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## Disruption

Swiss Chamber of Commerce  
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# My relationship with Switzerland



Mainly via skiing-Wengen & Zermatt since the early 1980s.



Last time there was 2015-skiing on the Lauberhorn above Wengen, got bitten by a small dog as I skied past him-portent of things to come? When skiing on Bumps-hit some heavy snow, felt a pop...had to be taken off the mountain on a skidoo by mountain rescue. Anterior Cruciate Ligament (ACL) tear.



Love Switzerland-the trains REALLY DO run on time!



Sunday afternoon-looked after beautifully-thankfully no surgery required but end of skiing holiday. Cost of medical care significantly lower than what it would have cost for the same treatment in SA.



Expensive country but you get what you pay for



In front of Matterhorn 1983

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*Toblerone deluxe!*

# CFA Conference

My third Chartered  
Financial Analyst  
(CFA) Conference

Edinburgh 2011,  
Philadelphia 2017,  
London 2019

1900 delegates-500  
from UK; 385 from  
USA and 265 from  
SOUTH AFRICA

# Disruption Presentation Agenda

Global factors

Brexit

The Investing  
outlook in a  
Changing World

The Case for  
Emerging Market  
Investment

Mohamed A. El-  
Erian

Summary





*“Disruption is a constant-  
not just a moment in time”-  
Gary Baker, CFA Society UK*

# Disruption Emotions

- Politics can be extremely disruptive eg Brexit.
- Disruption is becoming the norm-feeling uncomfortable with it is fine-think Discovery, Uber and City Lodge.
- Disruption fosters curiosity and ambition.
- Never ask an incumbent what they think of disruptive technology.



The future of  
global  
politics!



# The end of Pax Americana

Trump systematically dismantling Pax Americana-in place since 1945

Essentially, the US has been the global “policeman” -changing under Trump. No other country has the military capability to take over

The US is not a great trading nation-trade/GDP lower than any other country

The US’s internal economy is massive-trade not a big deal


US military, especially naval might, is unparalleled-China nowhere. At current rates of naval buildup, the combined navies of the RoW will only equal that of the US in 2240!

The unravelling all started in 1989 with the fall of the Berlin Wall

Successive US presidents have not kept Pax Americana together



Robert  
Lighthizer US  
Trade  
Secretary



# The end of Pax Americana- continued

The global order that America created in the 1940s no longer serves America's strategic interests

US baby boomers will be net absorbers of capital in three years' time

Millennial consumption has kept the US out of recession since 2009

China is now the most over-credited economy in human history

The US is moving from the greatest source of stability to the greatest source of disruption

Consumption-led growth in Europe is impossible-not enough young people

In return for a trade deal post-Brexit, the US will demand half of London's USD clearing capability. Europe will get ¼. City of London will shrink.

# Brexit



- “There is no version of Brexit that is going to result in anything other than a hard divorce”-Peter Zeihan
- Muddled thinking by UK government on Brexit
- Will probably lurch towards Oct 31 with nothing-if so, the EU 27 may decide the UK's fate
- Immigration has been a net positive for the UK
- Trade-the EU is the UK's largest trading partner-it will take a massive improvement in trade with the RoW to offset loss of EU trade
- The world order is unravelling with the collapse of Pax Americana-what does the UK have to offer in such a disruptive situation?

# Brexit-continued

- High chance of Scotland seceding from the UK in the next 5 to 10 years
- Scottish FM Nicola Sturgeon wants as hard a Brexit as possible, c/w a hard-core Brexiteer as new PM
- Brexit unlikely to be copied by other European countries
- But major reform required in the EU
- Many EU27 members likely to press for a looser association of member states, rather than the current move to greater centralisation



# The Investing Outlook in a Changing World

What's not to like? The market economy has delivered over many decades. And yet, global politics is in flux-so should we worry?

Historically, we've been here before-The Dutch East India Company in the 1700s had a market capitalisation in today's money of \$7.9 trillion, larger than all the big names of the NYSE put together.

But, just as society chose to make the current system, it can also choose to destroy it.

3 Main elements of disruption-Demographics, Climate Change and Loss of Trust



# Demographics

Baby boomers, falling populations in the west, aging populations

However, millennials the first generation for a while that will be poorer than their ancestors.

Young people today can't hope for the generous benefits of yesteryear. This leads to demands for revolution. Mao Zhe-Dong's Red Guards very very young, the soldiers in the American revolution were much younger than their British counterparts.

# Climate Change

Increasing CO2 levels especially worrying. Only a few years to change things. UN recommending a policy shift away from trying to protect existing species to taking proactive steps to reduce CO2 in the atmosphere.

Moving from “Do no harm” to “Do good”

*“If we don’t, as an industry, engage on these issues, and create the changes that we think will help our clients, changes may very well be made for us in ways which may not be in our clients’ interests”.*-Anne Richards, CEO Fidelity International.

# Loss of Trust

Capitalism facing major political challenges from both the right and the left

Urban elites being shackled to a corpse-the corpse being the left-behind regions. London 40% of UK GDP

The left-behind are voting for change a la Trump in the rust-belt states of the US and the voters in the NE of England

Only 42% of Americans <30 support capitalism-millennial anger brewing

Capitalism without competition, without the risk of failure, ossifies the status quo

Private vs public markets-private capital growing faster than public capital

# Loss of Trust continued

Political attention increasingly focused on capitalist excess

The clear conflict of interest when executive compensation is aligned solely with share price movements

If capitalism is fuelling inequality, rather than promoting it via the democratisation of capital, will people continue to support it?

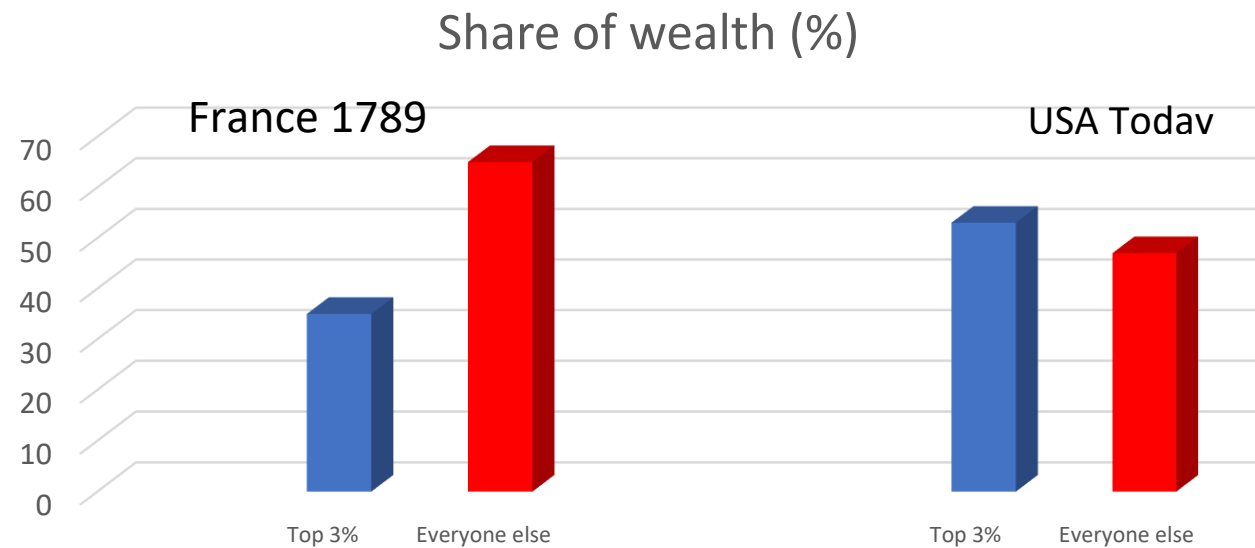
Reduced public participation in markets undermines the social contract between the public and capitalism, undermining its very reason to operate

Less public access to growth stocks-smaller investors being frozen out. Public markets have become pools of liquidity rather than risk capital. The number of listed companies is falling fast globally

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# The Rumble of the tumbil



# Emerging Markets (EMs)

SA not a real EM-Rather it is a small, open, Developed Economy (DM) with high unemployment

Conveniently categorised as an EM for investment purposes

No proper definition of EMs or frontier markets

DMs-The US, UK, western Europe, Australia. South Korea has transitioned from EM to DM.

China largest EM but rapidly transitioning to DM.

# Emerging Markets- continued

For many years, global investors have been piling into US equities

But US equities have only provided a relatively modest return over almost 20 years. Strong USD has masked this under-performance

Central banks have provided almost \$10 trillion in liquidity since 2009

Mkt cap/GDP has been elevated for a long time in DMs

Global trade is collapsing to levels normally associated with crises

The only incremental growth globally is coming from EMs

Wayne Gretsky-"Skate to where the puck is going to be, not where it has been"

# Emerging Markets- continued

Since 2000, US stocks have been over-valued 90% of the time

Europe is looking increasingly like Japan iro demographics. High interest rates are often a sign of economic health

Every time the US Fed goes from tightening to loosening interest rates, it always precedes a recession

EM share of global GDP keeps rising

EMs tend to have a better fiscal situation and more flexibility in debt markets

MSCI allowing Chinese equities into their indexes-moving from 2% to 20%

The strength of the US equity market has sucked the air out of EMs. "Being wrong is OK, staying wrong is not"

## EM Comparisons

- SA's budget deficit one of the highest, but inflation not too bad. 10-year bond rate one of the highest in EM, resulting in SA being a yield-seeker destination. Unemployment rate more than double that of Brazil

	GDP Growth %	Inflation %	Budget Balance%	10-Year Bond %	Unemp.%
<b>South Africa</b>	<b>1.1</b>	<b>4.5</b>	<b>-4.0</b>	<b>8.4</b>	<b>27.6</b>
Brazil	1.1	4.9	-5.8	6.8	12.7
Russia	2.7	5.2	2.4	8.3	4.7
India	6.6	2.9	-3.4	7.4	7.6
China	6.4	2.5	-4.5	3.2	3.7
Indonesia	5.1	2.8	-2.1	8.0	5.0
Turkey	-3.0	16.8	-2.3	19.5	14.7





# Mohamed A. El-Erian



The US is becoming the most protectionist country on earth



\$10 trillion of bonds globally trading at negative yields



*"A lot of unthinkables have become reality"*



An unusual amount of fluidity in the global financial system that is not going away.



US Fed's abrupt U-Turn last year



Synchronised pickup in global growth replaced by synchronized slowdown



Germany-growth rate slashed from 1.3% to 0.5% in 3 month this year



# Mohamed A. El-Erian continued

- Why did the global market get things so wrong? With the benefit of hindsight, US pro-growth policies, Russia's commodity woes improving, Brazil turning around, natural healing in Europe all added up to strong growth-BUT, it WASN'T synchronised!
- Many of the traditional instruments eg the US yield curve, are not functioning the way that they used to.
- US/China trade war-is it really? The Trump administration made the correct assessment that China was cheating but has decided to implement a non-cooperative approach with China to deal with the situation.

# Mohamed A. El-Erian continued

- Trade-The US is willing to take ST pain for LT gain-see Mexico and Canada-and the same is likely with China. However, China as yet hasn't caved like Mexico & Canada and the outcomes are thus becoming more uncertain.
- How much damage has been done to the international financial system after 9 years of QE etc?
- Reliable economic relationships are breaking down-eg The Phillips Curve
- Changed global relationships-the privileges that attached to being part of the stable "middle" in the US and Europe are breaking down.
- The middle is being hollowed out-this is naturally destabilizing or disruptive

# Mohamed A.El Erian continued

Unwillingness of mainstream economics to deal with its limitations

“Growing up, I was taught that DMs offered predictability and stability. That’s no longer the world in which we live”

Divergence is the name of the game in the new normal. The US, a closed economy, will continue to do relatively well.

Europe to remain slow-the Big 5 in EU; Germany, UK, France, Italy and Spain, all operating well below potential. Risking stalling.

Stretched financial valuations, depressed economic performance-gap filled by central banks-but for how long?

Beware of “active inertia”-making the wrong decisions even when you know what the right decisions are.



# Mohamed A. El-Erian continued

- Need a lot of cognitive diversity to avoid group-think
- Central banks will go from being part of the solution to being part of this greater complexity.
- The only thing preventing greater diversity of investment throughout the world is regulatory constraints.
- Every month that passes in the US/China standoff bolsters the US position. China has suffered far more than the US.
- The US/China standoff is no longer an economic issue but a national security issue.
- China's transition from being a manufacturing economy to a consumer economy is the most difficult type of transition and the US knows this.

# Conclusion



The existing world order is unravelling. This is providing massive disruption in financial markets and elsewhere.



Brexit will have a far-reaching impact transcending not just the UK and Europe but into the RoW.



Millenials will disrupt global society when they take over.



Inequality has become problematic for the survival of capitalism-if financial institutions don't take the lead in changing this, events will overtake them.



EMs are poised for a large turnaround in fortunes