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How do multi-asset strategies need to evolve to address the new macroeconomic regime?

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We believe the bull market for beta is likely dead!

4 macroeconomic themes we are monitoring at Newton

… these all point to a change in regime!

Big government

- Structural challenges
- More moderate pace of global economic growth
- Growing disillusionment amongst electorates
- Elevated state intervention
- More extreme forms of monetary intervention
- Accompanied by fiscal policy (e.g. people's QE)
- Overt control and regulation of key industries in future

China influence

- Far greater influence than in the past
- Consumption share of commodities
- Increasing impact of Chinese political views
- Competitive threat from Chinese businesses
- Unprecedented state-inspired credit expansion has made the economy more risky
- Moving the economy safely to being consumption-led is of great global significance

Financialisation

- Scale, complexity and interconnectedness of global financial system has mushroomed
- De-regulation, globalisation and dominant central bank belief in not leaning against financial excess
- Growth of the financial economy has outpaced that of the non-financial economy
- Global financial system remains largely unchanged despite GFC, with elevated leverage at the system level
- Continued pressure on the pillars of globalisation is likely to impact how the global financial system operates and evolves

Great power competition

- China's rise, Russia's revisionism and America's domestic politics are changing the global balance of power
- Liberal democratic and economic order that dominated for the last thirty years is now over
- A new international paradigm which shapes markets will play out over coming decades
- Impact across 5 dimensions:

- Trade War
- Tech War
- Finance War
- Resource Competition
- Security Competition

3 major implications for asset owners and fund managers

How do multi-asset investors need to evolve their approach for a new macroeconomic regime?

1

Current models, assumptions and received wisdom are a function of the great beta bull market

2

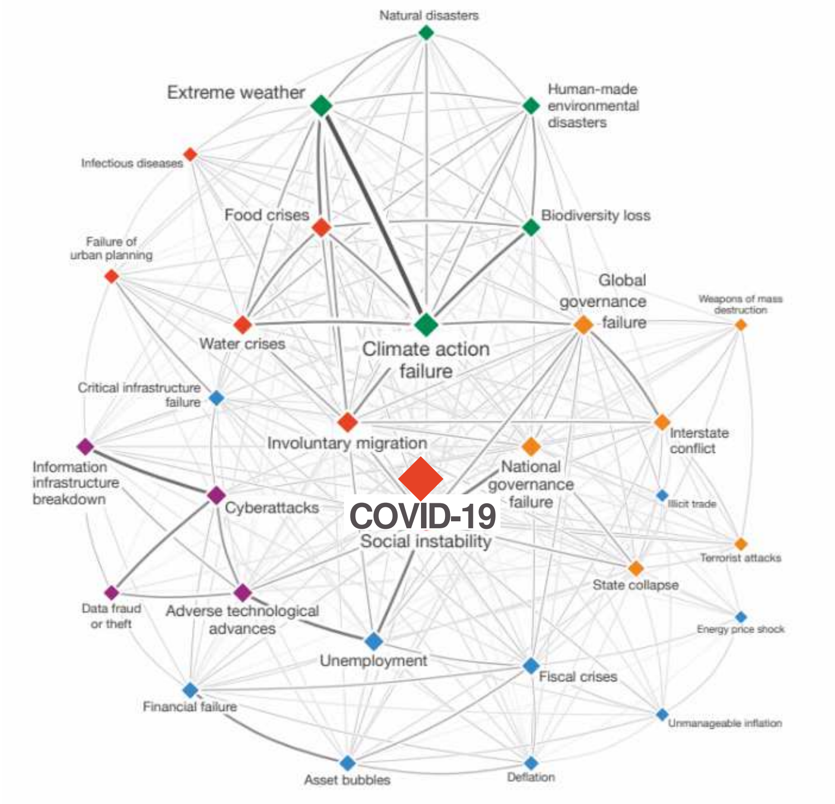
Existing specialised mandates, fund construction, benchmarks and restrictions may not fit for the future

3

If it takes us too long to adapt to the changing market regime we risk giving up our gains from the past decade

(1) We are coming up against boundary conditions for our planet

A broadening ecosystem of risks and opportunities



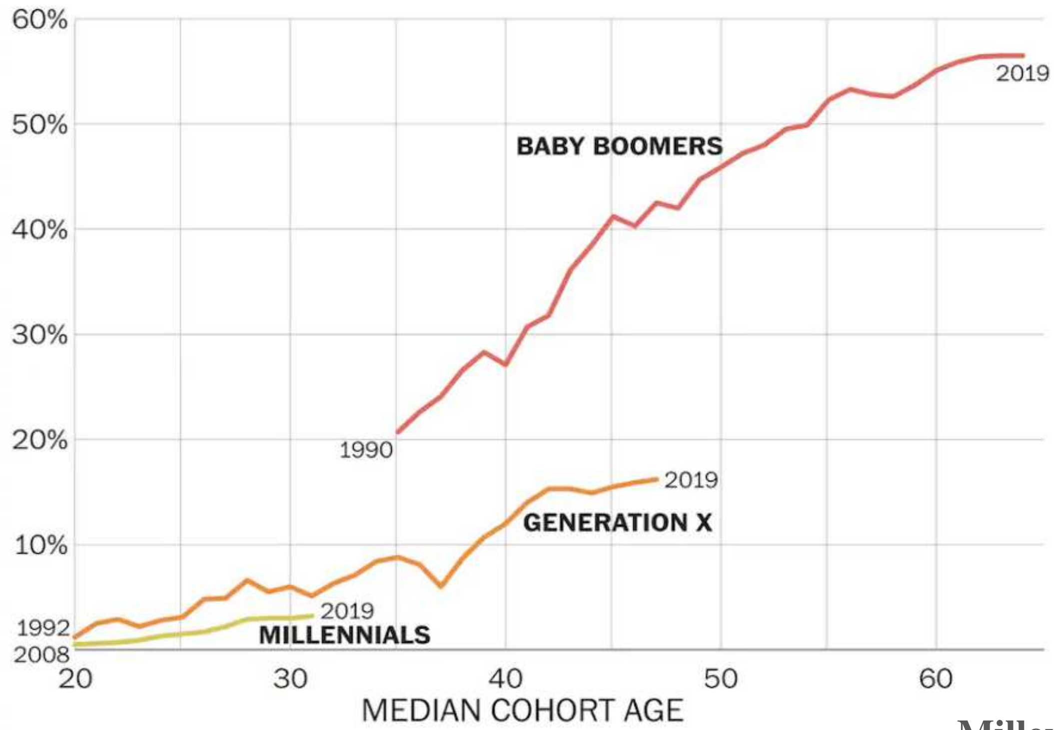
We cannot continue to invest without any concern for externalities or consequences

Source: based on World Economic Forum Risks Report 2020.

(2) We cannot avoid the growing inequalities

When all boats are no longer rising issues of inequality become more prominent

Share of national wealth owned by each generation, by median cohort age



Source: Federal Reserve Distributional Accounts, The Washington Post. Chart adapted from Gray Kimbrough. 3 December 2019.
https://www.washingtonpost.com/business/2019/12/03/precariousness-modern-young-adulthood-one-chart/

Millennials and Gen Z to become the dominant voter block in the coming decade

(3) Move from supply-side economics to demand-side economics

Increased role for government in economic management

"I'm from the government & I am here to help."

Government intervention is not going away as citizens are unhappy with the size and influence of big corporations

(4) We are seeing a reversal of globalisation

From Globalisation to Balkanisation

The 4 pillars of globalisation are increasingly challenged

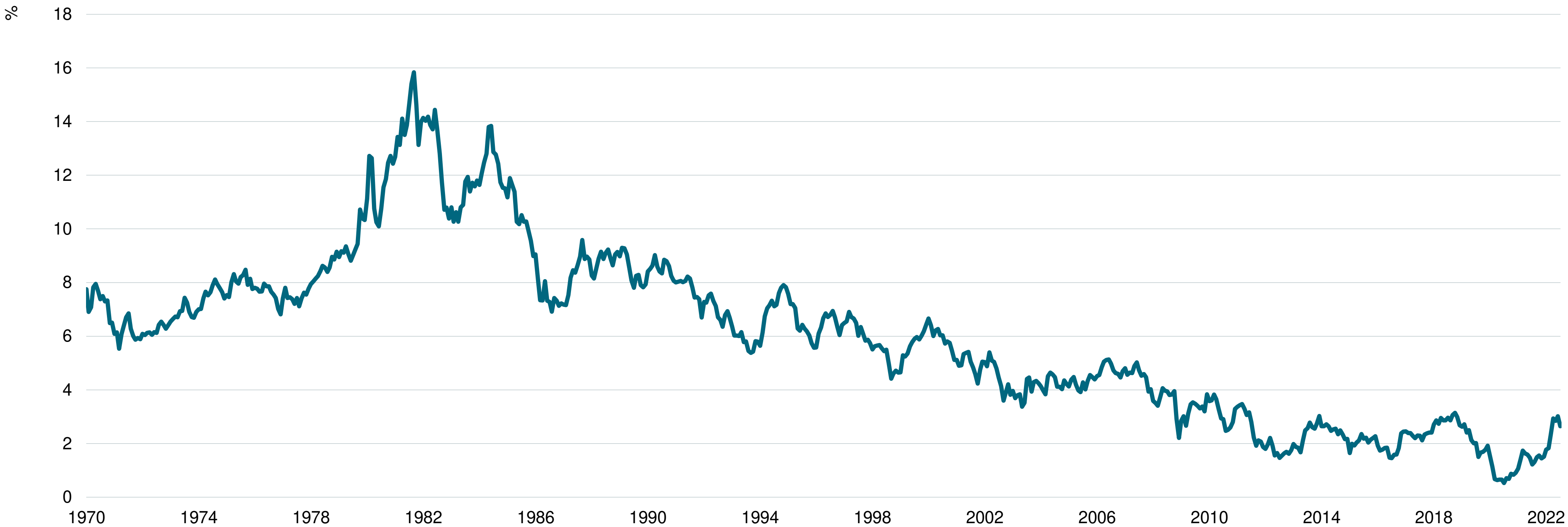
Free trade	Free movement of intellectual capital	Free movement of financial capital	Free movement of people

From efficiency to security

(5) An end to the 40-year decline in interest rates

10-year battle between the forces of inflation and disinflation

US 10-year treasury yield



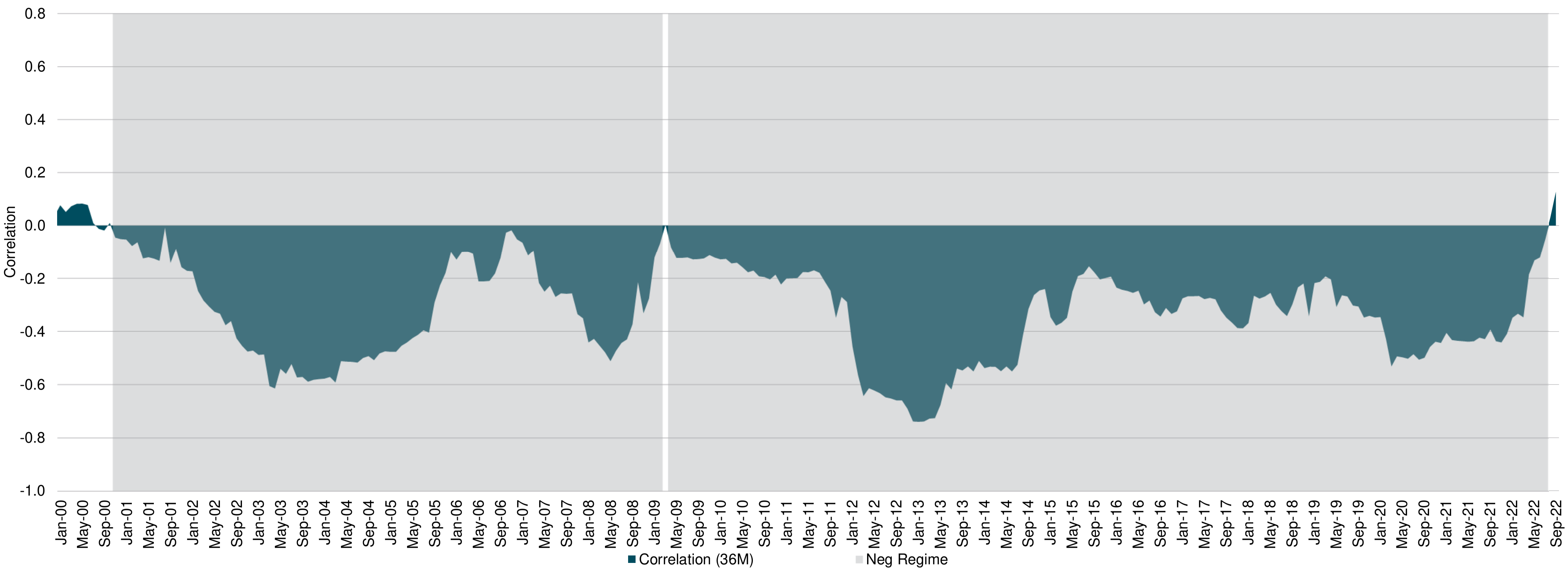
Source: Bloomberg, July 2022.

An end to disinflation?

(6) The past 20 years is not representative..

Will bonds offer diversification?

US Equity Bond Correlation, January 2000 to September 2022

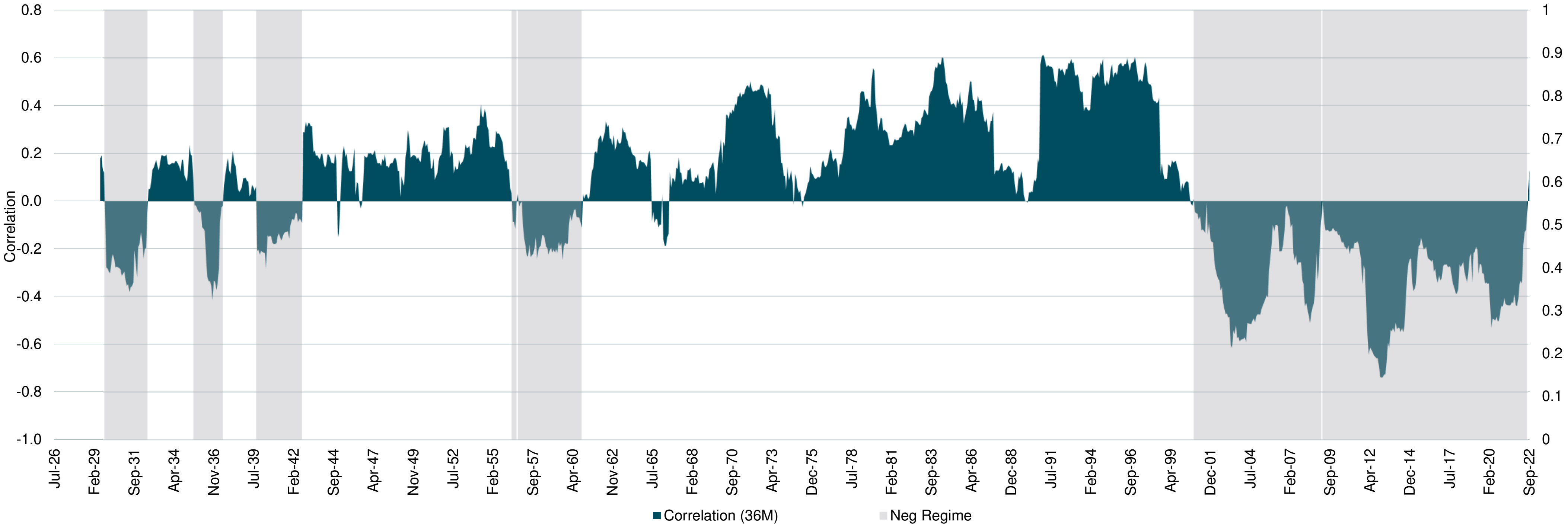


Sources: US Equity is the S&P500 TR from 1988; prior US Equity returns from Ken French website. US Bond is the US Treasury 10 Yr from 1962; prior US Bond returns from Fed Reserve Board H15 website. 30 September 2022.

(6) Over longer periods bonds are more positively correlated with equities!

Will bonds offer diversification?

US Equity Bond Correlation, July 1926 to September 2022



Multi-asset investors have to consider alternatives to bonds to build more diversified and resilient portfolios.

Sources: US Equity is the S&P500 TR from 1988; prior US Equity returns from Ken French website. US Bond is the US Treasury 10 Yr from 1962; prior US Bond returns from Fed Reserve Board H15 website. 30 September 2022.

So what?

	1983	TODAY
Real/perceived social imbalances	Low	High
Monetary policy	Tight	Easy
	Real Rates Positive	Real Rates Negative
Role of government	Contracting Role	Expanding Role
Labour	Peak Unionisation	Renewed Interest in Unionisation
Geopolitics	Cooperation Increasing	Competition Increasing
	Advance of Globalisation	Decline of Globalisation
Demographics	Declining Dependency Ratios	Increasing Dependency Ratios

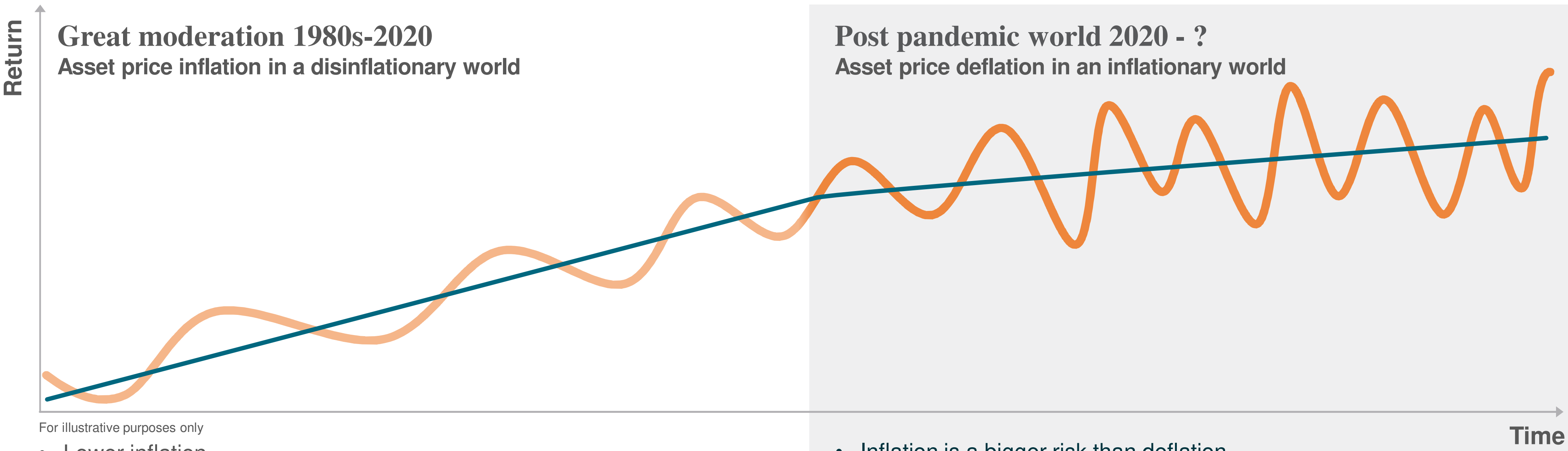
So what?

The conditions that underpinned the disinflationary period between 1980-2020 are either coming to an end or being replaced by something else.

This means there is an elevated probability of a change in macro financial regime.

The weight of evidence points towards an environment characterised by higher and more volatile inflation.

So what?



For illustrative purposes only

- Lower inflation
- Low volatility longer cycles
- State intervention: prolong the cycle if inflation not prohibitive
- Increasing corporate profit share of GDP

- Inflation is a bigger risk than deflation
- High volatility & short boom-bust cycles
- State intervention: limited scope to stimulate as inflation elevated
- Increasing labour share of GDP, expensive labour and commodities

Source: Newton, 2022.

There are risks to consider…

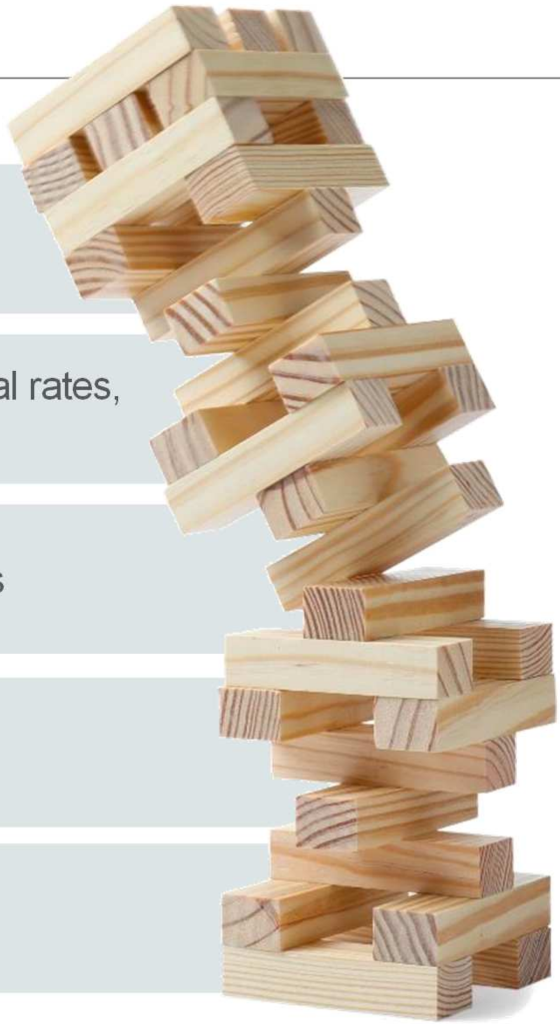
1 The 40 year bull market in bonds and equities is probably over

2 Strategies for which success has been predicated on a continued decline in nominal rates, free money or trending markets will likely struggle in this environment

3 We expect to see greater dispersion in equity, credit and government bond markets

4 Bonds are unlikely to diversify equities as correlations increase

5 The historical data set is short and largely confined to the post-1980 period of disinflation



There will also be opportunities!

1 Dynamic asset allocation should be a real opportunity to add value if your mandate is broad and flexible enough

2 Absolute return strategies should be able to benefit from this market environment

3 Macro, currency, rates, commodities and other alternative strategies could become much more relevant again

How do you need to evolve your approach for a new macroeconomic regime?

1 You need to **question** your priors, models, assumptions and received wisdom.

2 You must be **nimble**, active, diversified, liquid, and opportunistic.

3 You need to be able to **adapt** quickly stand to protect gains, limit loses and meet commitments.

Important information

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