



Institute  
and Faculty  
of Actuaries

## The New Political Paradigm

LGIM Asset Allocation

Lars Kreckel, CFA – Global Equity Strategist, Asset Allocation



Institute  
and Faculty  
of Actuaries



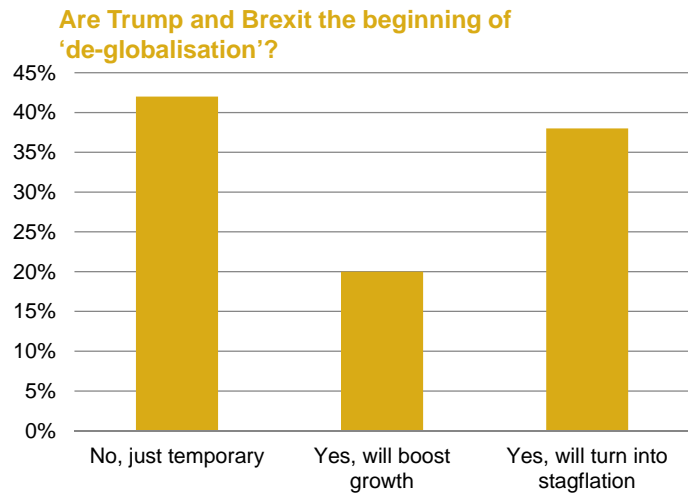
## Agenda

- Why are people so angry?
- What can be done about it?
- What will be done about it?
- Asset Allocation – don't predict, prepare

22 May 2017

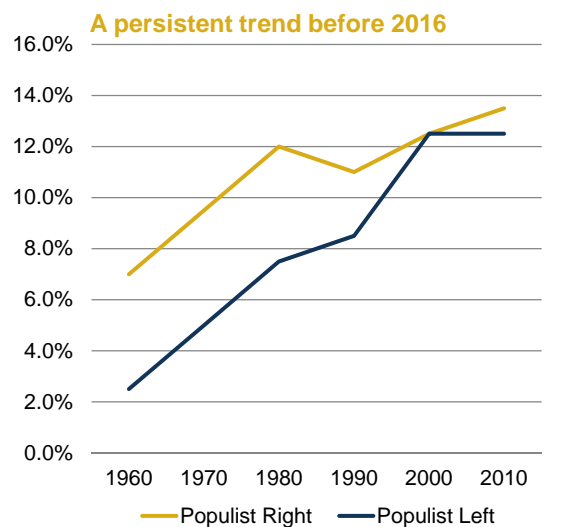
## Why this matters

- The New Political Paradigm
- ...drives markets
- ...creates winners and losers
- ...is here to stay
- ...will likely get stronger
- ...is not consensus



## Why are people so angry

- Trump and Brexit are symptoms, not causes
- Populist parties are on the rise across the West
- The trends are not new, but 2016 was when it started to matter
- A simple question without simple answers



## More than a feeling?

Income inequality vs  
wealth inequality

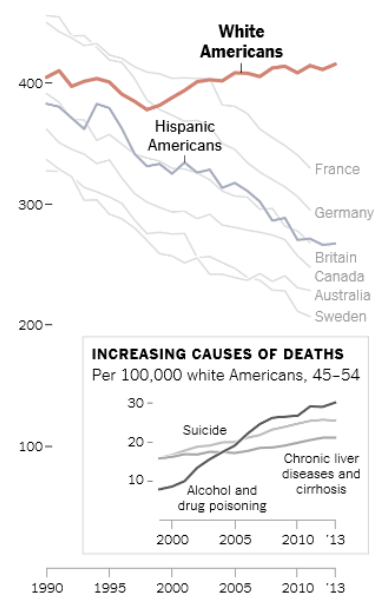
£ gap vs % gap

Are living standards  
understated?

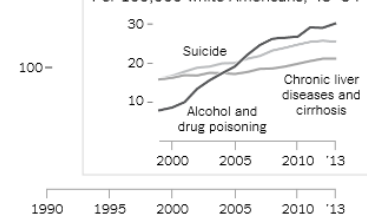
'Rising Mortality' is definitely  
more than a feeling

Does it even matter?

DEATHS per 100,000 people aged 45-54



INCREASING CAUSES OF DEATHS  
Per 100,000 white Americans, 45-54

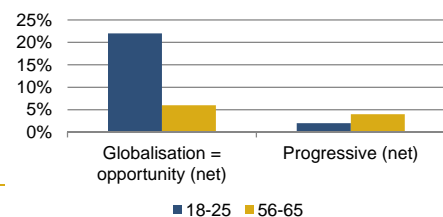
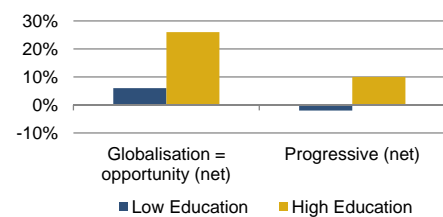
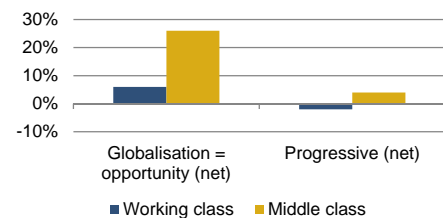


22 May 2017 Source: New York Times, Anne Case and Angus Deaton data, LGIM

Sources: Anne Case and Angus Deaton; PNAS  
By The New York Times

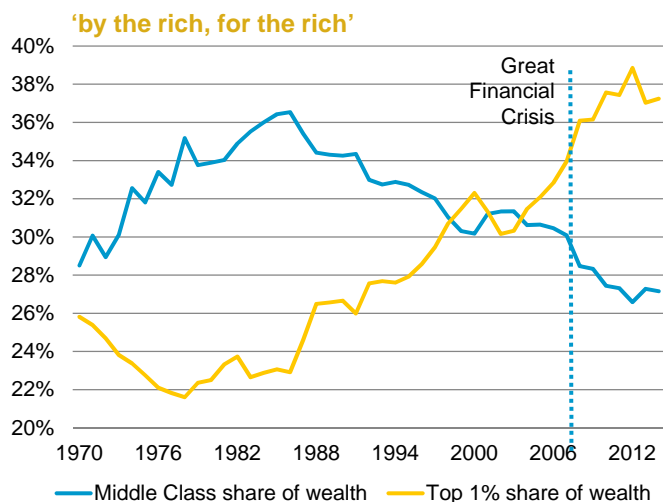
## Shifting values, globalisation

- Excessive and quick shift to progressive values; advanced by the liberal elite against the will of ordinary people
- Progressive vs Traditional values
- Globalisation makes a bigger pie, but divides it up to create winners and losers
- Survey says: it's fear not values
- Values don't explain the fear of Globalisation. Age, class and education do.



22 May 2017 Source: Bertelsmann Stiftung, LGIM

## QE and bank bailouts



- Reinforced the view of inequality; the elites are looking after themselves
- ...while ordinary citizens are left to fend for themselves

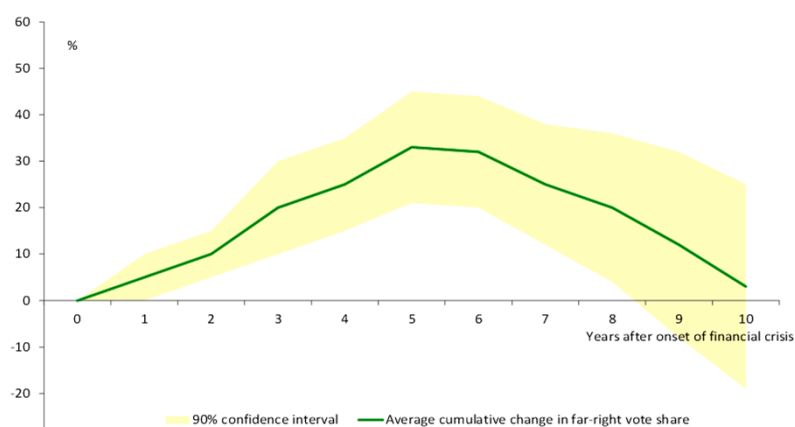


Institute  
and Faculty  
of Actuaries

22 May 2017 Source: World Wealth & Income database, LGIM

7

## History points to a hard right turn after financial crises



- Average 35%(!) pick-up in vote share for the far right, peaking five years after the onset of financial crisis
- On average, after financial crises...
  1. Share of vote for the far-right increases
  2. Political polarization increases
  3. Street protests (riots, strikes and demonstrations) increase

Study of 827 parliamentary elections from 1870-2014 in Australia, Austria, Belgium, Canada, Finland, France, Germany, Greece, Italy, Japan, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, UK, USA. Source: "Politics in the Slump: Polarization and Extremism after Financial Crises, 1870-2014" Funke, Schularick and Trebesch (Sep 2015)

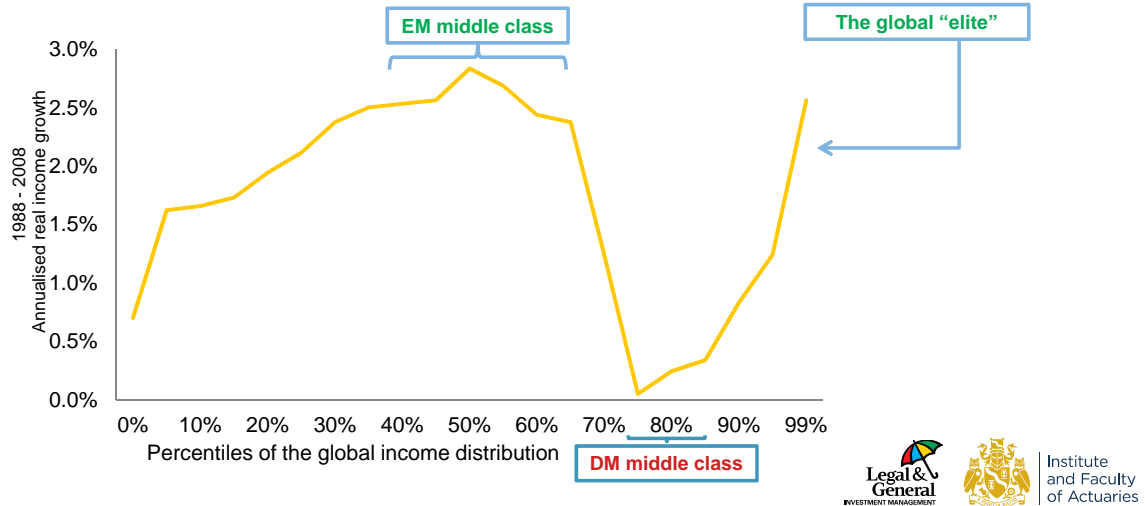


Institute  
and Faculty  
of Actuaries

22 May 2017 Source: "Politics in the Slump: Polarization and Extremism after Financial Crises, 1870-2014" Funke, Schularick and Trebesch (Sep 2015)

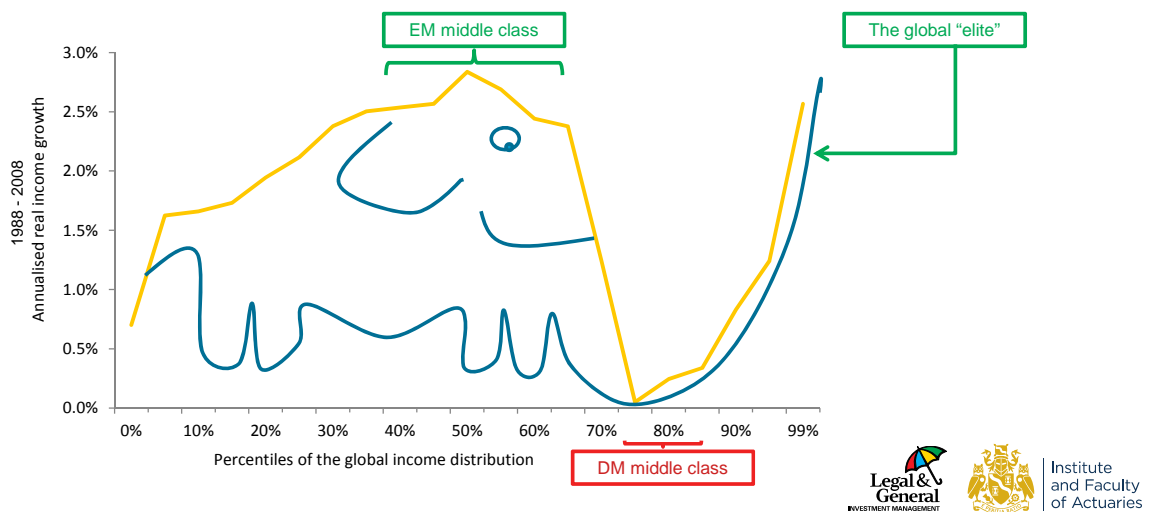
8

## Inequality, the Elephant graph



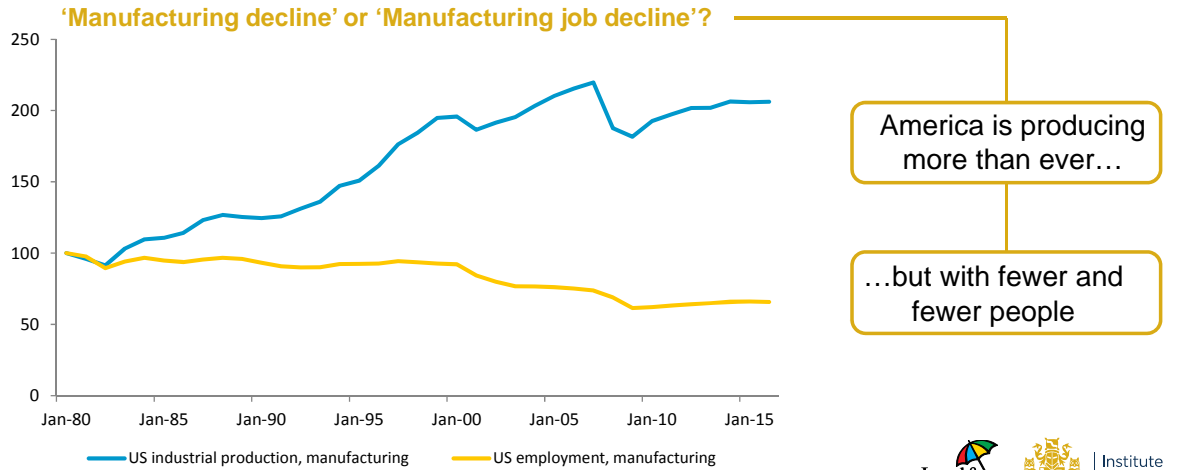
22 May 2017 Source: "Global Income Distribution: From the fall of the Berlin Wall to the Great Recession" Lakner and Milanovic, World Bank Economic Review, Sep 2015 9

## The Elephant graph



22 May 2017 Source: "Global Income Distribution: From the fall of the Berlin Wall to the Great Recession" Lakner and Milanovic, World Bank Economic Review, Sep 2015 10

## Automation

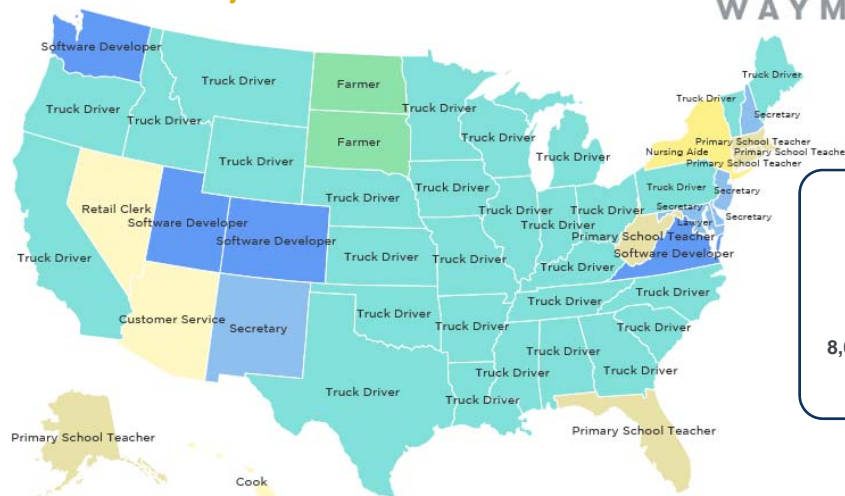


22 May 2017 Source: Bloomberg LP, LGIM

11

## Automation – only the beginning

The most common job in each US state - 2014



### In the US there are:

168,000 transit bus drivers  
 181,000 taxi drivers  
 505,000 school bus drivers  
 600,000 Uber drivers  
 2,500,000 truck drivers  
 8,000,000 retail salespeople / cashiers  
 14,000,000 restaurants workers  
 A total of 146,000,000 jobs

22 May 2017 Source: NPR, US Census Bureau data, LGIM

12

## Institutional degradation

Degradation by a thousand cuts

Same pattern across countries

*'6 in 10 believe search engines over human editors'*

*'Peers are as credible as experts'*

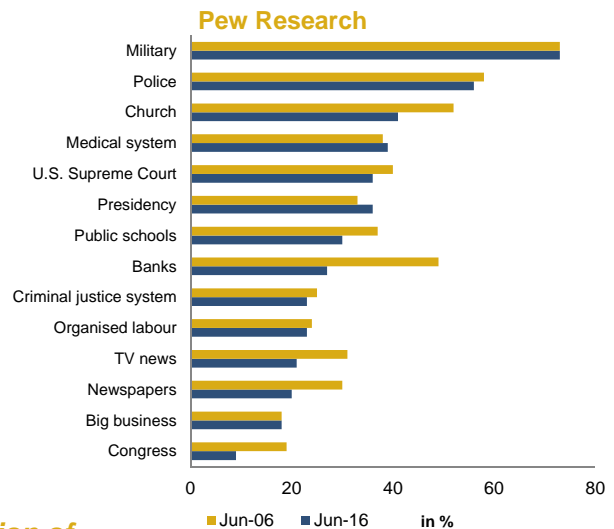
*'In 1960 70% of Americans trusted the government, today it's only 18%'*

*'53% don't regularly listen to anyone with whom they often disagree'*

*'4x more likely to ignore information that supports an opposing view'*

**“The third line of my work is the deconstruction of the administrative state.”**

Steve Bannon, February 2017



Legal & General  
INVESTMENT MANAGEMENT



Institute and Faculty of Actuaries

22 May 2017 Source: Pew Research, Edelman Trust Barometer 2017

13

## Elite anxiety

### Survival Condo Project

- Luxury Survival Condos in an old Atlas Missile Silo
- \$1.5m - \$4.5m
- 70 people can live completely 'off-grid' for more than 5 years
- Sold out, second project underway

New Zealand citizenship:  
e.g. Peter Thiel

**“**It's a very odd thing. You're seeing the people who've been the best at reading the tea leaves – the ones with the most resources, because that's how they made their money – are now the ones most preparing to pull the rip cord and jump out of the plane.  
**”**

Robert Johnson

### Survival Condo Project



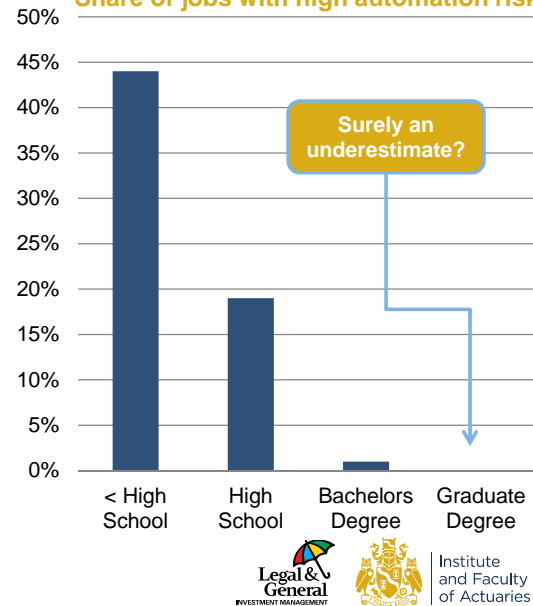
22 May 2017 Source: survivalcondo.com, LGIM

14

## Solutions – more education?

- Education ticks a lot of boxes
- More education = less risk from automation
- More education = less risk from globalisation
- More education = lower appeal of Populist parties
- The college earnings premium has continued to grind higher

Share of jobs with high automation risk



22 May 2017 Source: Arntz, Gregory and Zierahn (2016), LGIM

15

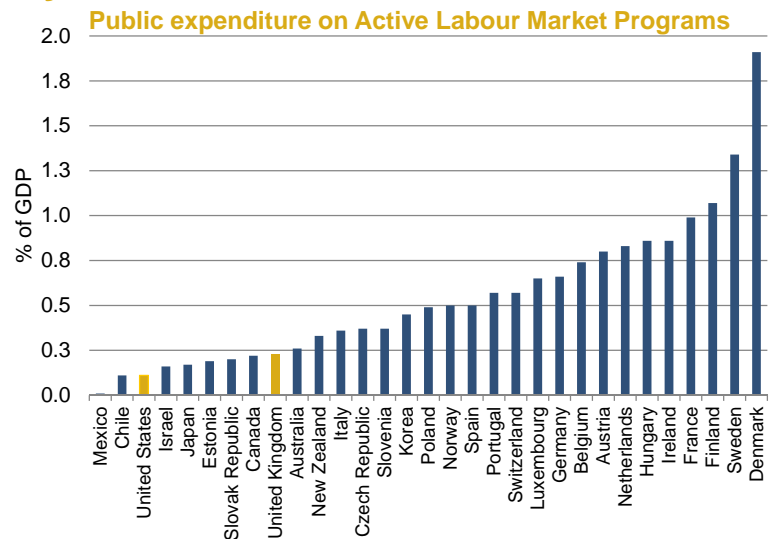
## Solutions – social safety net?

US spending on ALM programs has halved (in % of GDP) since the 80's

Social Security Hammock or money well spent?

Can this explain the lack of social tensions in the euro crisis?

Public expenditure on Active Labour Market Programs

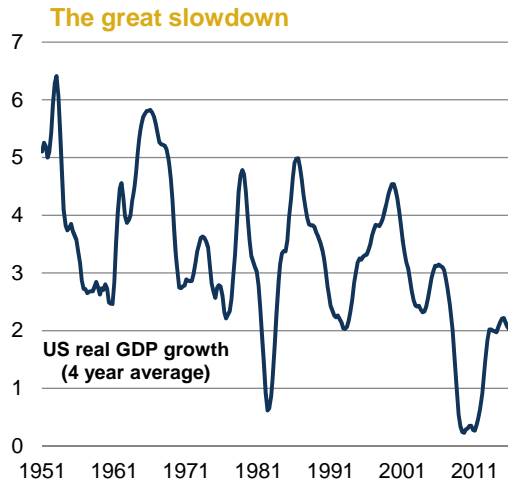


22 May 2017 Source: OECD, LGIM

16



## Solutions – more nominal growth?



<https://macromatters.lgim.com/categories/macrobites/4-growth-without-inflation-you-canute-be-serious/>

22 May 2017 Source: OECD, LGIM

“To get the economy back on track, President Trump has outlined a bold plan to ... return to 4% annual economic growth”

WhiteHouse.gov

- LGIM estimates that trend growth in the US is **1.5%**
- The Federal Reserve estimates it is at **1.8%**
- The CBO estimates **2.0%**
- House Republicans estimate **3.0%**
- Steven Mnuchin, Treasury Secretary is “...aiming for **3% annual growth or higher**”



Institute  
and Faculty  
of Actuaries

17

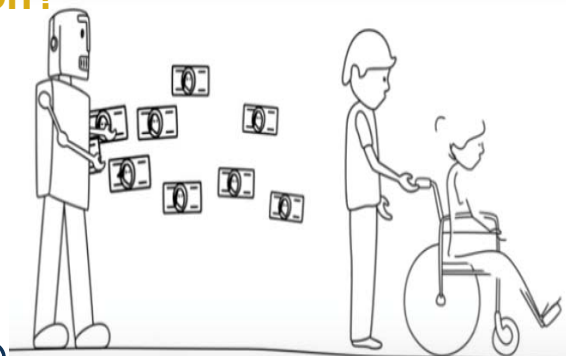
## Solutions – more redistribution?

A new approach to  
resource allocation

Universal basic income?

Robot tax?

Redistribution to save  
Capitalism



“If a robot comes in to do the same thing, you’d think that we’d tax the robot at a similar level.”

Bill Gates, February 2017

“There is a pretty good chance we end up with a universal basic income, or something like that”

Elon Musk, November 2016

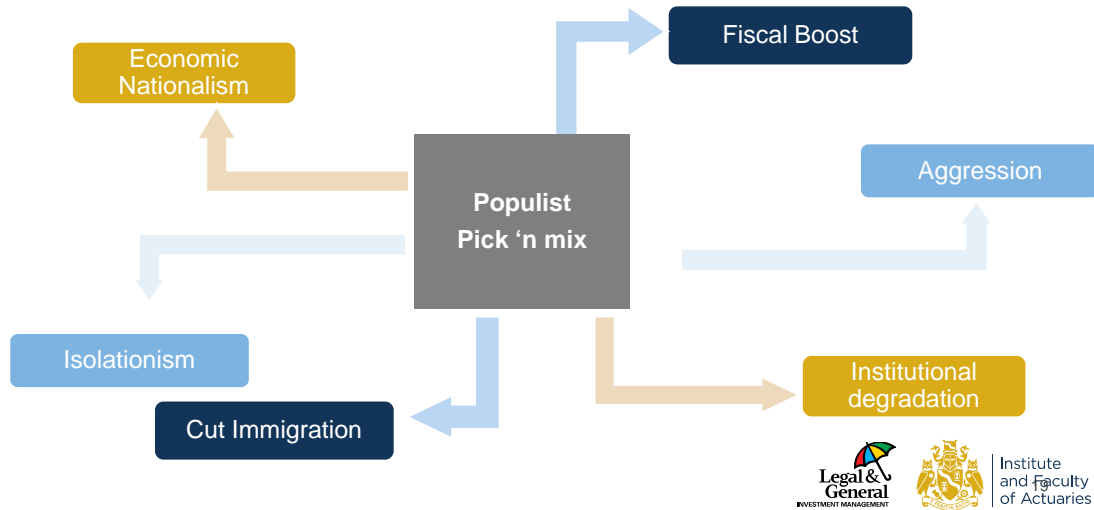


Institute  
and Faculty  
of Actuaries

22 May 2017 Source: Design News, LGIM

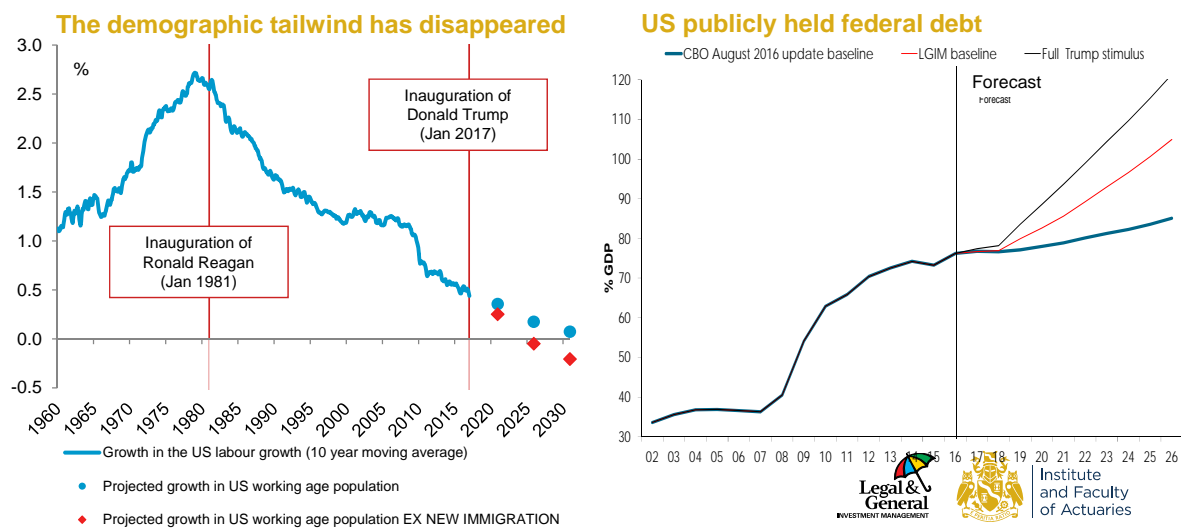
18

## How will policymakers respond?



22 May 2017 Source: LGIM

































## President Trump is trying to fight the demographic tide



22 May 2017 Source: Macrobond, Pew Research, LGIM

20

## The Thucydides Trap and the risk of multi polarity

	Period		Ruling Power	Rising Power		Result
1	First half of 16th century		France	Hapsburgs		War
2	16th-17th centuries		Hapsburgs	Ottoman Empire		War
3	17th century		Hapsburgs	Sweden		War
4	17th century		Dutch Republic	England		War
5	Late 17th-early 18th centuries		France	Great Britain		War
6	Late 18th-early 19th centuries		United Kingdom	France		War
7	Mid-19th century		United Kingdom, France	Russia		War
8	19th century		France	Germany		War
9	Late 19th-early 20th centuries		Russia, China	Japan		War
10	Early 20th century		United Kingdom	United States		No war
11	Early 20th century		Russia, U.K., France	Germany		War
12	Mid-20th century		Soviet Union, U.K., France	Germany		War
13	Mid-20th century		United States	Japan		War
14	1970s-1980s		Soviet Union	Japan		No war
15	1940s-1980s		United States	Soviet Union		No war
16	1990s-present		United Kingdom, France	Germany		No war

**“It was the rise of Athens and the fear that inspired in Sparta that made war inevitable”**

*Thucydides 5<sup>th</sup> century BC*



Institute and Faculty of Actuaries

22 May 2017 Source: Harvard Kennedy School, Professor Graham Allison, author of the book *Destined for War*

21

## New Political Paradigm matrix

	Economic nationalism	Fiscal boost	Cut immigration	Political risk	Isolationism	Total
Equities	●	● ●	●	●	●	●
Bonds	●	● ●	●	●	●	● ●
Credits	●	● ●	●	●	●	●
Inflation	●	● ●	●	●	●	● ●
USD	●	●	●	●	●	●
Commodities	●	● ●	●	●	●	●

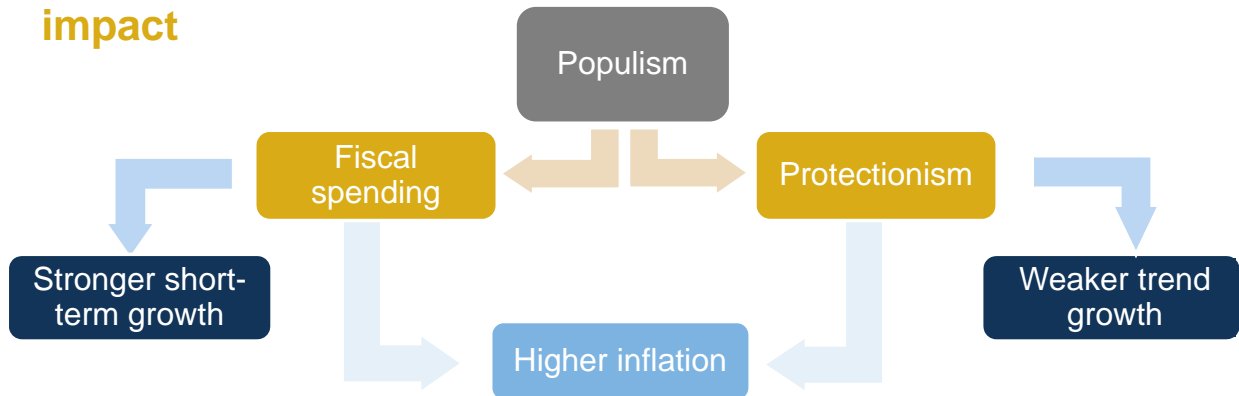


Institute and Faculty of Actuaries

22 May 2017 Source: LGIM

22

## Inflation impact of populist shift clearer than growth impact



“An ideology that pits a virtuous and homogeneous people against a set of elites and dangerous ‘others’ who are together depicted as depriving (or attempting to deprive) the sovereign people of their rights, values, prosperity, identity, and voice”

Albertazzi & Duncan (2008), Twenty-First Century Populism



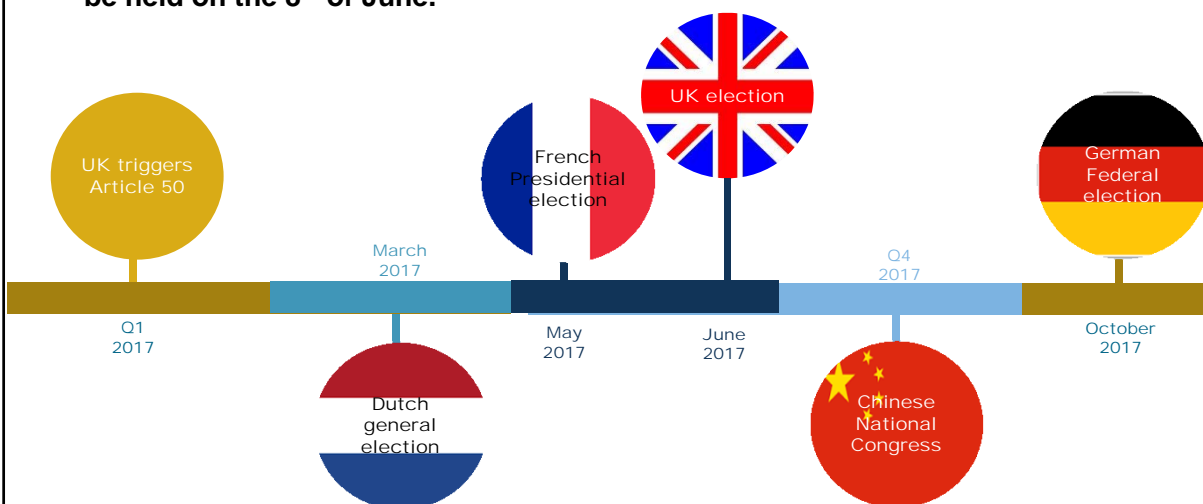
Institute  
and Faculty  
of Actuaries

22 May 2017 Source: LGIM

23

## Political risk - UK joins EU (2017 election club)

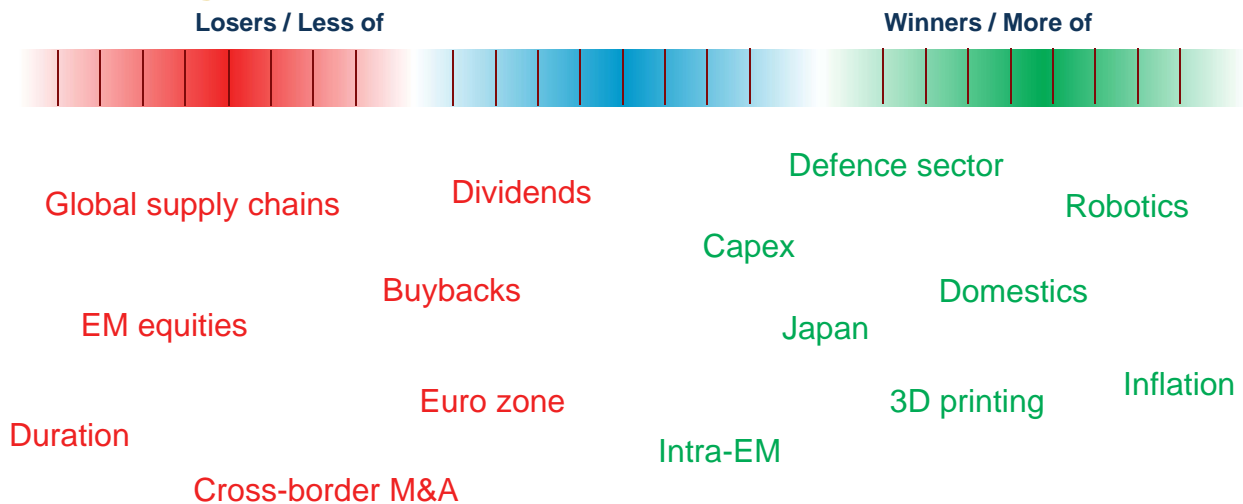
- The UK government will move a motion in Parliament calling for a general election to be held on the 8<sup>th</sup> of June.



22 May 2017 Source: LGIM

24

## A more granular look at Winners and Losers



22 May 2017 Source: LGIM

25

## Lessons from 2016

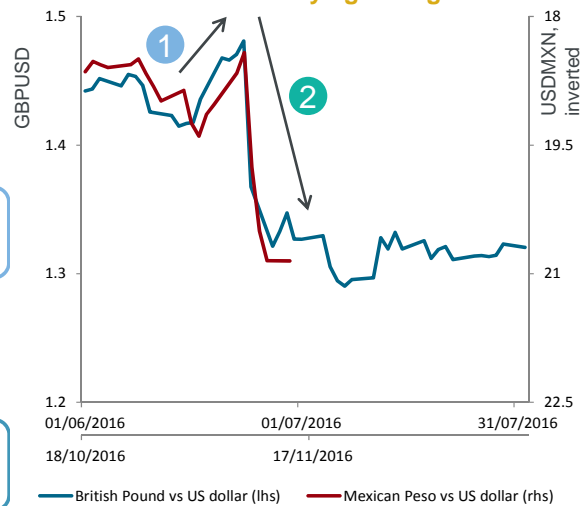
The favourite doesn't always win

Don't trust the polls, Bookies or market

Checks & balances work

Have more confidence in relative than absolute views

### Markets don't always get it right!



1 GBP and MXN both rally (c. 4%) going in to the event in anticipation of Remain/Clinton

2 GBP and MXN both collapse (c. 10%) faced with the reality of Leave/Trump

22 May 2017 Source: Bloomberg LP, LGIM

## Don't predict, prepare

### French election scenario planning

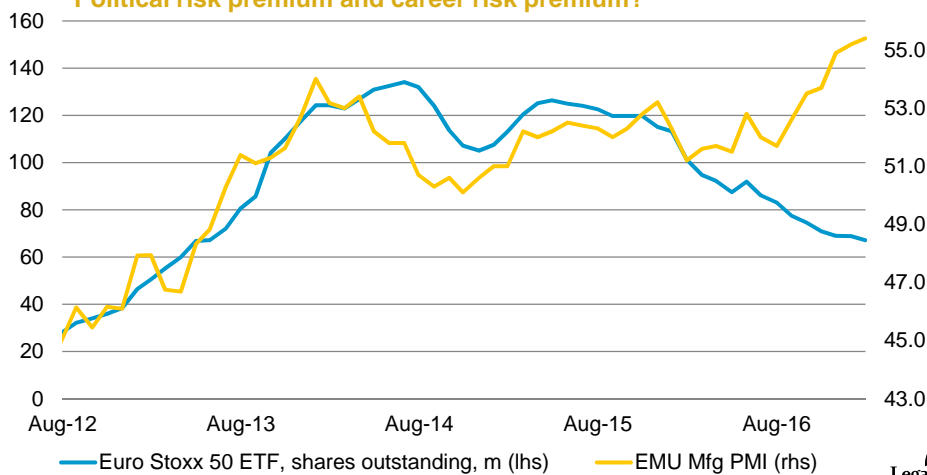
	Macron/Fillon	Le Pen	Hamon
EMU Equities	●	● ● ●	●
Other Equities	●	● ●	●
UK Sovereign	●	● ●	●
US Sovereign	●	●	●
EU Sovereign	●	● ●	●
UK Investment Grade	●	●	●
EU Investment Grade	●	● ● ●	●
Global High Yield	●	●	●
EM Debt, lcy	●	● ●	●
GBP/EUR	●	● ●	●
USD/EUR	●	● ● ●	●

22 May 2017 Source: LGIM

27

## What's different from 2016?

### Political risk premium and career risk premium?



22 May 2017 Source: Bloomberg LP, LGIM

28

22 May 2017

29

## Disclaimer and important legal notice

The information contained in this document (the "Information") has been prepared by Legal & General Investment Management Limited ("LGIM", "we" or "us"). Such Information is the property and/or confidential information of LGIM and may not be disclosed by you to any other person without the prior written consent of LGIM.

No party shall have any right of action against LGIM in relation to the accuracy or completeness of the Information, or any other written or oral information made available in connection with this publication. Any investment advice that we provide to you is based solely on the limited initial information which you have provided to us. No part of this or any other document or presentation provided by us shall be deemed to constitute 'proper advice' for the purposes of the Pensions Act 1995 (as amended). Any limited initial advice given relating to professional services will be further discussed and negotiated in order to agree formal investment guidelines which will form part of written contractual terms between the parties.

Past performance is no guarantee of future results. The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.

The Information has been produced for use by a professional investor and their advisors only. It should not be distributed without LGIM's permission.

The risks associated with each fund or investment strategy are set out in this publication, the relevant prospectus or investment management agreement (as applicable) and these should be read and understood before making any investment decisions. A copy of the relevant documentation can be obtained from your Client Relationship Manager.

### Confidentiality and Limitations:

Unless otherwise agreed by LGIM in writing, the Information in this document (a) is for information purposes only and we are not soliciting any action based on it, and (b) is not a recommendation to buy or sell securities or pursue a particular investment strategy; and (c) is not investment, legal, regulatory or tax advice. Any trading or investment decisions taken by you should be based on your own analysis and judgment (and/or that of your professional advisors) and not in reliance on us or the Information. To the fullest extent permitted by law, we exclude all representations, warranties, conditions, undertakings and all other terms of any kind, implied by statute or common law, with respect to the Information including (without limitation) any representations as to the quality, suitability, accuracy or completeness of the Information.

Any projections, estimates or forecasts included in the Information (a) shall not constitute a guarantee of future events, (b) may not consider or reflect all possible future events or conditions relevant to you (for example, market disruption events); and (c) may be based on assumptions or simplifications that may not be relevant to you.

The Information is provided "as is" and "as available". To the fullest extent permitted by law, LGIM accepts no liability to you or any other recipient of the Information for any loss, damage or cost arising from, or in connection with, any use or reliance on the Information. Without limiting the generality of the foregoing, LGIM does not accept any liability for any indirect, special or consequential loss howsoever caused and on any theory or liability, whether in contract or tort (including negligence) or otherwise, even if LGIM has been advised of the possibility of such loss.

## Disclaimer and important legal notice

### Third Party Data:

Where this document contains third party data ("Third Party Data"), we cannot guarantee the accuracy, completeness or reliability of such Third Party Data and accept no responsibility or liability whatsoever in respect of such Third Party Data.

### Publication, Amendments and Updates:

We are under no obligation to update or amend the Information or correct any errors in the Information following the date it was delivered to you. LGIM reserves the right to update this document and/or the Information at any time and without notice.

Although the Information contained in this document is believed to be correct as at the time of printing or publication, no assurance can be given to you that this document is complete or accurate in the light of information that may become available after its publication. The Information may not take into account any relevant events, facts or conditions that have occurred after the publication or printing of this document.

Issued by Legal & General Investment Management Limited which is authorised and regulated by the Financial Conduct Authority. Legal & General Investment Management Limited, One Coleman Street, London EC2R 5AA



Institute  
and Faculty  
of Actuaries

22 May 2017

31

# Questions

# Comments

The views expressed in this [publication/presentation] are those of invited contributors and not necessarily those of the IFoA. The IFoA do not endorse any of the views stated, nor any claims or representations made in this [publication/presentation] and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this [publication/presentation].

The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this [publication/presentation] be reproduced without the written permission of the IFoA [or authors, in the case of non-IFoA research].



Institute  
and Faculty  
of Actuaries

22 May 2017

32