MONTHLY BAROMETER
PRESCIENT & SUCCINCT ANALYSIS OF WHAT'S OUT THERE

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- 2017 ends with the world economy performing well and in better shape than expected this time last year. Yet, three dark clouds hang over the global economic outlook: **(1) stagnant real wages, (2) increasing inequality and (3) weak productivity**. Even so, next year, global growth could exceed 3.5%, but this aggregate number doesn't tell us much about economic and social welfare: in a majority of high-income countries, people have a job, but most feel neither rich, confident nor secure.
- **In 2018, inequality will be by far the greatest socio-economic issue**, and could even constitute a threat to democracies. Since 1980, inequality has increased rapidly in the US and Asia, moderately in Europe while remaining stable but at an extremely high level in the Middle East, Africa and Brazil. Since 1980, globally, the top 0.1% has captured as much growth as the bottom half of the world adult population. To prevent the rise of 'plutocratic populism', taxes and public spending will be the policy tools increasingly employed to reduce inequality.
- **In the short term, Trump's $1.5tr tax cut will energize the US economy** by boosting GDP growth, with two immediate consequences in 2018: (1) the US economy will outperform the rest of the world; (2) the USD will appreciate. Beyond that time horizon, **the tax law will start generating higher than expected fiscal deficits** – a rise in inflation and a contraction in social spending.
- US news will dominate in 2018. Trump will deregulate the economy further and will promise to spend more on infrastructure – possibly **securing his way to win a 2nd term**. This will provoke a heightened level of polarization and raise the prospect of civil unrest and un-governability. As the US retreats into a form of modern isolationism, global market uncertainty will rise.
- Despite all the evidence that the EU is on the mend and doing much better than many expected (in terms of growth, employment, capital investment, managing the migration crisis, containing populism), the conventional wisdom around much of the world still maintains that Europe is in irreversible decline. It is wrong. **Three recent developments support the argument that EU cohesion will strengthen**: (1) Trump – who (in Merkel's words) "is forcing Europe to take its fate into its own hands"; (2) Brexit – showing how painful exiting can be; (3) Putin – convincing the reluctant Europeans that it's safer to be in than out. Beware complacency, but there are good reasons for long-term investors to be 'long' Europe!
- **Brexit and Macron are powerful examples of what narratives** (negative for the former, positive for the latter) **can do to economic performance**. A year ago, it would have seemed inconceivable that France could raise more venture capital than the UK, but a 'wow' factor brought €2.7bn in the first 8 months of the year, compared with €2.3bn for the UK. A feel-good factor is now self-fulfilling, drawing technology talent back to the EU - capitalizing on its strength in education, infrastructure and quality of life. **In 2018, innovation will make a comeback in Europe**.
- Moody's – a leading rating agency – just decided to weight more heavily risks associated with climate change when evaluating creditworthiness. The consequence: **the cost of borrowing will increase** for states, regions and local authorities that are more susceptible than others to extreme weather events. In turn, this means that **people living in these places will have to pay more taxes**. The consequences are twofold: (1) as shareholder activists fight climate change, the risk for stranded assets will increase; (2) the value of assets that are particularly vulnerable (in coastal or heat wave areas for example) will decrease.
- As shown by different indices, **volatility has never been lower** – in 2017, shorting the VIX index returned 170%! How long can this last? The cocktail composed of (1) ultra-low interest rates, (2) over-leverage, and (3) financial engineering that drives asset allocation based on low volatility may prove explosive. Any market setback could be amplified by the feedback loop between these three ingredients, implying that **just one tiny trigger could provoke dramatic consequences**. No wonder many of our subscribers favour capital preservation…
- KSA's Crown Prince Mohammed bin Salman (MbS) is suffering retribution in kind for his anti-corruption campaign. Recent media reports revealed that, on top of the yacht he acquired for $500m in 2015, he is also the buyer of da Vinci's *Salvator Mundi* (for $450m) and the world's most expensive property (a folly near Paris for $300m). **Such conspicuous extravagance smells of hubris and is hard to reconcile with plans for fiscal austerity and financial discipline.** MbS has started to liberalize a stifled society and made in the process powerful enemies, but in the end it may be his own hubris (which impairs judgement, leading to flawed decisions) that proves to be the greatest threat to successful reform.
- Bitcoin is in a (deflating) bubble, but its phenomenal rise (from 39 cents to $18,000 in 8 years – now down to $14,000) portends a seismic change: **social trust in most human institutions** (government, media, business, etc.) **is waning and shifting to technology**. In 2018, the Bitcoin bubble will continue to deflate, but crypto-currencies will continue to rise inexorably.
- **AI's move to centre stage was** one of the most notable things of 2017. 2018 will see it engulf our personal and professional lives. This is reflected in the rise of the US Faamgs (Facebook, Amazon, Apple, Microsoft and Google: worth $3tr between them and up 63% this year) and the Chinese Bats (Baidu, Alibaba and Tencent: worth $900bn and up 80%). They epitomize a world of capitalism without capital, in which intangible assets create the most value. Unlike a piece of land or a factory, the value of intangible assets is hard to measure for it lies purely in 'expectations'. **This makes them prone to asset bubbles.**
- In Q1 2018, top **"must-watch" issues include**: (1) Whether Trump will cause a significant deterioration in US-China trade and/or global trade relations; (2) How China will deleverage without sacrificing too much growth and how this will affect the exponential increase in household consumption; (3) The effect of a $ appreciation and/or slowing China on EM, particularly Latin America; (4) Signs of a possible UK snap election, bringing Corbyn to power; (5) The vast array of geopolitical and societal risks – all interlocked and most potent in EM (with a focus on the Middle East and the Korean peninsula). **For real-time / in-depth analysis on any of these, please contact us.**