longer term: it would bring a recession closer, which is long overdue, believes Williams.

“I don’t want a recession, but it would invigorate the economy,” he says.

In his book, he claims that globalisation has distorted the financial ecosystem, in combination with the deregulation of financial markets which led to a credit boom. “Checks and balances in the economy have been muted because we have not had enough corporate decay. Many inefficient companies have been kept alive artificially. Because of cheap credit and low interest rates, even marginal operations generated a return,” he says.

Rising inequality

The credit boom has, until 2008, masked the fact that investors and the super-rich took the lion’s share of the economic benefits of globalisation. Real wage growth for the working and middle class in many Western countries has been stagnant for decades, while real incomes of the world’s top-1% have risen by 60% since the mid-1970s.

“Globalisation has helped companies to grow profits a lot more than it has grown wages,” says Wade. No wonder 60% of British people believe ‘ordinary people do not get their fair share of the nation’s wealth’, according to a survey by consultancy PwC.

“Public dissatisfaction is all coming back to stagnation of real wages,” concludes the Schroders economist. As long as living standards were improving, as they did quite consistently across the Western world until 2008, workers could put up with rising inequality. But workers are facing a ‘lost decade’, with real wages now lower than they were 10 years ago, Bank of England Governor Mark Carney said in a recent speech. The last time something like that happened was in the 1860s, “when Karl Marx was scribbling in the British Library,” he added.

Unless we do something to address inequality, the populist revolt may put globalisation in reverse and will make all of us poorer, was his implicit message. **LW**