Australian Standfirst

What People Misunderstand About Investing In The 2020's:
Where The Outperformance & Money Is Being Made

Portfolio Attribution
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In the early 1840's French mathematician Urbain Le Verrier, predicted the existence of Neptune using disturbances in the orbit of Uranus and achieved this solely through written calculations and deductive logic (it took several years for the planet to first be observed at the Berlin Observatory). Emboldened by hubris and prophetic arithmetic, Verrier then tried to convince the scientific community that an intermercurial planet – dubbed Vulcan – existed between Mercury and the sun, explained by the peculiarities of Mercury's orbit as a result of the gravitational influence of another unknown and speculated nearby planet. The existence of Vulcan wasn't confuted until Einstein's 1915 theory of general relativity evidenced that Mercury's departure from an orbit predicted by Newtonian physics was explained by effects arising from the curvature of spacetime caused by the Sun's mass and not another speculated planet. It turns out deductive logic and hand written arithmetic only gets you so far.

In the ides of the 2020's, many global investors now feel that the deductive logic that worked for them for forty years (1971 until 2011) now doesn't and continuing to follow modish investment strategies and secular themes only leads to confusion, appears contradictory to what we've all been taught and to boot, is unnecessarily complicated, leading many to *Risk Off* (selling) when they should have been *Risk On* (buying).

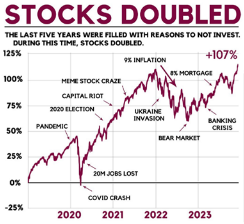
Cite:- Risk On 2019-2020, 23 October 2019

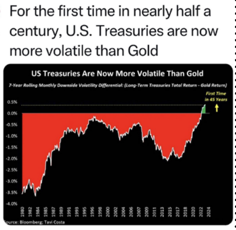
Take for example, the Corona Crisis, the pundit's narrative since March 2020 was to exit nearly all Risk Assets and yet exactly four years later to the week, the bellwether US stockmarket has doubled and gold (the ultimate *Risk Off* darling) is less volatile than US Government debt >> there is, understandably, something in this calculus that has been misunderstood and missed by many.

Cite:- 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, 23 November 2020

Cite:- Cheating, On Cheating, On Cheating: Maintaining Portfolio Quality In The Era Of Cheating, 13 March 2020

Following the Global Financial Crisis, or GFC, the US equity market experienced a notable increase in value, this growth surpassed that observed in other major markets, resulting in the US holding a significant fifty percent share of global market capitalisation. A robust analysis of post-GFC equity market performance suggests that the US market's outperformance and growing dominance can be attributed, in part, to superior earnings growth compared to its international counterparts. Analysis of post-crisis market performance reveals three key factors contributing to US dominance. Firstly, the US market exhibits greater exposure to high-growth industries compared to its global





counterparts; this is particularly evident in the technology sector, which has experienced significant expansion relative to slower-growing, traditional sectors like banking and commodities which dominate pan-Asian and Eurobloc listed bourses. Banks needed to recapitalise and cut dividends, while commodity-related companies suffered from falling prices as end-demand was weak.

It is also worth remembering that the current dominance of the technology sector, even in the US equity market, is not unprecedented relative to other dominant sectors in the past. The Information Technology and Communications industry is the biggest but this is by no means exceptional. Over the past two centuries, the biggest industry represented in the stockmarket at each point in time has reflected the major driver of economic growth. The Technology sector is about the same size as the Energy sector was at its height in the mid-1950's. It remains smaller in the index than both Transport (which dominated in the 20th century) or finance and real estate which drove the dominant part of the equity market in the 19th century. The very rapid growth rates in companies associated with AI has fuelled a further rise in the relative exposure of this sector but it is about the same size as the energy sector on a relative basis at its peak in the 1950's.

Secondly, the high correlation between the US market and other markets reduces the diversification benefits often associated with international investing, particularly in Europe which in turn muted the popularised secular narrative of a global recession since 2019 (which never came and was never coming).

The third and ultimately pinnacle factor contributing to US investment returns dominance has been the full deployment of the once-academic but now laboured and fully executed, ***Modern Monetary Theory, or MMT***.

Cite:- MMT, 1 April 2019

MMT recognises that a developed currency-issuing government such as the United States faces no financial constraints on its spending. This means that the government is not like a household, which uses the currency that the government issues. It also means that the government can purchase anything that is available for sale in that currency, including all idle labour.

In the context of the United States, MMT suggests that the government has the ability to finance its spending by directly creating new money. This process, often referred to as "*printing money*" involves the Federal Reserve (the central bank of the United States) creating new reserves through various mechanisms, such as purchasing government bonds or other assets. Subsequently, these freshly minted reserves can be leveraged by the government to underwrite its expenditure initiatives, thereby circumventing sole dependence on public taxation or borrowing.

This disposition goes a long way to explaining why gold has become less volatile than US Government debt since March 2020 and why muted US quantitative tightening, or QT has underwritten US and Japanese equity bourses **out until 2028 or thereabouts**. {Japanese Reflation is highly reactive to ten-year US treasury yields, ten-year "*breakevens*" and the Greenback-Yen carry}. This is because printed money crowds out the institutional debt markets and pushes that liquidity higher up the capital stack into listed equities.

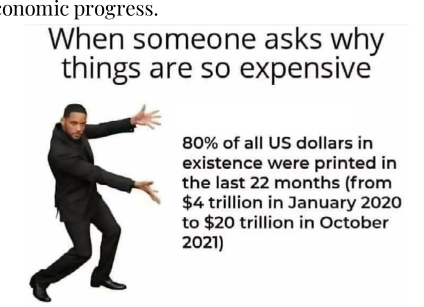
Cite:- The Reflationary Effect Of Muted QT: Evidencing The Stimulation Of Residual Printed Money, 27 February 2024

Cite:- Japan's Secular Bull Run: The Foreseeable End Of YCC & NIRP In April, 4 March 2024

Cite:- Japan Since Abe's Assassination: 2023's Topix Index-Level Appreciation & The Legacy Of Abenomics, 2 December 2022

US equity valuations have expanded and driven seventy percent of the bellwether S&P500's 2024 *year-to-date* return. The aggregate P/E has increased from 17x in late October to 21x and currently ranks in the 90th percentile since 1985. However, the latest leg of valuation expansion has not been confined to the mega-cap stocks. The equal-weight S&P500 P/E has also increased from 14x to 17x and now ranks in the 92nd percentile.

Supporters of MMT postulate that the framework in and of itself, provides a superior lens for understanding the operations of the monetary system and the capacities of the currency-issuing government within that system. Detractors flag legitimate concerns about runaway inflation, misappropriations (as often is the case with government sector spending) and economically, the fact that further manipulating the broad monetary base adds little to nothing to productivity growth, which after all, is the only demonstrated catalyst of real and meaningful economic progress.



All considered, biases for or against MMT become moot points when it is becoming abundantly apparent that the climate of this era is turning to unhinged monetary mechanics at a national political level and as the 2024 US Presidential barnstorming begins, do not be surprised to hear the term MMT finishing the sentences of promises spruiking universal healthcare, border enforcement and unequivocal US military hegemony across the South China Sea.

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