Australian Standfirst

Preparing For Tomorrow Today: What's Coming Next & Why

Asset Allocation

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The Global Financial (GFC, 2007-2009) and incumbent Corona crises are very different beasts but they do share important parallels and these are worth illuminating whilst proactively preparing for tomorrow's investment decisions today.

Today is the relative quiet between two storms.

Beyond the material fact that the crises have been triggered by two very different causes (one financial and the other a real-world medical event), the effects have eerie parallels, which presciently prepare us for what's likely coming next.

Similar to how the, 'Great War', escalated in importance and after the fact came to be known as, 'World War One' (WW1), the 2007 to 2009 Global Financial Crisis, or GFC, began as something else entirely and it was initially referred to as the 'Credit Crunch'.

[The Credit Crunch was a period beginning in April 2007, when a sharp rise in US, Californian sub-prime mortgages defaulted, triggering a credit crisis which then spread globally]

There was a time between the April 2007 Credit Crunch and the now accepted escalation point beginning in October and November of the same year and this window of time is worth comparing to today for several important reasons.

For those who have read Michael Lewis' biographical drama, "*The Big Short*", later made into the US Blockbuster by Adam McKay, the initial blow of the April 2007 Credit Crunch was not found in the step-change from bull to bear market sentiments but in the ferocity and speed of the change and subsequent contagion.

It is not insignificant then that March 2020's, '**Corona Crunch**', ratcheted-up the velocity levels even further, making it the fastest correction (retracement) in modern history.

But the analogy does not end at comparisons of haste, April 2007's Credit Crunch and March 2020's Corona Crunch share three additional and uncommon similarities – in both instances there was also a simultaneous collapse (or spike, depending on perspective) in all three traditionally uncorrelated market risks: equity risk (equity risk premia), credit risk

and liquidity risk.

These attributes (destructively) correlating not only reflect deeply distressed financial markets, they continue to communicate that there are malfunctions persisting deep within the plumbing of the global economy – "**Cheating, On Cheating, On Cheating**".

But this is known and even known before the onset of COVID-19.

acronym popularised by former Goldman Sachs Asset Management Chair, Jim O'Neill in 2001.

[BRIC: Brazil, Russia, India and China]

Initially attractive, the amassed interest in BRICs caused contagion in and of itself, simply because the vast majority of BRIC publicly traded debt was still priced in US Dollars, and this vicious feedback loop saw **BRIC opportunities lose their lustre** rapidly.

Today, April 2020, **precisely thirteen years** after the Credit Crunch began, the same inclinations are driving many to consider a rotation (a polite way of saying *Flight-To-Safety*) towards hard US Dollars themselves, US debt or similarly to the 2011's, 2012's, BRIC equivalents, today dubbed, Emerging Markets, or EM's.

In 2020 that would be a mistake.

> "Where the road bends abruptly, **take short steps.**"

What is also known is that we will not find an economic bottom until the real-world health challenges stabilise, as again, the Corona Crunch is a crisis stemming from a real-world trauma, and one yet far from resolved.

British author, Ernest Bramah expressed it the simplest, "*Where the road bends abruptly, take short steps*".

Taking short near-term steps remains prudent and illuminating what transpired between April 2007 to October/November 2007's informative but there remain crucial differences between these two beasts.

Despite the Credit Crunch predominantly at fault of the Americans, when the global system shook, *Flight-To-Safety* in 2007 still meant a rush to the US Dollar, or Greenback, Treasuries as had recurred since the dismantling of the **Bretton Woods system** four decades earlier.

Those who moved fast between April and Christmas 2007 initially found refuge until the beast transformed again thanks to the aforementioned simultaneous collapse of equity, credit and liquidity risks, morphing the American beast into a European Medusa: **2011-2012 Grexit fears**.

Fleeing the euro bloc, many moved their focus to the still glamorised, BRIC bloc, an

Despite the effects of these two crises having eerie parallels, the causes of them remain inimitable and until an economic bottom is found only after the real-world health challenges stabilise, not only do we not know when the second storm will hit, we can't today pre-empt the eye of that storm.

After all, when you think you may be one step ahead of the crowd, you're a genius but when you believe you are two steps ahead, 'you're a crackpot'.

The US Dollar in the era of **Trumponics** has wobbles and Emerging Markets, or EM, today remain structurally weak as a collective asset class; impulses of 2007 belong where they began, in history and preparing today for tomorrow involves a sober reassessment of the risks surrounding all knowing that until the Novel Coronavirus trauma stabilises, deciding what to do more than two steps ahead is a fool's errand.

The important lesson learnt from the April 2007 Credit Crunch was that sudden economic stops have lasting consequences, returning escalation points and likely more serious challenges ahead.

Proactively preparing for tomorrow involves acceptance of this as much as it does specific portfolio repositioning.

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