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ASSET MANAGEMENT

marketing

Politics matters in the 2020s

2024 is the biggest election year the world has ever experienced, with about half of the world population voting. Why is this important to longer-term investors?

"The probability of political interference is high, and it matters more than ever."

No company or stock exists in a vacuum

Governments have the powers to fundamentally change the short and long-term profit dynamics and after-tax returns for companies and minority shareholders. The probability of political interference is high, and it matters more than ever as government spending across the world is at a historic high. It matters how governments, central administrations and central banks manage their significant role and influence in societies.

Figure 1 on the following page shows historic government involvement in the all-important US economy.

The repercussions of unexpected election results in significant countries like India, Mexico and Indonesia are yet to be seen. We have recently returned from a company research trip in Indonesia (a population of 275 million with an average age of 29 years). Even Local experts were uncertain about the political future. This is exactly our

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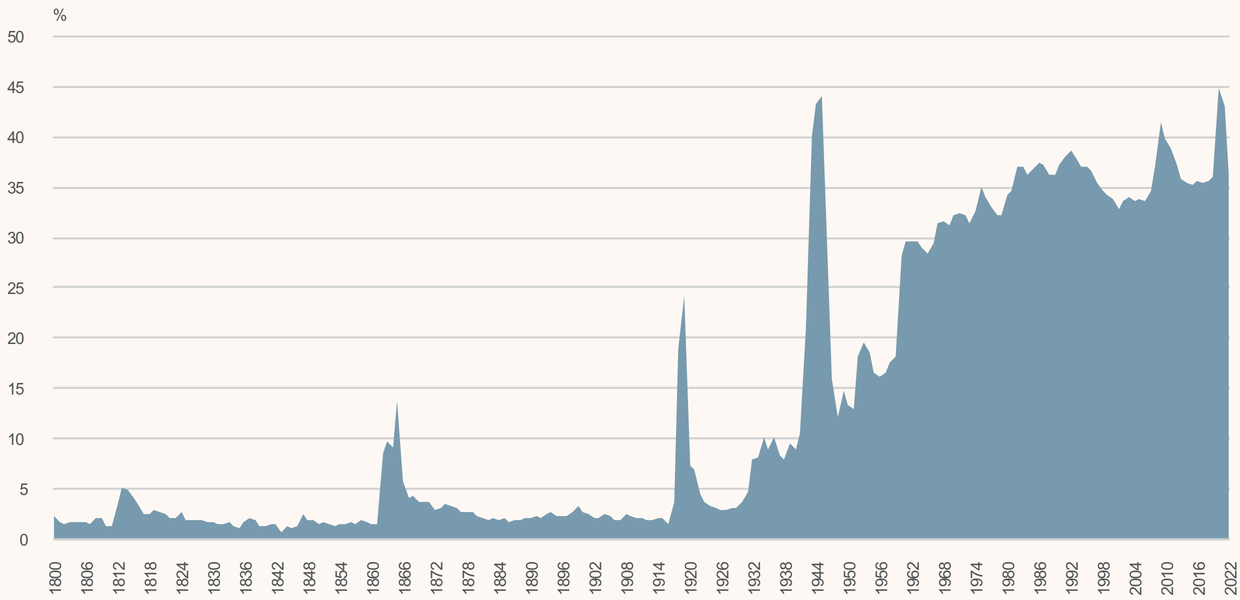
Figure 1
Total Government Spending as of % of GDP



Source: IMF, 2024

point; a more political environment, with greater government influence, can lead to a more unpredictable investment environment.

We live in a world dominated by "Big Government", as described in our 2022 white paper titled "The Rise of Big Government – Investment Implications", which we plan to update later in 2024. In today's world, governments have more influence compared to the free-market forces that ruled the world post the fall of the Berlin Wall. Despite the increase in uncertainty, we continue to identify select themes and trends that remain relevant and that will coexist with Big Government creating long-term investment opportunities. This is a key part of our upcoming Big Government paper. India, Mexico and Indonesia need to and will continue down the road of creating better living conditions for their big, growing and young populations. This creates societies that eventually move up the value chain and the consumption ladder seeking a better quality of life. It is the natural evolution towards creating a fundamentally healthier economy – not unlike humans striving towards a fundamentally healthier body. This is built on a foundation of better incomes, giving access to more protein and fat-rich diets. In the same way, it is built via the expansion of basic infrastructure for growth consisting of a sound financial system and a government and governance structure low on corruption that the population can trust. These building blocks also include a basic support system and safety net that provides basic education and healthcare. All three countries stand a very good chance of delivering over the coming decades, even if there are some questions that will be answered in the coming quarters regarding the agendas of the new or changed leadership mandates post the elections.

The mindset of a government and the leader of a country matters

As politicians increasingly manage countries, the country factor is back and alive in the 2020s. Just like the mindset of management matters in a company, where we have witnessed the creation of trillions of US dollars of market cap driven by the conviction of a few individuals. The significant progress in India over the past 10 years has been driven by the mindset of Modi.

Shorter-term political uncertainty is not just an emerging markets issue. The snap election in France that Macron

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has called raises a fundamental question. Are the 2024 elections going to increase or decrease the polarisation in societies seen across the world? Taking France as an example, it seems like today's extreme left- and right-wing political factions are less homogenous than in the past possibly giving power to the middle ground.

Adding technology into the mix, the internet has cut the cost of content distribution towards zero, and with generative AI cutting the cost of content creation, there is a risk that voters will be bombarded with false information from deep fakes. The good news is that voters are pretty used to creative information from politicians already. Technology can also be used in many positive ways as seen in the recent Indian election.

Many describe the presidential election in the US as crucial for the world economy and stock markets which might very well be the case – at least in the short term. This election symbolises a deep political split that goes beyond Washington. Still, there is a less vocal but critical societal foundation that we experience when we travel and visit companies across the US. Namely the strength and impressive depth of the US corporate sector that is often forgotten in the broader media. This power goes beyond the S&P 500 companies and the internet gatekeepers like Apple and Alphabet. Our main scenario is a continuation of value creation in the US built on a long culture of innovation and risk-seeking capital to fund it. This benefits stakeholders and minority shareholders, with the US being the leader in the 'Productive and Digital Society' within R&D and across biotech, AI, quantum computing and space.

A different geopolitical reality – the move from a unipolar world to a multipolar world

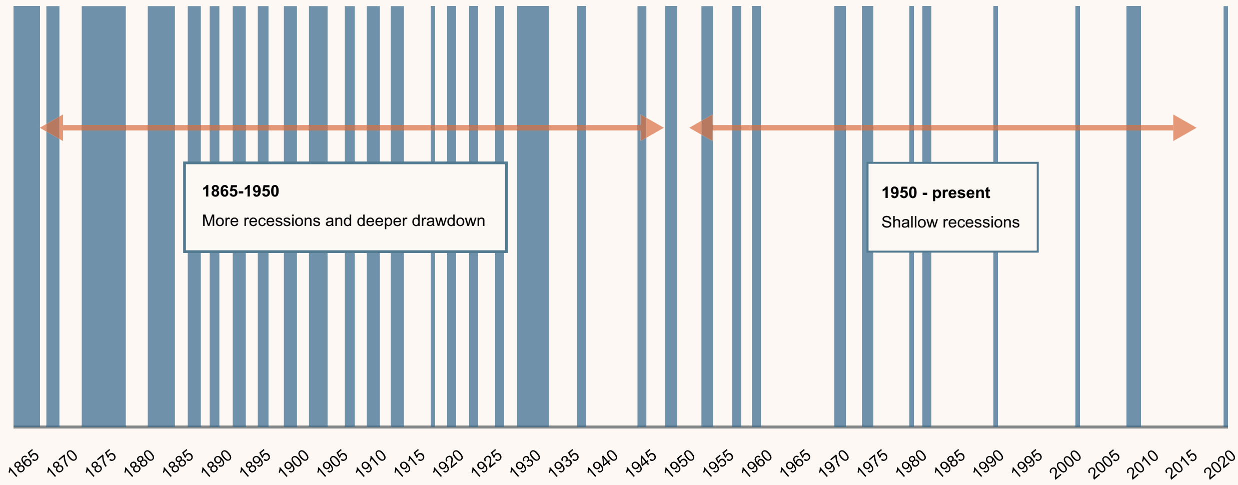
No matter who wins the next US election, the world has changed. The rise of China and what some label the "Global South" has increased their share of global GDP, and they want to play a bigger role on the global stage.

"When the global power balance is less clear, there is a risk of countries battling each other with monetary and political power."

This is a different and more dynamic geopolitical reality we have seen before. It is exemplified by the reduced influence of some global institutions designed and built post-World War II, such as players in the international financial architecture, the WTO and the World Bank. The world is facing several cross-country challenges where reformed and new global institutions are needed to target the problems of the coming decades more efficiently such as climate change, technological change, demographics, and space.

15 years have passed since the Great Financial Crisis. The crisis was resolved when one large and very dominant economy was able to use its overwhelming political and monetary power to stabilise the situation. The economist Elise Brezis concludes in her recent paper "Do Financial Crises Differ Between Periods of Hegemony and Power Struggles?" (June 2024) that when the global power balance is less clear, there is a risk of countries battling each other with monetary and political power increasing the likelihood of a crisis spreading and spiralling out of control. As the years pass and investors forget the last

Figure 2
US Recessions 1865-2023



Source: Macquarie Global Strategy, June 7th 2024

crisis, there is the potential for a more complex crisis in a multipolar world.

Bigger Government as a stabilising force?

If a US recession defines crisis, there is a significant historical observation to remember. The bigger role of government has probably been a stabilising force. Figure 2 highlights the fall in both the number and the seriousness of recessions over the last 75 years compared to history. However, the price is a higher total debt level and the higher risk and impact of policy mistakes.

With the caveat of statistical data uncertainty over such a long time series, recessions have been shallower. With the " rolling recessions" we have seen in one sector after another lately, it becomes harder to identify economic cycles. Central bank activity has been and will continue to be crucial in a very interest-rate-sensitive world. Especially in a Trump-led US economy, there will likely be intense pressure on the sitting and coming Chair of the

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Fed (coming up for election in May 2026) as the world and the US need low real interest rates with budget deficits and government debt at record highs.

The dynamics of world politics and economics are closely linked

Undoubtedly, China is playing a more significant role. Anecdotally, these dynamics were very apparent to us during our recent visit to Indonesia, where China is a dominant foreign direct investor overall and also in the nickel value chain. This provides significant support to the local Indonesian economy. Trade finds its way in new links, providing new arteries for the global economy.

The unshakeable stock market

With all of the above happening, stock markets have been extremely resilient and strong despite the massive rise in interest rates and the increase in political and geopolitical risks with potentially adverse outcomes. Not many

economic models would have predicted this strength with the backdrop of a US inverted yield curve and a historic rise in the real rate of Fed funds.

Tighter liquidity has hit segments of the market, with higher-risk debt-loaded companies being an example. Nevertheless, there has still been sufficient liquidity to support markets. There are at least three factors of support:

1. Inflation falling and inflation expectations normalising have been an important factor. The US consumer inflation expectation (1 year ahead – University of Michigan) is back at its 10-year average of 3%, although still higher than before Covid-19, when it was 2.5%. This reduces uncertainty for stock market investors.

2. The Covid-19-induced boom in government spending and the resulting increase in savings has played a role here. The budget deficits of the last couple of years, some catch-up spending post-Covid-19 and the launch of bigger investment programs have supported the US consumer and the US economy.

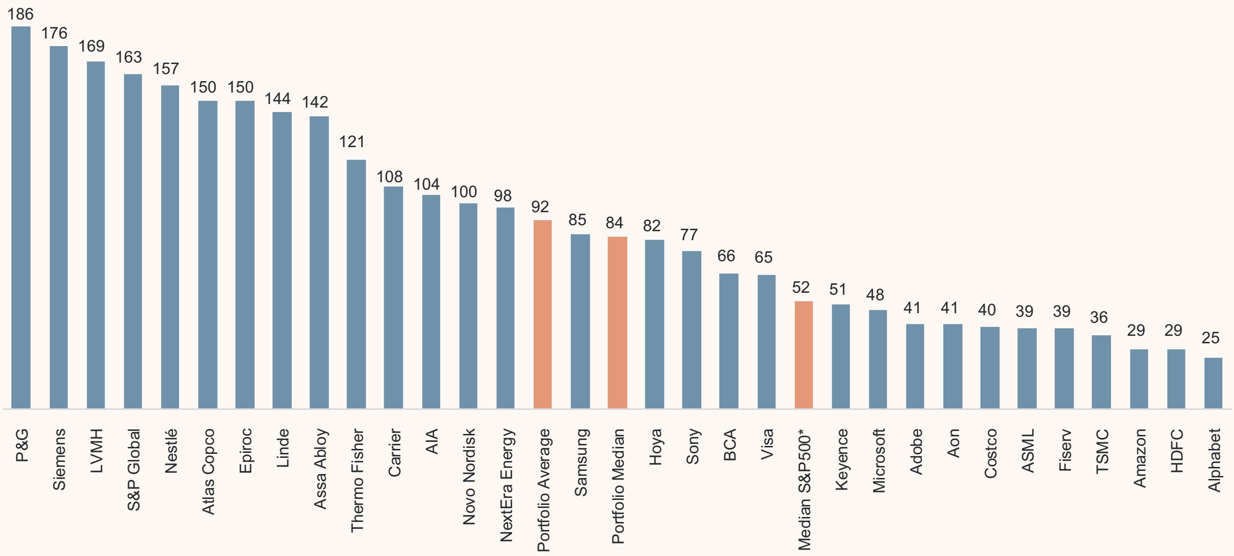
3. The other dimension to understand is the bifurcation of markets driven by the AI boom that started with the launch of generative AI and Chat GPT in November 2022. Nvidia is the poster child of the boom and has risen from 0.7% of the MSCI World Index to 4.2% during this period. Other winners in the AI boom such as Microsoft and ASML, have also done very well, while big parts of the global stock market have done more or less nothing over the past three years. The MSCI World Equal Weighted Index has been almost flat since the beginning of 2021, while the market cap-weighted index, MSCI World Index, has increased by 32%.

Looking ahead

The Covid pandemic increased government debt levels to historic highs globally, which in turn has increased the

Figure 3

Age of portfolio companies in Global Equities (number of years)



Source: C WorldWide, 2024

"We think the coming years should be a period with support to our long-term investment style with a focus on quality companies with sustainable business models."

sensitivity of the world economy to a potential downturn. There are ways for the US and China to manage their government debt levels as global superpowers. For others, fiscal discipline and good management are still needed to weather coming storms. The Bank of Canada was the first G7 central bank to lower rates from 5% to 4.75% at the beginning of June. Like many other countries, inflation has fallen to 2-3% from a peak of above 8% two years ago. Signs of softening in Canada, with unemployment hitting 6.1%, was probably part of the reason, as is slow growth in the EU pushing the ECB to cut deposit rates from 4% to 3.75%. This is likely the start of a rate-cutting cycle. We don't know the speed of rate cuts, but the direction should support long-duration assets.

We think the coming years should be a period with support to our long-term investment style with a focus on quality companies with sustainable business models. It boils down to the earnings power and compounding of fundamentals after the Covid-19 period, and here at the beginnings of what might be the foundation of the next tech revolution ignited by AI. A revolution that will proliferate as corporations and consumers find the right use cases and relevant AI apps are developed.

Our conviction levels are anchored in the longevity and robustness of corporate business models. We have expo-sure to companies that are well-positioned from a polit-ical and thematic perspective. A portfolio of a select few companies, where the average lifespan of the companies in the Global and International portfolios is close to 100 years, as illustrated in figure 3 above.

Disclaimers

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