Australian Standfirst

More Money Will Be Made In Financial Markets In The Next Two Years Than The Past Twenty Combined: Reflation, Cost Of Capital & Pricing Systematic Risks

Portfolio Attribution

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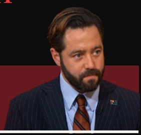

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When assessing over the coming thirty months, any number of likely geopolitical and economic scenarios unfolding here in Australia, the United States, China or the Euro bloc, all roads lead to Reflation – Sovereigns increasing attempts at stimulating economic activity by augmenting the money supply in lieu of sterling productivity growth or unadulterated '*animal spirits*'.

In all *six ways from Sunday*, "*real assets*", equities and hard commodities (distinct from soft commodities) will not only ratchet higher, they will become increasingly difficult to value, given increasing liquidity conditioning further decouples fundamentals from valuations.

Printed money distorts everything.

Looking through to the governing dynamics, over the past eleven years, Quantitative Easing ('QE') and every derivative thereof [*Helicopter Money*, MMT, UBI, et cetera] has repurposed fixed income products – bonds are today a funding tool and no longer a genuine investment vehicle in and of themselves.

Cite:- No to Universal Basic Income (UBI), 3 July 2019

Cite:- Modern Monetary Theory Or MMT, 1 April 2019

Cite:- 'End The Fed', 24 September 2019

Unlike the Reflation cycle that followed the ***Great Recession*** (2007-2009), which ostensibly involved limited unconventional monetary experiments by the Euro bloc, Britain, Japan and the United States, the still nascent ***Great Corona Crisis (GCC)*** Reflation periodicity involves a far wider Sovereign participation base and also extent; previously "*unconventional monetary experiments*" are now conventional monetary programmes and countries including Australia, China, Indonesia, Israel and many others today deploy QE programmes with prejudice and increasing haste.

In each idiosyncratic sovereign scenario, augmenting the money supply appears ineluctable – in the United States, whomever wins Georgia's Senatorial run-off elections in early January and even whomever takes office Wednesday, 20 January 2021, will require the US Federal Reserve to step in and reflate the money supply (to synthesise inflation in lieu of productivity growth and to fund Congressional spending) and the US Federal Reserve's FOMC will likely take new action at its sixteen to seventeen December meeting, laying out a more-detailed bond-

RANKINGS OF EQUITY EXCESS RETURNS BY DECADE

1950–2019 • US Dollar

	1950s	1960s	1970s	1980s	1990s	2000s	2010s
BEST	JPN	AUS	JPN	SWE	USA	AUS	USA
	DEU	JPN	CAN	JPN	CHE	CAN	SWE
	FRA	CAN	AUS	GBR	SWE	CHE	DEU
	ITA	EWB	GBR	ITA	FRA	EWB	JPN
	EWB	USA	EWB	EWB	GBR	SWE	FRA
	USA	SWE	SWE	FRA	EWB	GBR	CHE
	AUS	DEU	USA	DEU	DEU	FRA	EWB
	GBR	GBR	CHE	USA	CAN	USA	GBR
	SWE	CHE	FRA	CHE	AUS	DEU	CAN
	CAN	FRA	DEU	AUS	ITA	ITA	ITA
WORST	CHE	ITA	ITA	CAN	JPN	JPN	AUS

Source: Global Financial Data, Inc.

buying programme, shifting its purchases to longer-dated Treasuries, and if needed, speeding up the pace.

Even though quantitative easing is a very imperfect substitute for a credit market backstop, it has become the mechanism of choice for the FOMC.

During a time when foreign demand for US Treasury's continues to decline, the US is set to issue a net US$2.4 trillion while the FOMC has only committed (thus far) to monetising less than half of this, a stark reversal from 2020 when Jerome Powell purchased every dollar of debt sold by US Treasury Secretary Mnuchin.

In China, the development of the domestic bond market has been a major focus for China's policymakers, both for genuine sophisticated motivations but also to better predicate nativist QE programmes for the post-GCC reflation recovery.

With China's current account moving into deficit, the Politburo will be far more focused on finding its own foreign investors rather than funding US deficits via US Treasury auctions.

The past few years have seen tighter Chinese regulations on the shadow banking industry and continuing efforts to reduce the heavy reliance on bank loans.

As a result, the securities markets have become a more important source of financing and the China domestic bond market has seen continued rapid growth.

At the end of September 2020, the amount of domestic bonds outstanding reached RMB 111tn (US$ 16.3trillion), over fivefold larger than a decade ago

Irrespective of what the Bank of Japan (BoJ) did during the Great Recession Reflation with regards to Quantitative and Qualitative Monetary Easing (QQE) programmes, the current Chinese domestic bond market expansion is still expected to overtake Japan as the second-largest bond market in the world, ranking only behind the United States sometime in the nearing months.

The inclusion of China Government and policy bank bonds into major global bond indices are indicative of the reforms that have taken place and the recent policy relaxations for the Qualified Foreign Institutional Investor (QFII) scheme suggest reform measures are continuing.

Reflation doesn't always transmute from bonds to equities in a linear fashion, as the Bank of Japan's COVID-response initiatives evidence – after struggling for the first nine months of 2020, Japanese equities have since outperformed, with the USD-based Nikkei 225 rising eight percent, nearly matching the US's S&P500, up nine percent *Year-To-Date* and the rally in technology-tilted MOTHERS index (forty six percent in US Dollars, thirty nine percent in Yen) outperformed the US's NASDAQ which is up thirty three percent *Year-To-Date*.

But the greatest candidate for Reflation is found in Australia – Australia's average annual growth of about three percent since 1991 was driven by immigration but with it persistently falling real wages and an alarmingly asymmetric economic dependency on the ascent of China.

Cite:- Australia Begins Quantitative Easing, 17 March 2020

The Australian dollar's recent strength has eroded the economy's competitiveness and It will take a large-scale rise in export volumes, to offset the effect of a stronger currency – this will not come from a sanctimonious China.

Cite:- Market Microstructure Theory and the Australian Dollar, 14 August 2019

China has slapped tariffs and non-tariff barriers on a range of Australian agricultural and food products and threatened more actions due to Canberra castigating Běijīng over its treatment of Hong Kong and calling for an inquiry into the pandemic's origins.

The Reserve Bank of Australia (RBA) has said that the use of negative rates is "*extraordinarily unlikely*" – as this would impinge on the money multiplier function the 'Big Four', Four Pillars Policy shielded banks provide – thus the RBA may turn to targeting longer-dated bonds, or assets like mortgages, to help narrow credit spreads and so stoke domestic lending.

The RBA whom avoided QE and the gravity of Zero Interest Rate Policies (ZIRP) during the ***Great Recession***, can now, no longer afford to stay on the sidelines and whether through words or actions, will dramatically augment the Australian money supply, if only to offset the currency's outperformance impeding economic recovery.

As the table unassailably evidences, those whom augment their money supply in lieu of sterling productivity growth, in the short term enjoy excess returns whatever the longer-term systemic costs and risks may inevitably be.

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