POPULISM, MULTIPOLARITY AND THE RACE TO ZERO: MARKET DRIVERS FOR THE COMING DECADES

Christopher Gannatti — Global Head of Research
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On the first installment of the *Behind the Markets* podcast in July 2021, host Jeremy Schwartz spoke to Marko Papic, Partner and Chief Strategist at Clocktower Group.

Marko discussed his unique background, which was notable since his focus has been in the arena of political risk rather than specific market- or asset class-focused risk. He believes there are three big things that may have the potential to shape the market environment over the coming decades:

1. Populism
2. Multipolarity
3. The "Race to Zero"

Populism: The Washington Consensus to the Buenos Aires Consensus

Marko's view is that the Washington Consensus has been in place since the 1980s and was largely responsible for the so-called Great Moderation. Leaders like President Ronald Reagan and Prime Minister Margaret Thatcher were emblematic of this important shift in global ideology. The difficulties faced by the 1970s median-voter resulted in preferences shifting from more left-leaning approaches to more laissez-faire market-driven policies. Organizations like the International Monetary Fund (IMF) and the World Bank enforced these pro-market, pro-globalization policies across the world when they set conditions on loans or other packages.

More provocative statements are always exciting, and Marko indicated that he believes the U.S. is currently the furthest along the spectrum of populism in its politics, at least among developed markets. Reading the currents, one can see that swaths of U.S. society are feeling left behind or left out of the gains that parts of society have seen from the Great Moderation. Whether they are supporting Senator Bernie Sanders or former President Donald Trump, what they are really doing is rejecting the status quo.

The bottom line: Looking at the current level of U.S. interest rates, such as the level of the 10-Year Treasury note as at the start of July 2021, the market is not concerned with any sort of populist narrative. A true populist narrative would imply even more massive deficits and even more spending, which should naturally suggest a higher interest rate world.

Multipolarity

Marko indicated that analyzing the balances of global power in 2021 is very difficult, and that it may become even more difficult in the years to come. In the past, for instance in 1985, it was clear that the U.S. was in charge. This was a largely unipolar world and a stable construct. A true bipolar world might look something like the Cold War, with two powerful countries seeking to influence their allies to their side of thinking on global policies and issues. Then, there is how the system is starting to look today—a multipolar world.

While many might naturally think of U.S. vs. China, the reality is more complex. For example, while it is clear that the U.S. and Europe do have a certain rapport—and that rapport is better under President Biden than it was under President Trump—it's also clear that the U.S. would be hard pressed to get Europe to stop doing all business with China. It's also notable that alliances are no longer simply black or white, on or off. One could have watched Australia indicate it wanted to see further investigations of China relating to the origins of the COVID-19 pandemic. Clearly, the U.S. and Australia are more aligned than the U.S. and China. However, as China and Australia curtailed their trade relationships in response to the harsher lines of public discourse, in the background the U.S. stepped in to increase its trade with China to make up for the goods China was no longer receiving from Australia.

The bottom line: Countries are balancing a far more difficult calculus of their interests, which is driving how they are reacting to certain global catalysts. As a result, predicting simple black or white responses may not be possible in the coming years.

What Is the Race to Zero?

Marko thinks of this more as the 'Race to Efficiency' or the 'Race to Customization.' History thus far has been more about providing large quantities of goods for the median consumer, and in the future this could shift to providing customized products and services for the more extreme consumers. Investors may understand this better if we relate this discussion to a simple bifurcation of atoms versus bits.

It has become very clear that the market has become highly skilled at the process of nurturing capital for new software companies. We hear all the time about different private companies raising money in different rounds of funding. Over time, the most successful of these companies have a clear path into the public markets. This is the world of bits.

When we think of electric vehicles, batteries, solar cells, new nuclear technologies—the list goes on—this is the world of atoms. The models of success for these businesses are not the same as they are for software businesses, and they don't have the same clearly travelled path through the funding and development process. One consequence is that there is a lack of available public companies. Another consequence is that certain companies are using the special purpose acquisition company (SPAC) financing method earlier than they likely should. The outside observer may see high valuations, volatility and risk even if these concepts—green technologies—could be some of the more important developments in the next 20 years.

Marko also gave a very clear view on why he believes that we are in a Commodity Supercycle. Critically, he is thinking of the next 10 years rather than the next three months. He told an interesting story about lumens, or light. In the 1800s, if a person wanted light, it would likely come from whale oil, which had to come from harvesting whales. In 2021, having light in the developed world is not even thought of. He believes this is the model for many of the best green technologies. In the near term, things may become more expensive and indicate inflation. In the longer term, with the best innovations—things that might be like the concept of fusion power—prices for energy may actually come down and be deflationary due to the overall new levels of unforeseen abundance.

Clearly, this was a rich discussion, and we invite anyone interested in these topics to listen to the full podcast below.

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DEFINITIONS

Interest rates : The rate at which interest is paid by a borrower for the use of money.

U.S. 10 Year Treasury Note : A debt obligation issued by the United States government that matures in 10 years.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Commodity : A raw material or primary agricultural product that can be bought and sold.

Deflation : The opposite of inflation, characterized by falling price levels.