Investment Strategy

Global Strategy | March 5 2020

In a slow growth world Covid-19 is not the major threat

Rethinking endogenous market risks, in particular "re-distribution" risk

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Key Points

- The **Covid-19** crisis must be viewed in the context of two major economic developments:
  - Post 2008-deleveraging has both diminished and stabilized US growth;
  - The US Business Cycle is decoupling from the global manufacturing cycle, and thus increasingly resilient in the face of the post-2010 *Great China Slowdown*;
- Deleveraged private sector balance sheets not only mean that growth is stable and shallow, it also means that any **Covid-19** induced growth slowdown, including a possible recession, will also be brief and shallow, in particular in those economies – like the US – that are more driven by services and software, rather than manufacturing and hardware;
- The **Covid-19** crisis will protract the current global manufacturing slump:
  - As such it will further exacerbate the structural disruption of traditional manufacturing sectors, at the advantage of those companies that are more service oriented and more reliant on software than hardware;
  - More manufacturing repatriation to developed economies, in particular to the US, could be an additional consequence of the **Covid-19** crisis;
- The outperformance of both the Stoxx Global Sharing Economy Index and the ECPI Circular Economy Leaders Index is perhaps discounting the reality of more stable but more shallow growth;
  - The resilience of some new economy stocks such as Microsoft, Facebook and Alphabet in the recent **Covid-19** induced meltdown seems to confirm US-China decoupling;
  - As does the resilience of the relatively small Chinext Index
- Stable and shallow growth come together with an increase in inequality and political polarization, in particular in the United States;
- Economic stability thus becomes the unexpected source of political instability
  - Once the **Covid-19** crisis subsides, political instability will re-emerge as the main cause for financial markets instability
  - Indeed, it is the reduced likelihood of a recession (whether caused by **Covid-19** or any other supply- or demand shock) which will make it more attractive for Trump to escalate, rather than de-escalate, trade tensions;
  - Ultimately the real political risk for financial markets is the election of a US President who will want to address economic inequality through "re-distribution of income".
- For financial markets "re-distribution of income" will become the major endogenous risk through the 2020s:
  - "Re-distribution of income" risk dovetails with our assessment of lower long-term equity returns;
  - "Re-distribution of income" risk is part of our broader de-globalization world and the long-term equity investment ideas which we have labelled under the Yellow Brick Road Themes. **Covid-19** is merely an additional booster of a de-globalization process that started at least a decade ago.

Investment Implications – maintaining our neutral equity allocation

- Markets will remain very volatile over the next months, yet deleveraging has already led to shallow but more stable growth in the US, making further significant equity meltdowns less likely. We maintain our neutral equity allocation;
- Significant slowdowns in Asia, and recessions in Europe, are likely as a result of **Covid-19**. We maintain an overweight in US equities, and an underweight in European and Emerging stocks;
- We could see a temporary rebound in the latter as soon as the **Covid-19** crisis subsides and global policymakers unleash stimulus. But over a longer horizon European and Emerging stocks will continue to underperform;
- In the fixed income space, we stick to short-duration Treasuries, high quality GCC bonds and only a few selective hard currency emerging markets.

What to make of Covid-19 (Coronavirus)?

In this note we will argue that healthy private sector balance sheets are a straightforward corollary of sluggish global growth. This has been ongoing for a decade now and coincides with the *Great China Slowdown*. It tells us that any **Covid-19**-induced slowdown, whilst still not totally quantifiable, should be transient and brief. If the contagion from **Covid-19** is contained, a reasonable assumption as we will explain below, that slowdown should be minor too. Equities, in particular US quality growth stocks, should thus gradually recover.

Covid-19 impacting supply chains as well as consumer demand

The **Covid-19** crisis is a striking example of an exogenous shock[1]. Investors know that there is little they can do about it, other than maintaining a well-diversified portfolio. For sure **Covid-19** delivers an immediate supply shock as production activities around the world slow down, thereby hitting all those manufacturing companies that are fully integrated into global supply chains, many of which originating in China. It also triggers a demand shock in terms of reduced interest for airline flights, casinos and amusement parks and resorts, movie theatres (already under pressure from streaming proposals from the likes of Netflix), as well as energy and shipping. Some of the major groups in these sectors will face refinancing, and even default risk, following rating downgrades. Critically, as we show below, in a deleveraged world where private sector balances are healthy in the aggregate (yes, you read that correctly), authorities should be able to absorb isolated credit events fairly easily, thereby preventing excessive disruptions to the real economy.

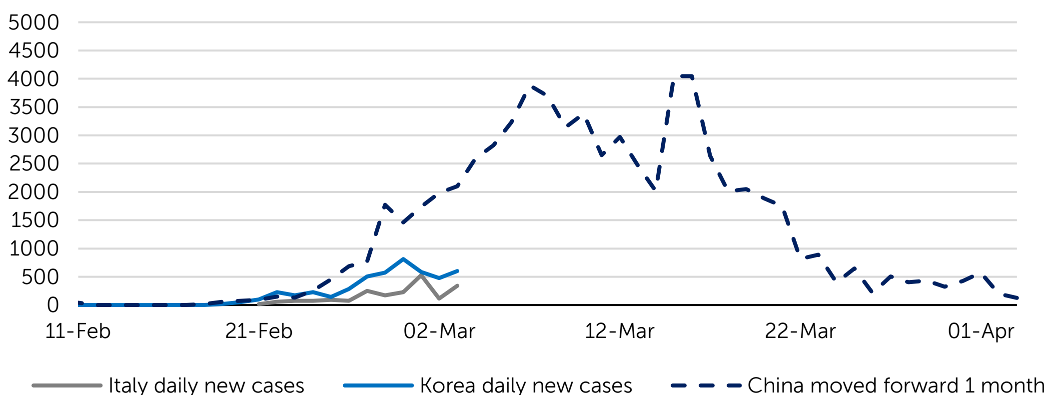
Market volatility determined by temporary unquantifiable risks

Markets hate exogenous shocks that carry new unquantifiable risks. When they happen markets become extremely volatile, undershoot, overshoot, perhaps undershoot again. After more than two months we are however able to say something about the **Covid-19** shock. China, in fact, has shown us that the spread of **Covid-19** can be contained. It has also shown us that, absent the full extermination of **Covid-19**, economic activities can still resume.

If China can contain Covid-19, so should others

Is there any reason why Korea and Italy – the two large economies outside of China that have been mostly affected – should not be able to succeed where China has? Other economies, from Europe to the US, are likely to see an increase in cases. They have by now received ample warning. In fact, it is worthwhile to notice that equity markets had started to stabilize when the daily new **Covid-19** cases started to subside in China. The recent corrections are related to an excess of complacency with regard to the risk of **Covid-19** spreading globally. Awareness that other countries can control the virus too, should thus help in stabilizing markets.

Exhibit 1: Will Korea and Italy be able to step in China*'s footsteps?



Source: Bloomberg and ADCB Asset Management | Notes: *The china data had an outlier on Mar 2 due to change in counting method

[1] Critics might disagree and point out how China's omnipresent "wet markets", and the lack of proper hygienic conditions in such markets, magnify the probability of zoonotic virus breakouts (a zoonotic virus is a virus that jumps from animals to humans). We would agree that in a very broad sense the Coronavirus is an endogenous shock. In fact, India is a giant country too, and it has much less resources to impose high sanitary standards. Yet, its completely different dietary habits make the outbreak of zoonotic viruses arguably less likely. Then again, from the viewpoint of any humble financial markets operator, all new and potentially lethal virus outbreaks are exogenous in that their occurrence is rare and practically impossible to predict.

But co-existence with Covid-19 virus is by now an inevitable and necessary scenario

The China experience, however, also tells us that containment does not equal total and immediate extermination. To some extent we will have to live with **Covid-19** and mitigate, as much as possible, the consequences. Whilst we consider an uncontrollable global outbreak of **Covid-19** an extremely unlikely scenario, it is perhaps worthwhile to reflect on the implications of such an extreme scenario. Doing so allows us to attach some parameters to the risks we are talking about. The unlikely "victory of **Covid-19**" scenario would mean the death of about 10 million people (i.e. more than 1% of the world population). This would certainly lead to a major global economic recession. Worse than the 2008 Great Recession? Not so likely, given that the fatality rate of people below 50 is not below 0.5%, whilst for the cohort between 50 and 60 it is still less than 1.5%. More importantly even, the Great Recession lasted 4 quarters. i.e. an entire year. The containment of **Covid-19** in China – combined with the recent pick-up in economic activities in that country - tells us that the worst case scenario is very unlikely. The relative strength of private sector balance sheets across the world further favour the scenario of a brief, rather than long slowdown. Coordinated action by the G-7 Finance Ministers and central banks – like the 0.5% rate cut already enacted by the Fed – will not resolve the crisis itself, but greatly help in sustaining demand once the rate of increase of **Covid-19** decreases, and thus the situation normalizes. US equity markets have already lost more than 10% as a result of the **Covid-19** fears. It is therefore reasonable to assume that at this stage US stocks, in particular quality US growth stocks, should stabilize and rebound.

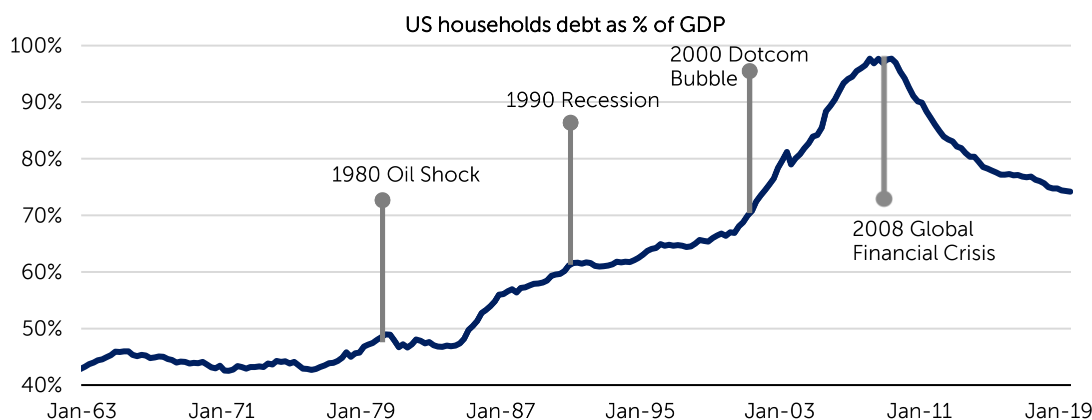
Beyond the Covid-19 distraction

Whilst we might have a hard time quantifying unprecedented exogenous shocks, we must try to assess endogenous risks facing financial markets. Endogenous risks, as opposed to exogenous risks, are risks that are generated by the system itself. It follows naturally that if the system changes, endogenous risks change too. Thus dramatic systemic changes, in particular in the US and China, impose a "rethink" of what could cause the next correction of financial markets, how that correction would pan out, and what kind of investment returns we can expect over the new decade.

QE has driven asset prices, but not created additional leverage

One thing has not changed, in our opinion. The US business cycle remains the key driver behind global growth, and as such behind the fortunes and losses of global financial markets, which are still highly interconnected. What is perhaps less well understood is the fact that over time, and through all its ups and downs, the US business cycle has never ceased to become more stable. Unfortunately, US growth has become increasingly shallow too[2]. But the crucial change of the last decade is that the US business cycle is no longer driven by debt expansion.

Exhibit 1:Household debt deleveraging and "The Great Shallowing"



Source: Federal Reserve Bank of St. Louis, Bloomberg and ADCB Asset Management

[2] See Appendix charts B and C

No overleveraging, no recession?

If US debt is no longer the main driver of the US business cycle, then perhaps it is no longer the most obvious endogenous risk behind the business cycle, the factor potentially triggering a US recession. Judging only from US debt levels[3], one could indeed at least make the case that the next recession should be shallow and short-lived. This is so because households will have to implement much smaller adjustments for any reduction in income level. Of course, critics would argue that it is difficult to pin down an exact level for what would be a sustainable debt to GDP ratio. To get a sense of debt sustainability one would also need to have a broad look at things like households' exposure to the real estate market and the equity market. After all the past recessions have been aggravated by corrections in asset prices further compromising consumer spending. As for the real estate markets they don't look overstretched[4]. Today US households are also much less exposed to equity markets, and saving a significantly large share of their income than they used[5] to. In sum, the simultaneous reduction in US household debt and wealth are most likely an important factor behind the reduction in growth over the last 10 years. But they may also have contributed to making growth more stable, less volatile.

The Great China Slowdown has so far been unable to trigger a global recession

Whilst debt in developed markets has remained by and large stable since the Global Financial Crisis, it has gone up in emerging markets and exploded in China. Is this the new big endogenous risk endangering the stability of global asset prices? Unlikely. For one thing, since 2013 the share of emerging markets in global financial markets has stopped growing[6]. Thus jitters in emerging markets are less likely to impact global financial markets. More importantly, the foreign ownership of bonds and stocks in China, the most important emerging market, is very low[7]. This greatly the reduces the scope for financial contagion.

But can there be economic contagion? If high domestic debt levels drive down Chinese growth, than surely that should impact global growth too? The answer is a resounding yes. It is also no news: it has been happening for the last 10 years! And, yes, dramatic slowdown in China's growth has gone together with lower global growth rates. Yet, whilst it has been particularly detrimental for China-centric commodity and manufactured goods exporting countries, the US business cycle has been relatively resilient. It is that resilience that has prevented the *China Great Slowdown* to trigger a major global recession. Whenever the Chinese authorities engage in some serious belt tightening, global manufacturing goes into recession together with those developed and emerging economies that heavily feed into China's manufacturing supply chain[8]. The **Covid-19** crisis is likely to push the Brazil's, Italy's and Korea's through an initial downturn, and then a rebound as China enacts stimulus. The US and other service economies are less likely to go through the same rollercoaster[9]. This was one major reason behind our call not to make too much of the Coronavirus concerns. Of course, the argument came easy to us because we are overweight US and growth stocks, at the expense of Emerging, European and so-called value stocks.

Covid-19, Industry 4.0 and the survival of US hegemony?

To be precise, the global manufacturing cycle has *not* vanished. It has simply become less important from the viewpoint of the US economy. For one thing, the global manufacturing cycle is no longer driven by the US but by China. For another, the US economy is increasingly less affected by it. In fact, and contrary to popular belief, 40 years of a rising Chinese economy have not led to a significant reduction in the weight of the US in the global economy[10]. It is of course too early to assess the exact extent of US decoupling from the global manufacturing cycle. Nonetheless, over the last 10 years it would seem that US services (80% of US GDP) are increasingly less affected by manufacturing. They should accordingly suffer much less from any **Covid-19**-induced slowdown.

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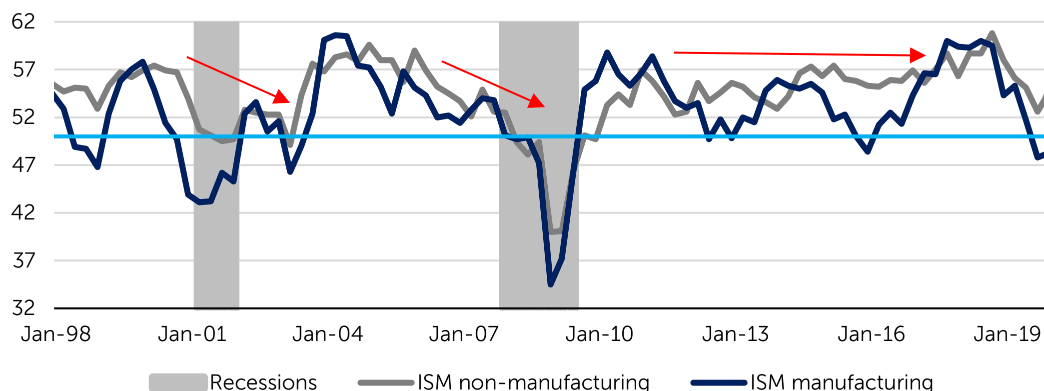
[3] See Appendix charts D
[4] US Home Price to Rent and US Home Price to Income levels are still significantly below the levels they attained in the run-up to the Global Financial Crisis. Real Estate Markets are arguably overvalued arguably only in Canada, Australia, New Zealand, Sweden and Norway. These are, however, relatively small economies such that overall debt has remained contained across developed economies (see appendix chart E).
[5] See Appendix charts and F and G.
[6] See Appendix chart H
[7] See Appendix charts I
[8] See Appendix chart J, where we use US manufacturing as a proxy for global manufacturing. Note that the impact of China stimulus on global manufacturing would be amplified when compared to the impact on US manufacturing.
[9] The importance of China for manufacturing and commodity economies is obvious from the way its huge current account surplus has shrunk over the last decade, implicating increasing imports from many countries. Yet, the current account surplus with the US has hardly bugged as China is simply not a major export market for the US. Not surprisingly, if there is one major economy that has hardly been affected by more than a year of trade tensions and the continuing slowdown in China's growth rate, that country is the US.
[10] See Appendix chart K

Exhibit 2: US services increasingly less sensitive to the manufacturing cycle?



Source: ISM, Bloomberg and ADCB Asset Management

A few thoughts about sharing and circular economies

Equity markets should discount transformations of the economy. Since mid-2012 the STOXX Global Sharing Economy index has outperformed the overall market (MSCI ACWI) by a stunning 367ppt[11]. Through digital networks, sharing economies allow consumers and companies to benefit from goods and services they were previously paying for. A particularly striking example is the cost difference between the *Encyclopedia Britannica* and today's online sources such as *Wikipedia* or anything else consumers *and* corporates can find on *Google*. Critically, such sharing not only has the potential of reducing GDP, whilst granting huge windfall profits to a few firms. It might also reduce GDP fluctuations since it creates a consumer surplus that allows for more savings. Such savings, in turn, should enable consumers to pre-empt eventual spending adjustments in case of a reduction of income. In addition to sharing, circularity is also transforming the economic landscape, at least according to the equity market. Over the last 10 years the ECPI Circular Economy Leaders Index has beaten the overall market with a more modest, but still significant 111ppt[12]. Circular economies are created by companies which reduce the acquisition of newly created inputs by recycling their own goods and services. Like sharing economies, such economies are not accounted for in GDP and like sharing economies, they have the potential of determining a rise in the consumer surplus. Critically, in particular sharing economies that are realized online, but also circular economies that reduce the manufacturing intensities of the global ecosystems, reduce – all other things equal – the impact of **Covid-19**.

Of course, one could ascribe the rise of the STOXX Global Sharing Economy index and the ECPI Circular Economy Leaders Index to a bubble. This is possible of course, and the valuations of the former in particular warrant caution. Bubbles, however, do not only give us a message of an eventually excessive valuation of inflated stocks. They also tell us a story about economic transformation, which can occur even when investors burn their fingers. At times the valuation is not excessive and investors do not get burnt. In the 19th century Charles Dow[13] pointed out that a narrow market, led by only one or two sectors (like carmakers or railroads), would inevitably lead to a correction if the other sectors would not pick up with the leading sectors. Dow's reasoning was quite simple: it is not possible for certain sectors of the economy to keep on making profits, whilst other stagnate.

Over the last decade, however, leading US technology juggernauts have disrupted and devoured companies operating in the *real* economy. By doing so they have transformed themselves, the real economy, and the equity markets. True, Alphabet, Apple, Netflix, Facebook, and Amazon have been leading the market as members of a specific sector (the tech sector), leaving other sectors behind. Today, however, these stocks are no longer mere tech stocks. Alphabet, Facebook and Netflix are communication services, and Amazon is consumer discretionary, leaving only Apple in the tech sector. The equity market (or benchmark) has transformed with the real economy. Instead of pulling other sectors, the leading tech sector has devoured the old sectors and morphed itself into (different

[11] See Appendix chart L
[12] See Appendix chart M
[13] https://www.marketinout.com/technical_analysis.php?t=Dow_Theory&id=43

modalities of delivering the goods and services) of those sectors. Furthermore, the "new age" companies are well diversified too, such that even Apple – "officially" still in the tech sector - has a good balance of manufacturing and services in its business. This means that, although in a way that is different from the way envisaged by Dow, the market has remained broad enough to be sustainable.

The dark side of economic stability

Of course, it is not all gold what shines under the sun. Reduced consumption and capital[14] spending has - through lower and more stable aggregate growth – increasingly depressed wage growth in the low- to medium wage segments. The increase in inequality in developed economies has in turn led to an increase not only in asset prices, but also in the prices of "key" goods such as health, education and housing (interestingly, whilst housing is obviously both a good and an asset, the same argument could also be made for health and education). The first two goods have become increasingly expensive in the US, the third one in many other developed economies. It seems that *Secular Stagnation* and inequality in developed economies are two phenomena mutually reinforcing one another. It is not entirely clear what the deeper forces behind this are. Some argue that it is historically high debt levels. Others relate it to ageing populations. Others again stress the absence of new technologies that are capital absorbing[15].

Secular Stagnation and the new endogenous risks

Whatever the deeper causes of Secular Stagnation, we would like to make two points that are essential from the perspective of investors. First, we do not expect the *Secular Stagnation* conundrum, and the relative economic stability that we associate to it, to be solved in the next two years. This has the immediate implication that over a two-year horizon the risks for financial markets will further shift away from the US business cycle to the US political cycle. This is so because low wage economic stability will remain a source of societal polarization, and thus political risks. Second, over a longer horizon US political risk will continue to rise, pushing the country increasingly versus redistribution from capital to wages, be that through fiscal, monetary or regulatory instruments. The Fed, as well as other developed economy central banks, will become increasingly irrelevant as autonomous decision making entities.

2020 elections: it is the polarization, stupid

US presidential elections are mainly a referendum on the incumbent with the country's economic conditions being the deciding factor. To be more precise, in the modern era all US presidential incumbents under whose tenure unemployment rose were not confirmed in office, whilst all incumbents which saw unemployment decline were re-elected[16]. In other words, Donald Trump is without any doubt the favourite candidate. Yet, whilst favourite, Trump's re-election is still far from reassured, and not really because we fear a **Covid-19**-induced recession, capable of triggering a significant increase in US unemployment. Why then? Simply because modern US society is split in two like never before, which means that *any* incumbent will have to fight for every possible vote.

2020: the paradox of US economic stability, a source of more, not less, political risks

Today's frontal societal polarization means that Trump will have to fight hard for votes in the key undecided – so-called swing - states, since in these states any political or economic development has the potential to flip the electorate in one direction or the other. To maximize his odds, he will want to galvanize the entire electorate on the one issue where there is bipartisan consensus and on which he can claim credibility. That is international trade. Now here is the catch. Precisely because Trump is aware that international trade tensions are today less likely to destabilize the US Business cycle, he might well be tempted to re-ignite trade tensions once the **Covid-19** crisis has subsided. This will give him an opportunity to reaffirm himself as the only man who stands up against China's "intellectual property theft" or, the next battle, Europe's "unfair trade barriers". We have thus run in the paradox of an unprecedented situation of economic stability becoming an important source of political volatility in 2020, with Donald Trump exploiting it for the purpose of re-igniting global trade tensions, and possibly also geopolitical tensions[17].

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[14] See Appendix chart N

[15] For a nice summary of the main issues related to *Secular Stagnation*, see Gordon, Robert J. (August 2012). "Is US Economic Growth Over? Faltering Innovation Confronts the Six Headwinds". NBER Working Paper No. 18315.

[16] The exception was Gerald Ford who, following the Watergate Scandal was not re-elected in the 1976 election. See Appendix chart N.

17 By trade tensions we mean the unilateral imposition by the US of tariffs on counterparts, such as China or the EU, with which the country has normal relations. By geopolitical tensions we mean the use of military action, or threat of military action, against

Exhibit 3: In a polarized society economic stability is a source of political instability

Economic volatility - chance of a significant recession	Trump's chance of re-election: Good but with narrow margin	Trump's chance of re-election: High with comfortable margin
High	• Strong but constrained incentive to foment trade tensions* • Strong and unconstrained incentive to foment geopolitical tensions* Result: High investment uncertainty and capital markets volatility	• Strong and unconstrained incentive to stabilize trade tensions* • Strong and unconstrained incentive to stabilize geopolitical tensions* Result: Low investment uncertainty and capital markets volatility
Low	• Strong and unconstrained incentive to foment trade tensions* • Strong and unconstrained incentive to foment geopolitical tensions* Result: Maximum investment uncertainty and capital markets volatility	• Not so strong and unconstrained incentive to stabilize trade tensions* • Not so strong and unconstrained incentive to stabilize geopolitical tensions* Result: Moderate investment uncertainty and low capital markets volatility

Source: ADCB Asset Management, *See footnote 16 for the distinction between trade tensions and geopolitical tensions

Moreover, the closer we get to the election the more likely Trump will communicate escalatory intentions (simply becomes the time window for a recession materializing becomes smaller by the day). The president of course also has the possibility to rally bipartisan support by igniting geopolitical tensions over security issues, with Iran being the most obvious candidate (but one should not exclude North Korea or tensions with China over Taiwan or Hong Kong).

2020 and beyond: "income redistribution" is the risk that won't go away

Unlike most commentators, we do not think that the leftist Sanders will immediately and permanently raise Donald Trump's odds of re-election, whilst the establishment candidate Biden would have a much bigger chance. For one thing Donald Trump remains the absolute favourite. But for another, the unprecedented degree of societal polarization makes all analysis based on past precedents less reliable. It is true, in the past, truly left-wing candidates - such as George McGovern - have suffered amongst the most bruising defeats as the American electorate would not stand for policies that upset free markets and private property. Yet, as a modern country the US has never faced Secular Stagnation and the decades of wage compression that have come with it. We would therefore caution against firmly discounting a Trump re-election once a left-wing socialist wins the Democratic nomination, if not only because of the dramatic policy shift[18] a Sanders Presidency would pose for financial markets. Moreover, given the obvious recent leftward movement of the electorate[19] that typically supports the US Democratic Party, if Biden would win the nomination, he would anyway be forced to introduce some "re-distribution of income" elements in his manifesto.

The US budget deficit will expand massively again this year, another thing – together with trade – Democrats and Republicans seem to be able to agree on[20]. Such massive deficit spending in the context of almost full employment is unprecedented and perhaps another indicator that the good old Business Cycle has vanished (at least the way we used to know it). It is worthwhile to point out, however, that at some point in time – possibly towards the end of 2021 – labour market tightness and higher wages should lead to some inflation. To us it is not clear whether the Fed will at that point have the courage or

countries with which relations are "less" normal, such as Iran or Korea, or non-State organizations who have the support of the latter. However, even between China and the US, geopolitical tensions – combined with potential military standoffs – can no longer be excluded, in particular with regard to the South China Sea or Taiwan.

18 We are talking about nothing less than the end of 40 years of persistent tax cuts, deregulation and de-unionization. For an economic assessment of the implications for equity prices, see in particular Daniel Greenwald, Martin Lettau, Sydney Ludvigson, "Origins of Stock Market Fluctuations".

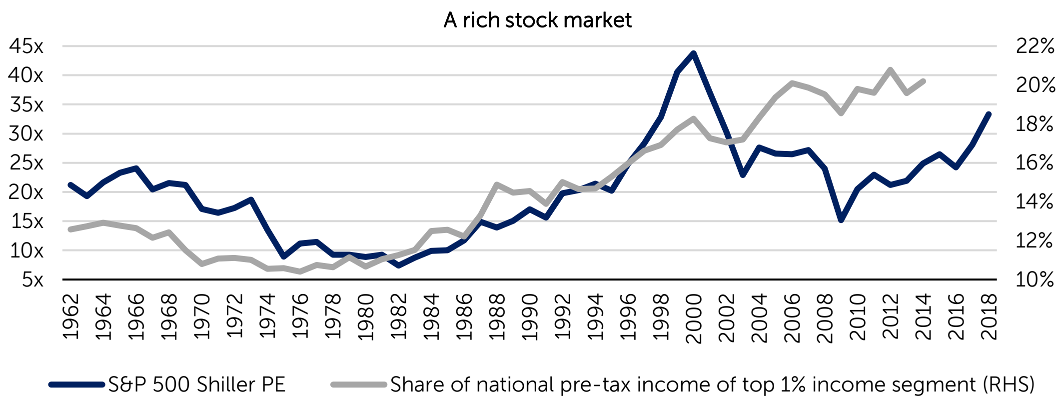
19 Not only is *Secular Stagnation* the most likely source of societal polarization in the US, it is also behind a marked shift in opinion polls. According to Gallup over the last 10 years Americans have become significantly more favourable versus a more active role for government, an increase in taxes, as well as regulation in businesses. This shift is bound to continue with the less wealthy Millennials and Gen Z generations taking the upper hand.

20 See Appendix Chart P.

political will to increase rates in a significant matter. Such abdication of responsibility by the Fed would confirm our hypothesis of increasing central banks' irrelevance. It might perhaps become the prelude to direct central bank deficit financing, a timeless tool for the redistribution of income that today is increasingly being discussed under the new label of *Modern Monetary Theory*.

One way to look at the risk of "income re-distribution" to equity markets is by linking inequality to cyclically adjusted (long-term) price / earnings (p/e) multiples. These multiples have the advantage, compared to the more commonly used p/e multiples, of providing a more stable indicator for earnings, i.e. the average earnings over the preceding 10 year period. Over the last 40 years this multiple has seen a steady rise, together with inequality, in the chart below measured as the share of pre-tax income going to the top 1% of income earners.

Exhibit 4: Higher long-term multiples go hand in hand with inequality



Source: Factset, World Inequality Database (www.wid.com)

Intuitively, a rising cyclically adjusted aggregate P/E in a low growth environment must be the reflection of increasingly lower costs, rather than higher revenues[21]. Again at the aggregate level, persistent cost cuts appear intrinsically unsustainable if growth (of revenues) remains shallow. In that sense the very high cyclically adjusted earnings imply long-term equity returns that are in the lower single digit[22].

We stress that the eventual unsustainability of high cyclically adjusted P/E is at least as much political as economic or financial. Economically, it is difficult to say for how long the transformative and disruptive technological juggernauts, such as the FAANG but also their slightly smaller offspring, can continue to command high valuations. After all, their business model might well continue to attract the bulk of consumer spending at a time that the capital costs for research and development might remain relatively contained. Be it as it is, the biggest risk to capital markets going forward is not **Covid-19**. It is political, and is specifically related to the possibility that redistributive "leftist" policies might at some point in time directly damage the interest of shareholders[23].

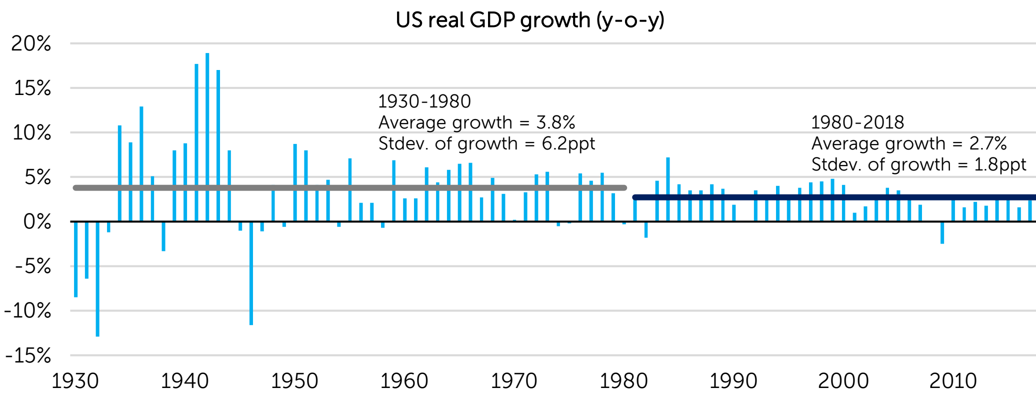
21 Note that the 10-year earnings average is depressed by the lower past earnings at the same time that high prices discount hopes for even more increases in earnings.
22 See also our paper Bracing for lower long-term equity returns written by our Equity Strategist Kishore Muktinutalapati.
23 Redistributive policies also have the potential of higher federal budget deficits, another way of taking resources away from capital and depressing long-term valuations. See Appendix, chart Q.

Appendix

Chart A: Valuations more reasonable after Covid-19 correction

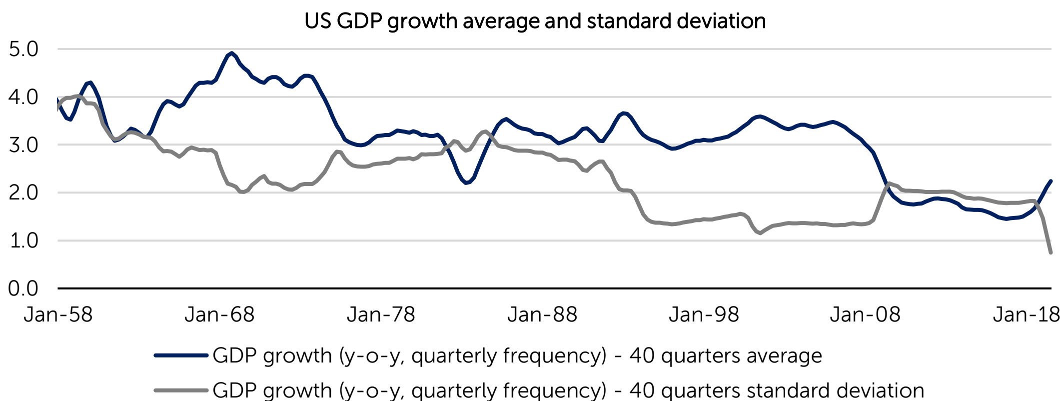
Source: MSCI, Bloomberg and ADCB Asset Management

Chart B: The Great Moderation in economic growth and economic volatility



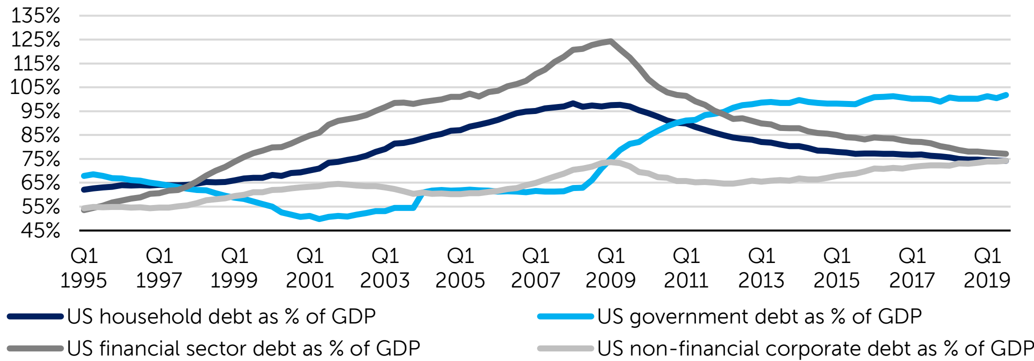
Source: Federal Reserve Bank of St. Louis, Bloomberg and ADCB Asset Management

Chart C: From "The Great Moderation" to "The Great Shallowing"?



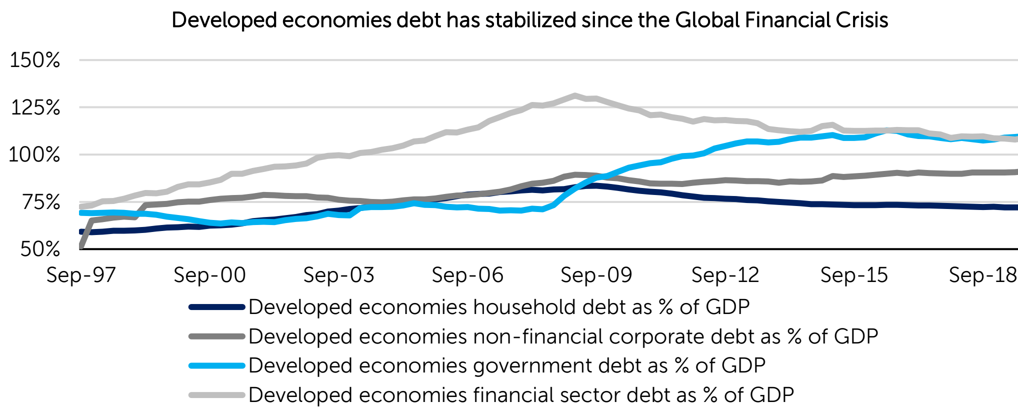
Source: Federal Reserve Bank of St. Louis, Bloomberg and ADCB Asset Management

Chart D: US debt has stabilized since the Global Financial Crisis



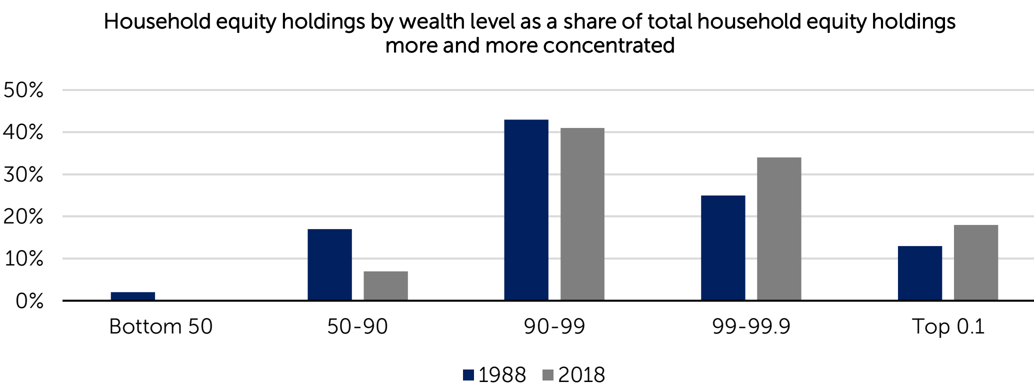
Source: Bloomberg and ADCB Asset Management

Chart E: Developed economies debt has stabilized since the Global Financial Crisis



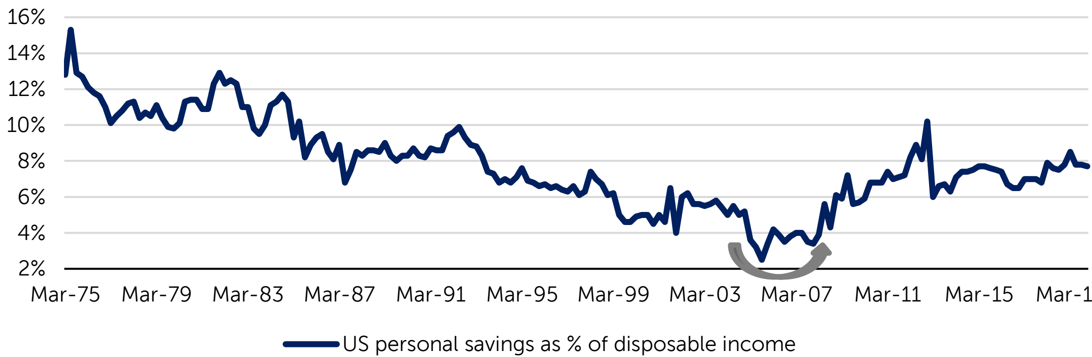
Source: Bloomberg and ADCB Asset Management

Chart F: Equity markets' fortunes less likely to affect balance sheets of most US households



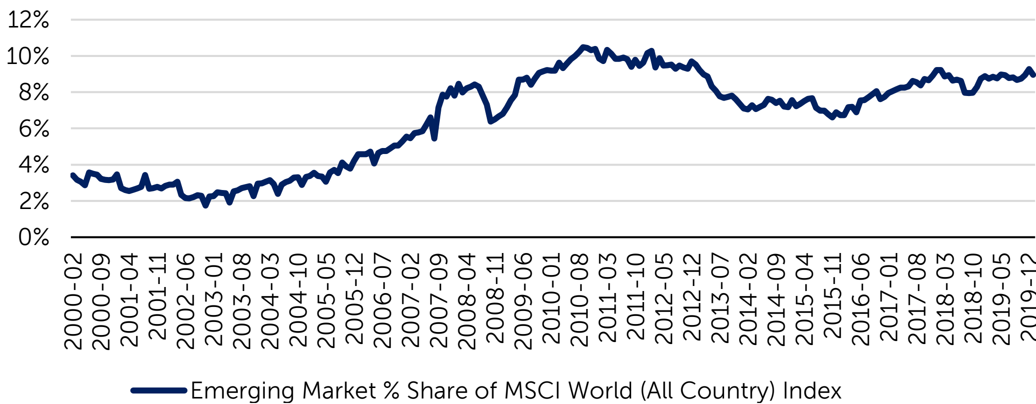
Source: Goldman Sachs Investment Research, Bloomberg and ADCB Asset Management

Chart G: US savings have been rising since the Global Financial Crisis



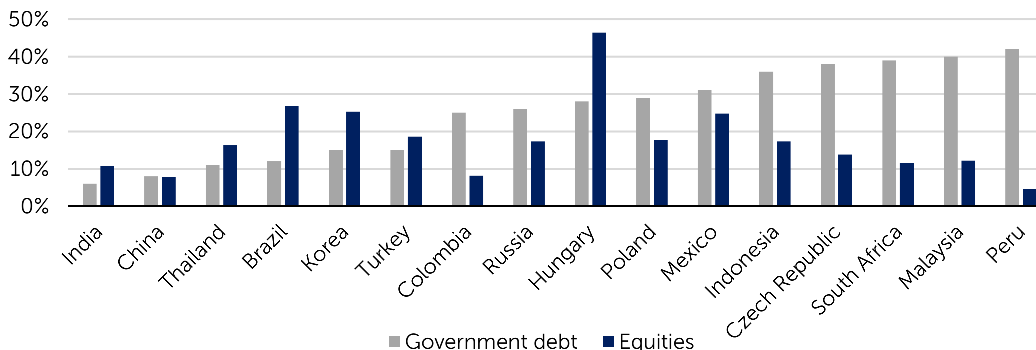
Source: Bloomberg and ADCB Asset Management

Chart H: Emerging markets surge over?



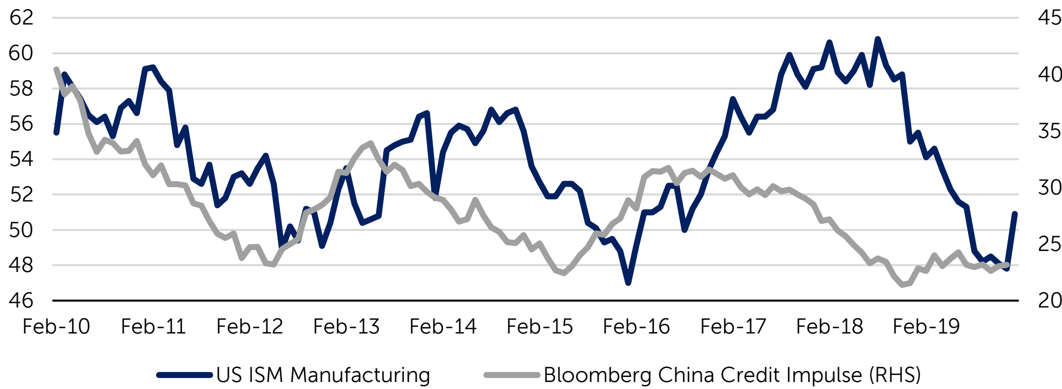
Source: MSCI, Bloomberg and ADCB Asset Management

Chart I: Low foreign ownership of China assets make China financial contagion less likely



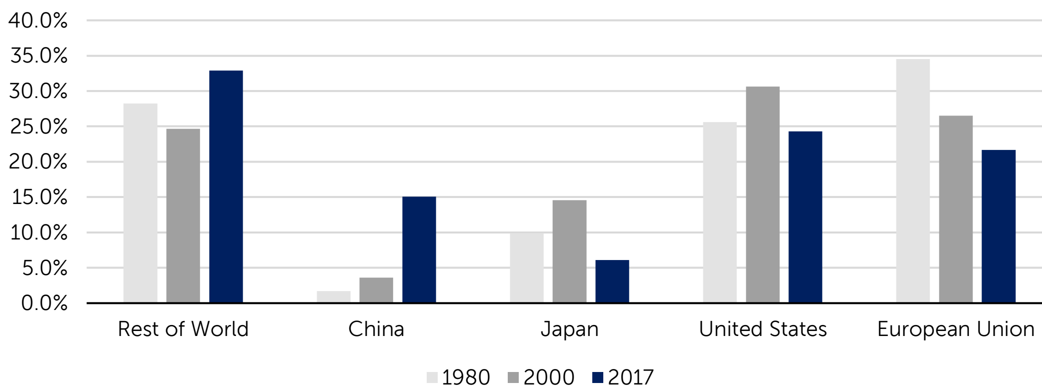
Source: Haver Analytics, Morgan Stanley Research, IMF, World Federation of Exchanges, Bloomberg and ADCB Asset Management | Notes: *derived as (A)/(B) where (A) Derived Portfolio Investment Liabilities of Equity Securities - Data obtained from IMF and (B) Market Capitalisation of domestic index - Data obtained from World Federation of Exchanges

Chart J: China credit impulse leads manufacturing sector



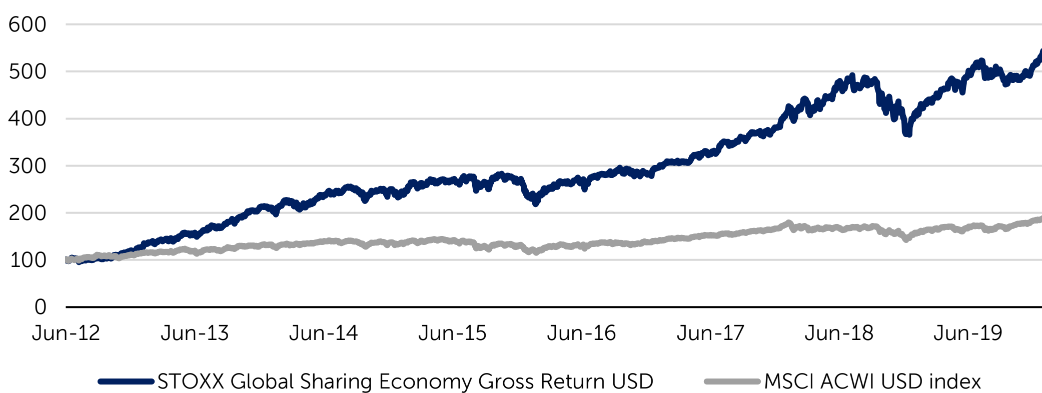
Source: Bloomberg and ADCB Asset Management

Chart K: US global economic weight more resilient than you think



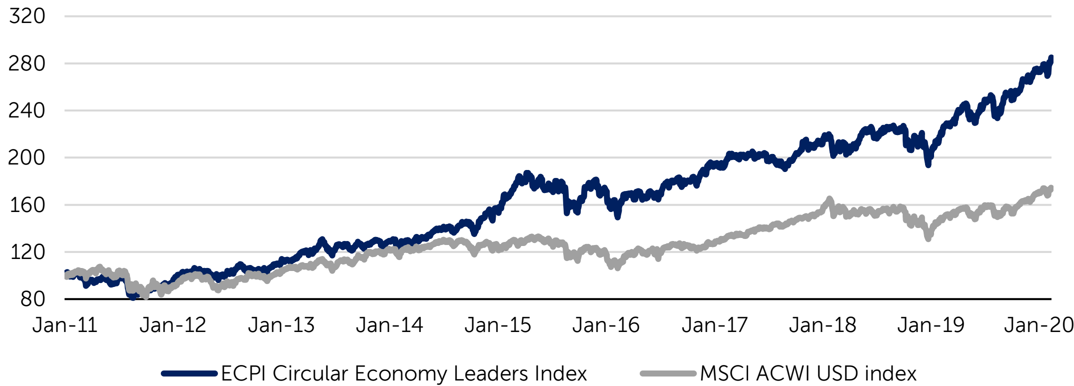
Source: Bloomberg and ADCB Asset Management

Chart L: Markets discount massive growth of the Sharing Economy?



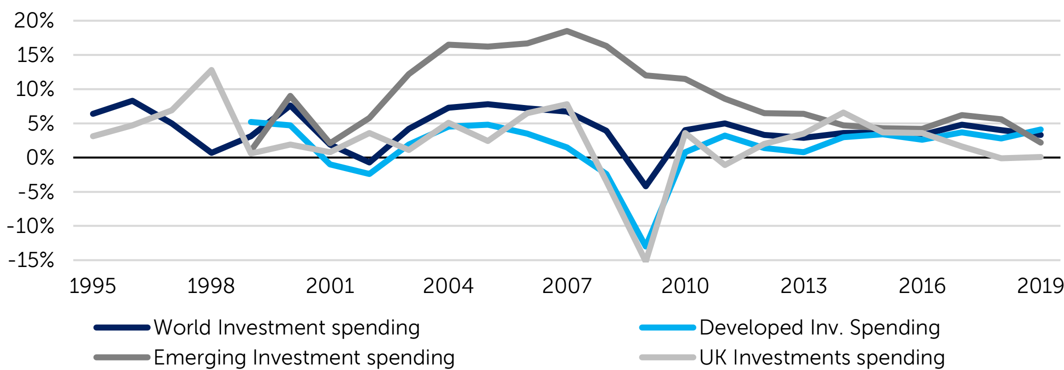
Source: MSCI, STOXX, Bloomberg and ADCB Asset Management

Chart M: Markets discount strong growth of the circular economy?



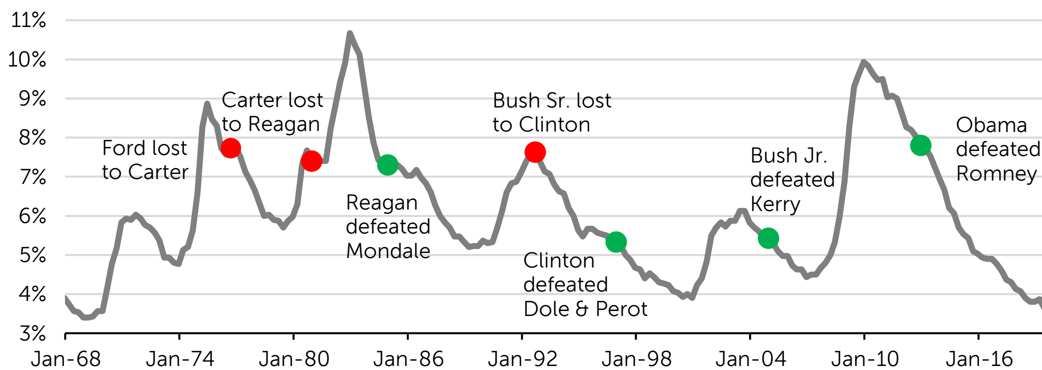
Source: MSCI, ECPI, Bloomberg and ADCB Asset Management

Chart N: Global investment spending is at best stagnating



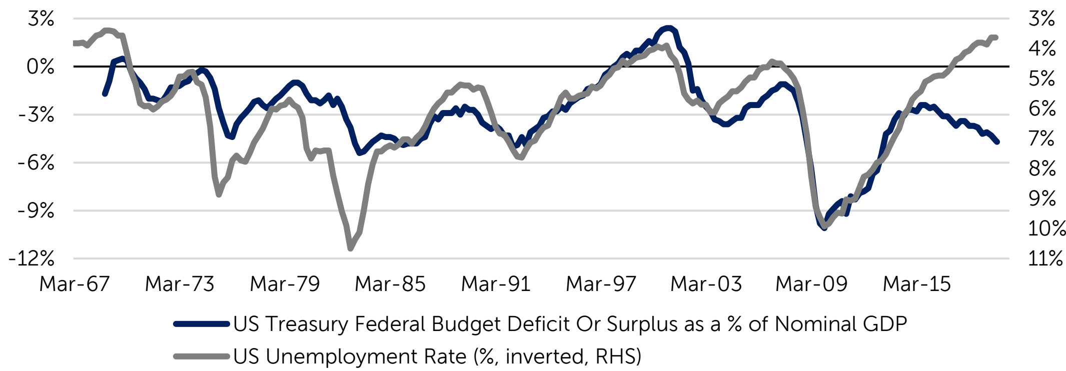
Source: HSBC, Bloomberg and ADCB Asset Management

Chart O: Rising unemployment breaks the incumbent's chance of re-election



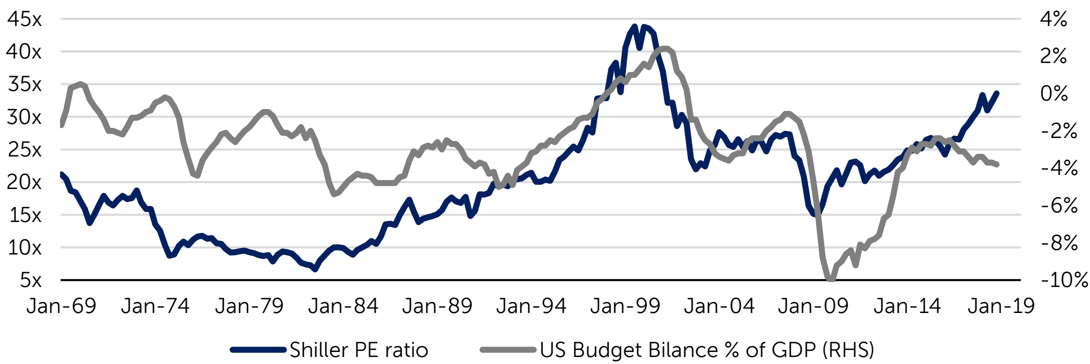
Source: Bloomberg and ADCB Asset Management

Exhibit P: Pro-cyclical stimulus in spite of very low unemployment



Source: Bloomberg and ADCB Asset Management

Exhibit Q: more government spending not good for long-term equity valuations



Source: Bloomberg and ADCB Asset Management

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTT News
4. Reuters
5. Gulfbase
6. Zawya

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