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## The New Political Paradigm

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28 November 2017



### Agenda

1. Why are people so angry?
2. What can be done about it?
3. What will be done about it?
4. Asset Allocation – don't predict, prepare

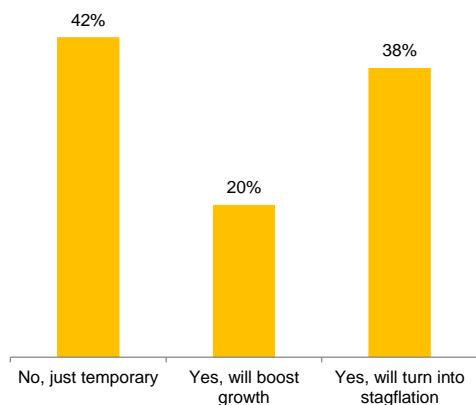


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## Why this matters

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

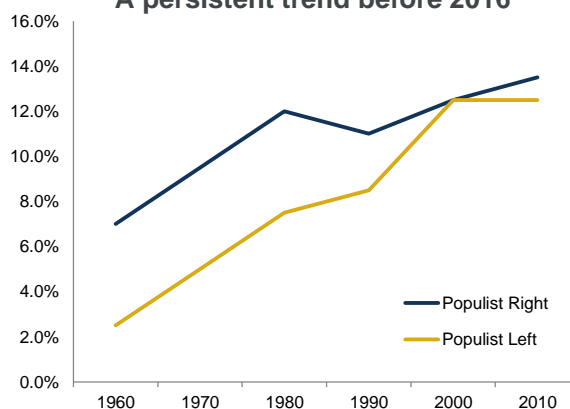
### Are Trump and Brexit the beginning of 'de-globalisation'?



## 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

### A persistent trend before 2016



## More than a feeling?

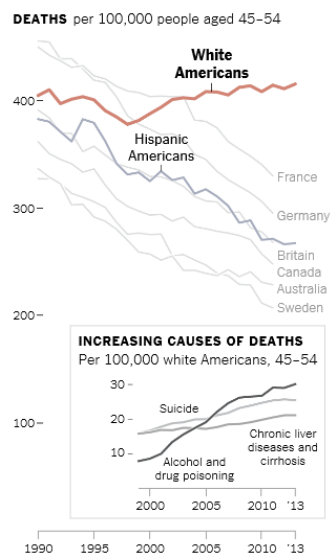
Income inequality vs  
wealth inequality

£ gap vs % gap

Are living standards  
understated?

'Rising Mortality' is definitely  
more than a feeling

Does it even matter?



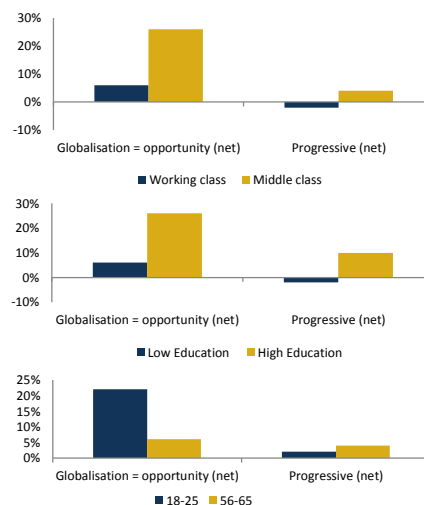
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## Shifting values, globalisation

- 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.

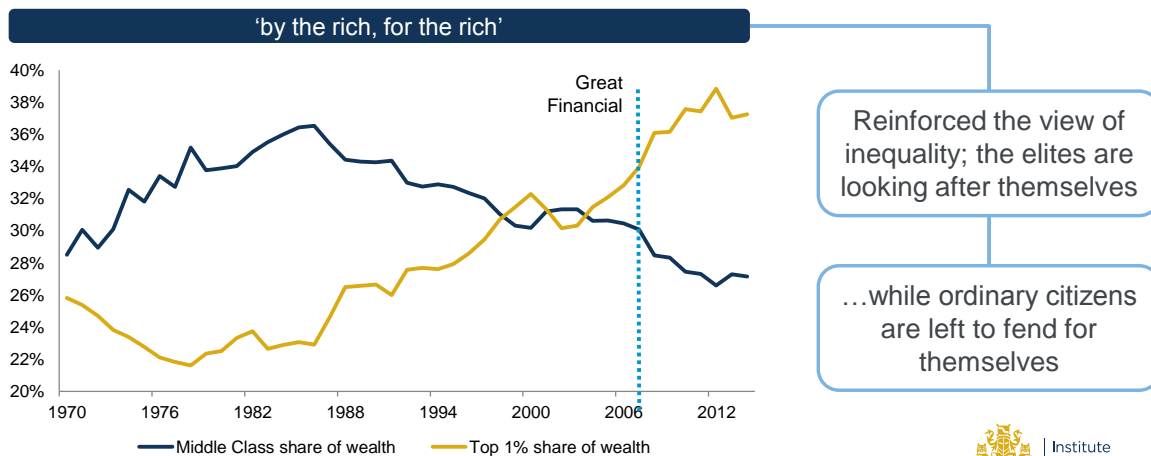


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Source: Bertelsmann Stiftung, LGIM

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## QE and bank bailouts

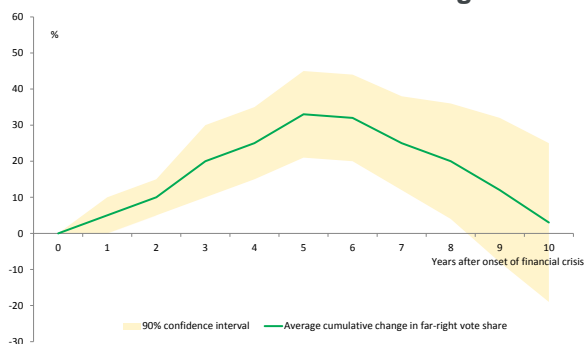


Source: World Wealth & Income database, LGIM

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

### Share of the vote for the far-right



On average, after financial crises...

- Share of vote for the far-right increases
- Political polarization increases
- Street protests (riots, strikes & demonstrations) increase

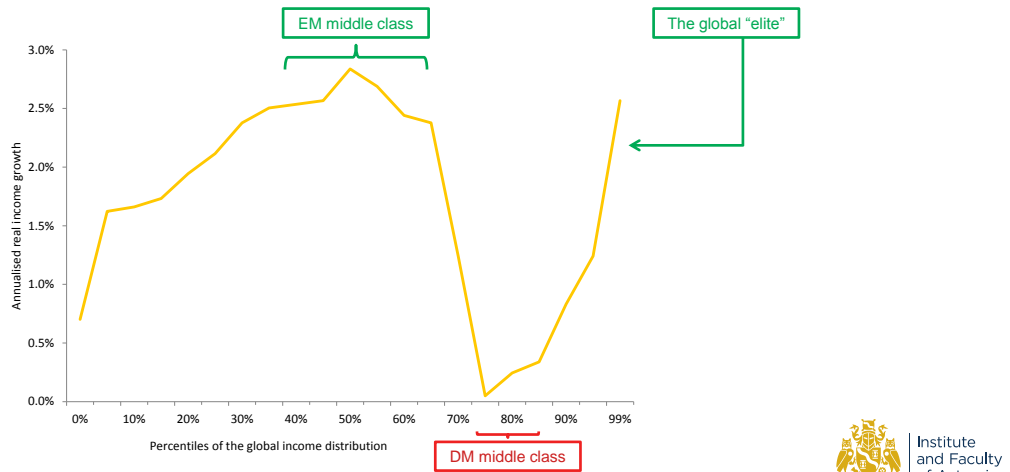
Average 35%(!) pick-up in vote share for the far right, peaking five years after the onset of financial crisis



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

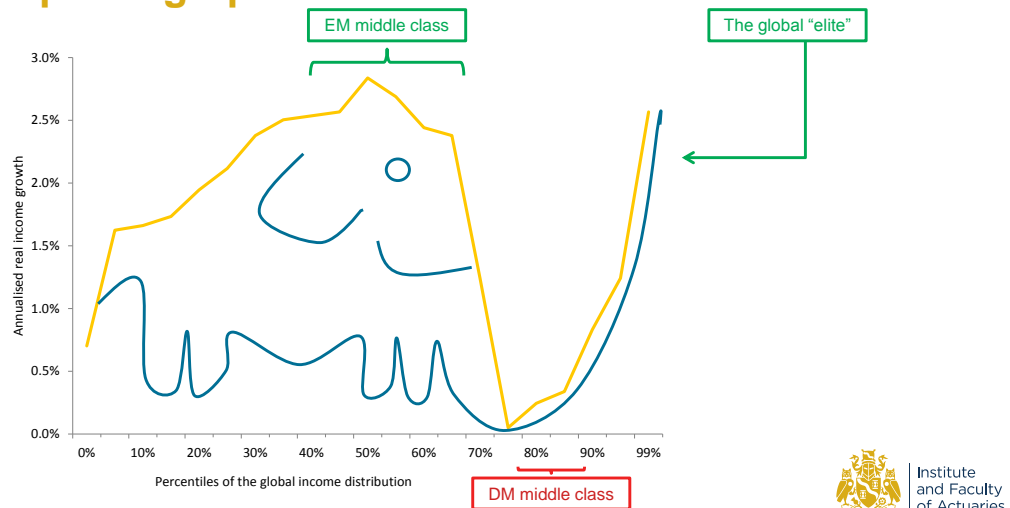
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## Inequality, the Elephant graph



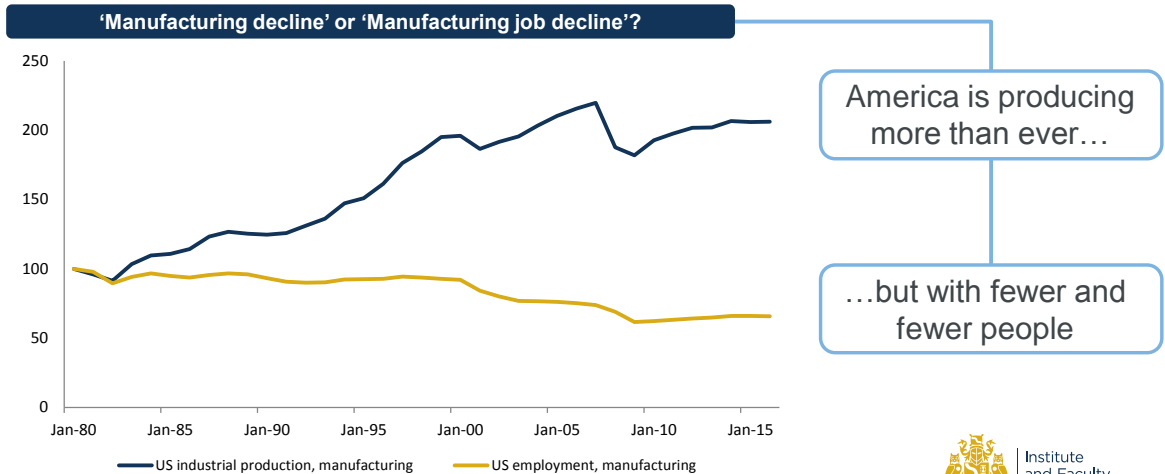
Source: "Global Income Distribution: From the fall of the Berlin Wall to the Great Recession" Lakner and Milanovic, World Bank Economic Review, Sep 2015 9

## The Elephant graph



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



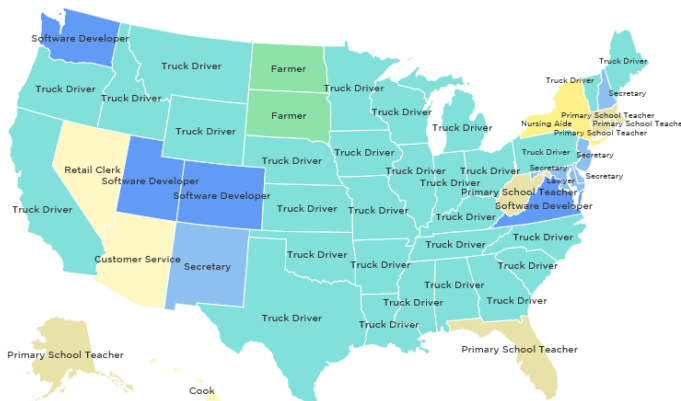
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Source: Bloomberg LP, LGIM

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## Automation – only the beginning

The most common job in each US state - 2014



CAFE X

WAYMO

amazon go



MOMENTUM  
MACHINES

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



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Source: NPR, US Census Bureau data, LGIM

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## Institutional degradation



'6 in 10 believe search engines over human editors'

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

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

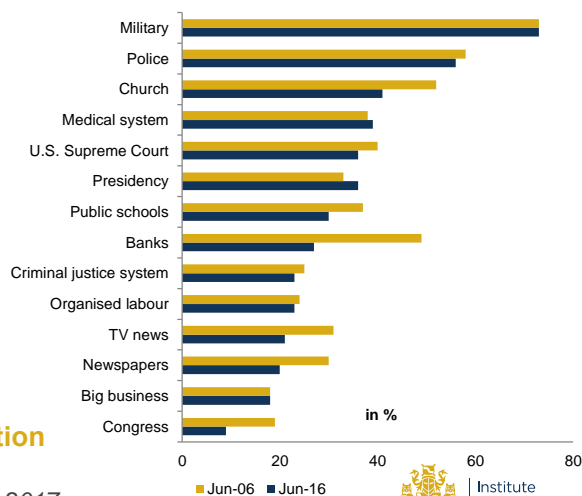
'Peers are as *credible* as experts'

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

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

*Steve Bannon, February 2017*

### Pew research



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Source: Pew Research, Edelman Trust Barometer 2017

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## 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



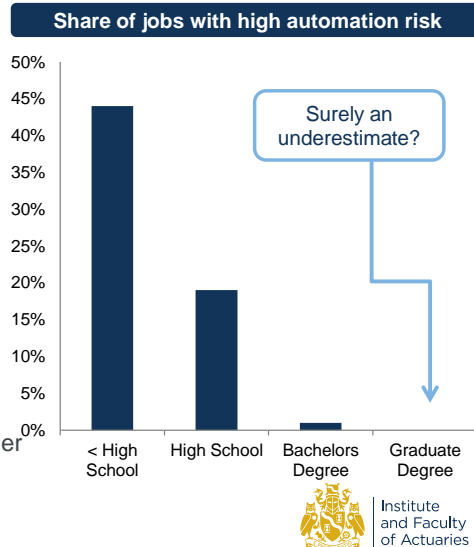
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Source: survivalcondo.com, LGIM

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## 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



Source: Arntz, Gregory and Zierahn (2016), LGIM

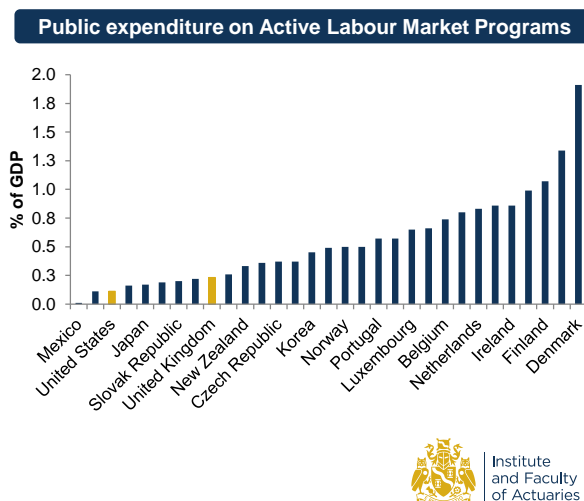
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## Solutions – social safety net?

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?



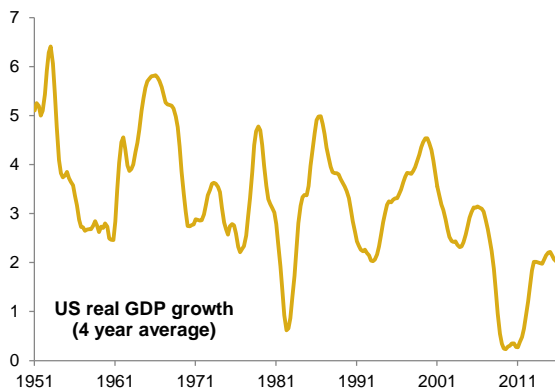
Source: OECD, LGIM

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## Solutions – more nominal growth?

### The great slowdown



Source: LGIM and Macrobond

**“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**”



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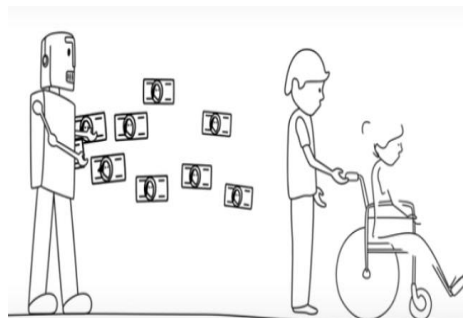
## Solutions – more redistribution?

A new approach to resource allocation

Universal basic income?

Robot tax?

Redistribution to save Capitalism



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

**Elon Musk, November 2016**

**“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**



Source: Design News, LGIM

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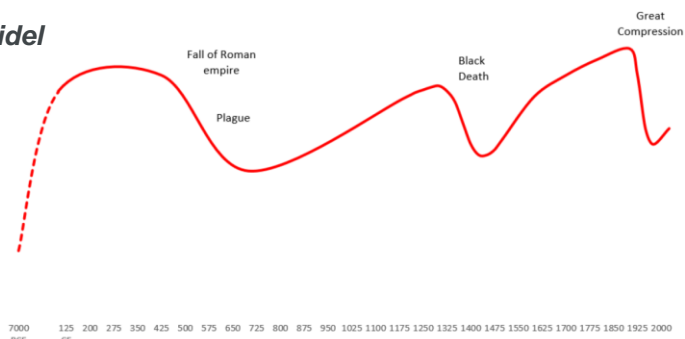
## Solutions – Don't look at history for inspiration

“Violence has been the single most important means of levelling wealth and income inequality in human history.”

**Walter Scheidel**

- Mass mobilisation war
- Revolution
- State collapse
- Pandemics

### Inequality trends in Europe in the (very) long run

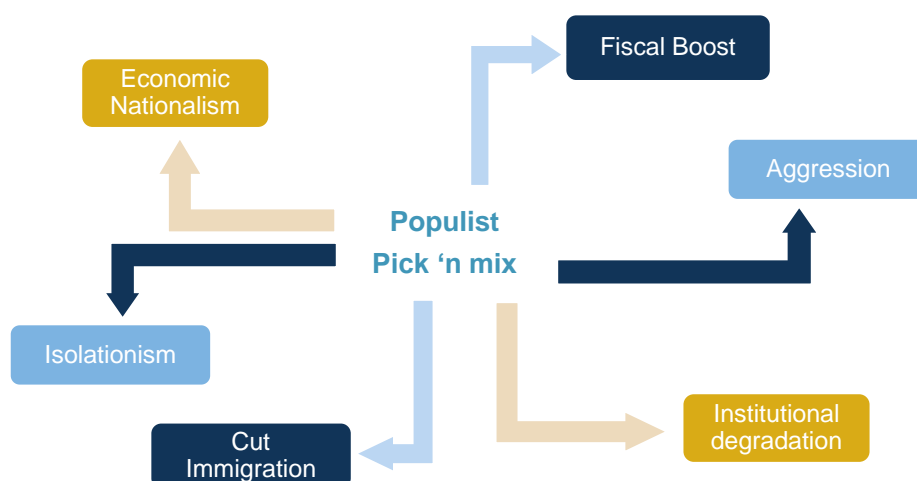


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Source: Walter Scheidel, LGIM

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## How will policymakers respond?

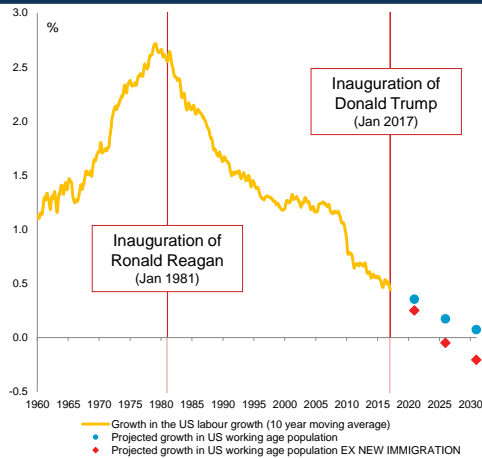


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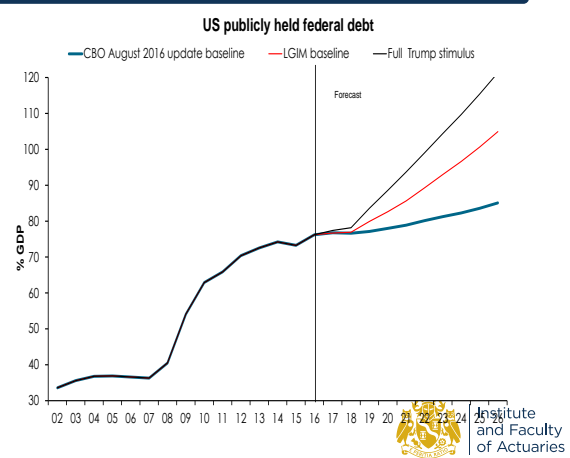
Source: LGIM

## President Trump is trying to fight the demographic tide

The demographic tailwind has disappeared



US publicly held federal debt



Source: Macrobond, Pew Research, LGIM

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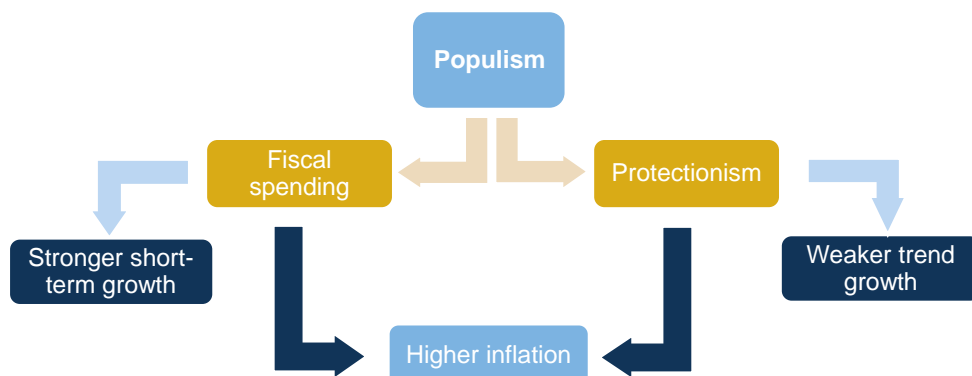
## New Political Paradigm matrix

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

Source: LGIM

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## 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



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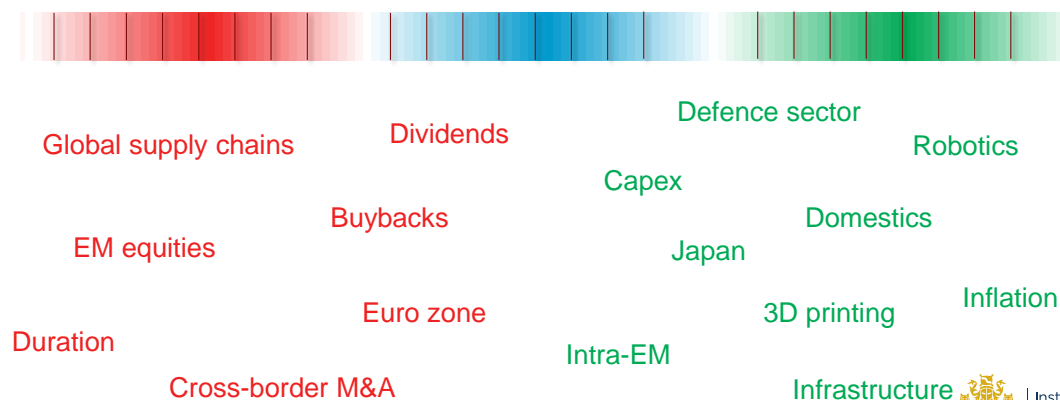
Source: LGIM

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## A more granular look at Winners and Losers

Losers / Less of

Winners / More of



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Source: LGIM

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## Political risk – A never ending story...



Source: LGIM

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## Lessons from 2016

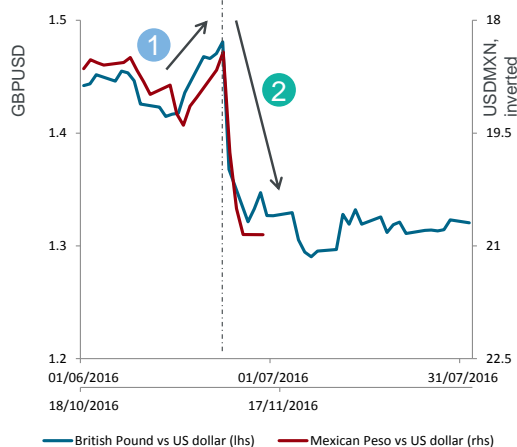
The favourite doesn't  
always win

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

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# 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	●	● ● ●	●



Source: LGIM

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# Thought leadership

**FUNDAMENTALS**

Time for coordinated policy to revive growth?

With global growth remaining subdued and increasing signs that monetary policy is reaching its limits, the calls for fiscal easing and more policy coordination are growing louder.

**THE RECOVERY OF MONETARY POLICY BEING AT ITS LIMITS IS EVIDENT.**

Global growth has remained subdued, and inflation expectations, meanwhile, have been hovering near historical levels. Monetary policy, therefore, has been pushed to its limits and will be less able to do so in the future. This means that fiscal policy and other policy coordination are growing louder.

**When I'm 64**

US bond growth has probably failed to around 1% due to an ageing population. Although reported GDP growth is modest by historical standards, it's enough to tighten the labour market. This implies a drag on profitability and a capital rise in inflation.

**THE QUESTION IS WHETHER THE MONETARY CHARACTERISTICS**

When I'm 64, the US bond growth has probably failed to around 1% due to an ageing population. Although reported GDP growth is modest by historical standards, it's enough to tighten the labour market. This implies a drag on profitability and a capital rise in inflation.



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## Questions

## Comments

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