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[Markets]

I've been thinking about...

... the “old normal” and
what it means for the future

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portfolio
construction

CONFERENCE

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1. The Old Normal – The Long Cycle:

A confluence of a number of Long Cycles at this current time, incl:

1. **Kondratieff** Commodity Super (20-30 yr cycle)
2. **Kindleberger** cycle; regarding the handover of world economic primacy – i.e. from US to China and/or India (100 year cycle)
3. **Howe & Strauss** Generational Cycle (80-85 year cycle); driven by ebbing and flowing of generational memory – Howe & Strauss's view = currently entering Fourth Turning – crisis period (2005-2025?)
4. **Toynbee** – 80-90 year cycle of peace and war...

The Long Cycles:

1a. Kondratieff Commodity Super Cycles (1780 – today)

US Commodity Super Cycles (1780s – today)

Start of super cycle	End of Super cycle	Size of Super Cycle	Length of cycle (years)	Index
Mar-1788	Dec-1814	135%	26.8	Warren and Pearson
Dec-1814	Feb-1843	-62%	28.2	Warren and Pearson
Feb-1843	Aug-1864	208%	21.7	Warren and Pearson
Aug-1864	Jun-1896	-70%	31.8	Warren and Pearson
Jun-1896	April-1920	218%	24.0	Warren and Pearson
Apr-1920	Jun-1932	-80%	12.2	CRB monthly
Jun-1932	Jan-1951	689%	18.6	CRB monthly
Jan-1951	Jul-1968	-40%	16.6	CRB monthly
Jul-1968	Oct-1980	215%	12.3	CRB monthly
Oct-1980	Oct-2001	-31%	21.0	CRB monthly
Oct-2001	today	129% (to Jul 08 peak)	8.9	World, CRB, Spot Index

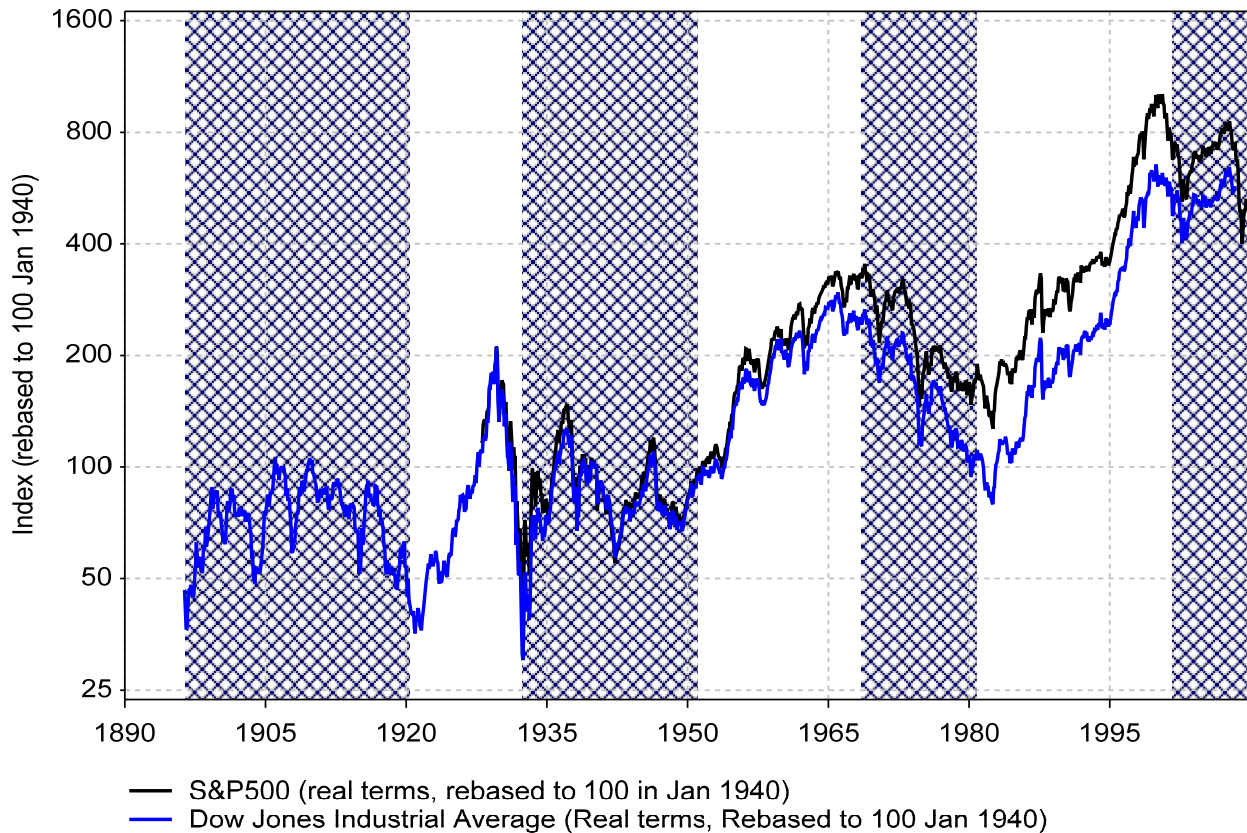
Kondratieff, a Russian economist working in the 1920s, found evidence of a commodities super cycle back to the 1780s

Since his work in the 1920s, those super cycles have continued although appear to have shortened in duration

Super Cycles – the very long term

US equity indices (real terms) 1896 to 2008 – shown against Commodity Super Cycles

S&P500 & DJIA inflation adjusted indices (1896 to 2009)



Source: Reuters EcoWin

US S&P500 and Dow Jones industrial Average (inflation adjusted) – long term performance 1896 to 2009

Criss-crossed areas represent Commodity Super Cycles, i.e.

- 1) 1896 – 1920
- 2) 1932 – 1951
- 3) 1968 – 1980
- 4) Oct 2001 - current

1b. Kindleberger Cycle:

Shifting World Economic Primacy – a weakened USA (& west)

Rule of Thumb – World Economic Primacy; The 100 Year Cycle

Economic Primacy	
C15th	Italian City States
C16th	Portugal & Spain/Hapsburgs
C17th	United Provinces of Netherlands
C18th	France (?)
C19th	Great Britain
C20th	United States
C21st	China-India???

Source: Kindleberger

Howe & Strauss – Generational Cycle

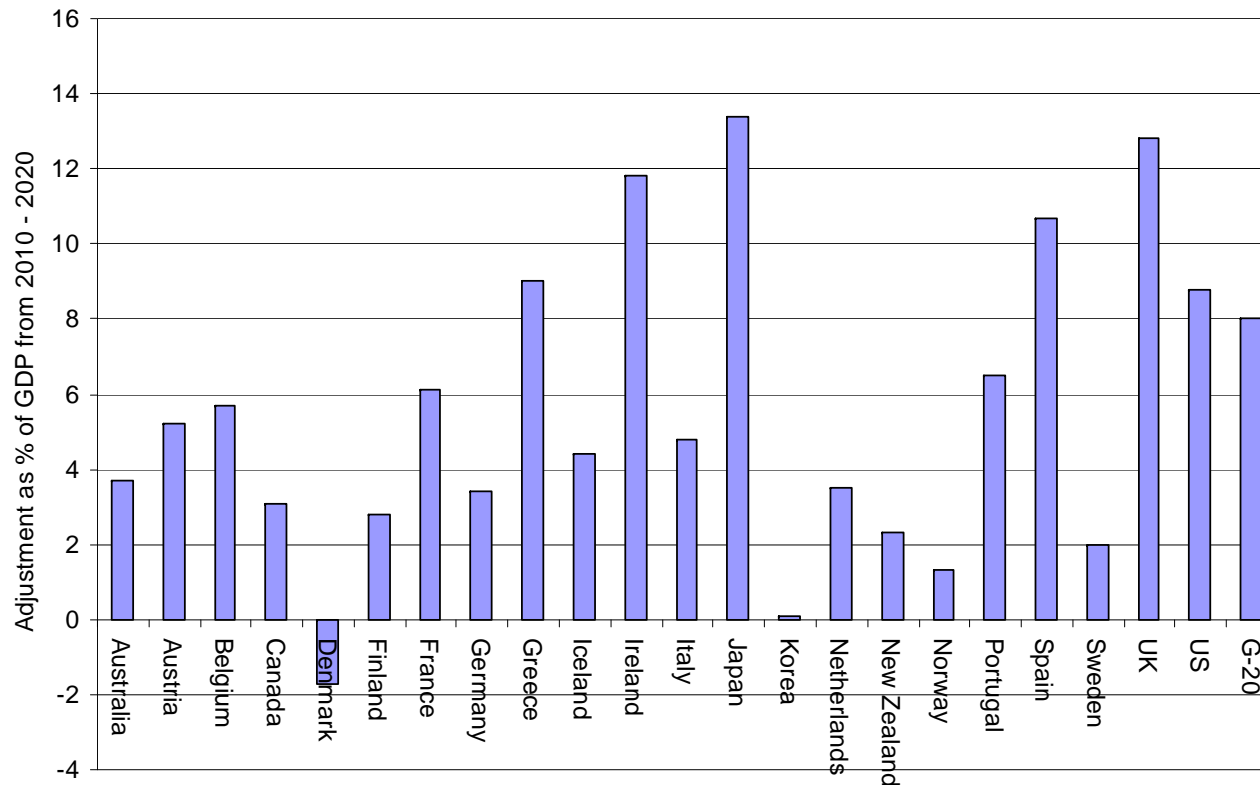
Saeculum (4 generations)	Time from Crisis to Awakening climax	(climax year) Awakening (full era)	Time from awakening to crisis climax	(climax year) Crisis (full era)	Full Cycle length (Crisis to Crisis)
Reformation	51 yrs	(1536) Protestant Reformation (1517 – 1542)	52 yrs	(1588) Armada Crisis (1569 – 1594)	103 yrs
New World	52 yrs	(1640) Puritan Awakening (1621 – 1649)	49 yrs	(1689) Glorious Revolution (1675 – 1704)	101 yrs
Revolutionary	52 yrs	(1741) Grt Awakening (1727 – 1746)	40 yrs	(1781) American Revolution (1773 – 1794)	92 years
Civil War	50 yrs	(1831) Transcendental Awakening (1822 – 1908)	32 yrs	(1863) Civil War (1860 – 1865)	82 years
Great Power	33 yrs	(1896) 3 rd Grt Awakening (1886 – 1908)	48 yrs	(1944) Grt Depression & WWII (1929 – 1944)	81 years
Millennial	30 yrs	(1974) Consciousness Revolution (1964 – 1984)	51 yrs?	(2025?) Millennial Crisis (2005? – 2026?)	81 years?

2. Underlying Macroeconomic Challenges

1. Risk of sovereign debt crises
2. Risk of loss of confidence in US\$ (spike in rates/US\$ collapse)
 - Budgetary concerns
 - Continued tepid recovery = more QE
 - Risk of further Financial Crises
3. Continued Deleveraging & its implications
4. Possible Euro break-up
5. Collapse in Chinese growth? (led by asset price collapse)
6. Inflation spike?

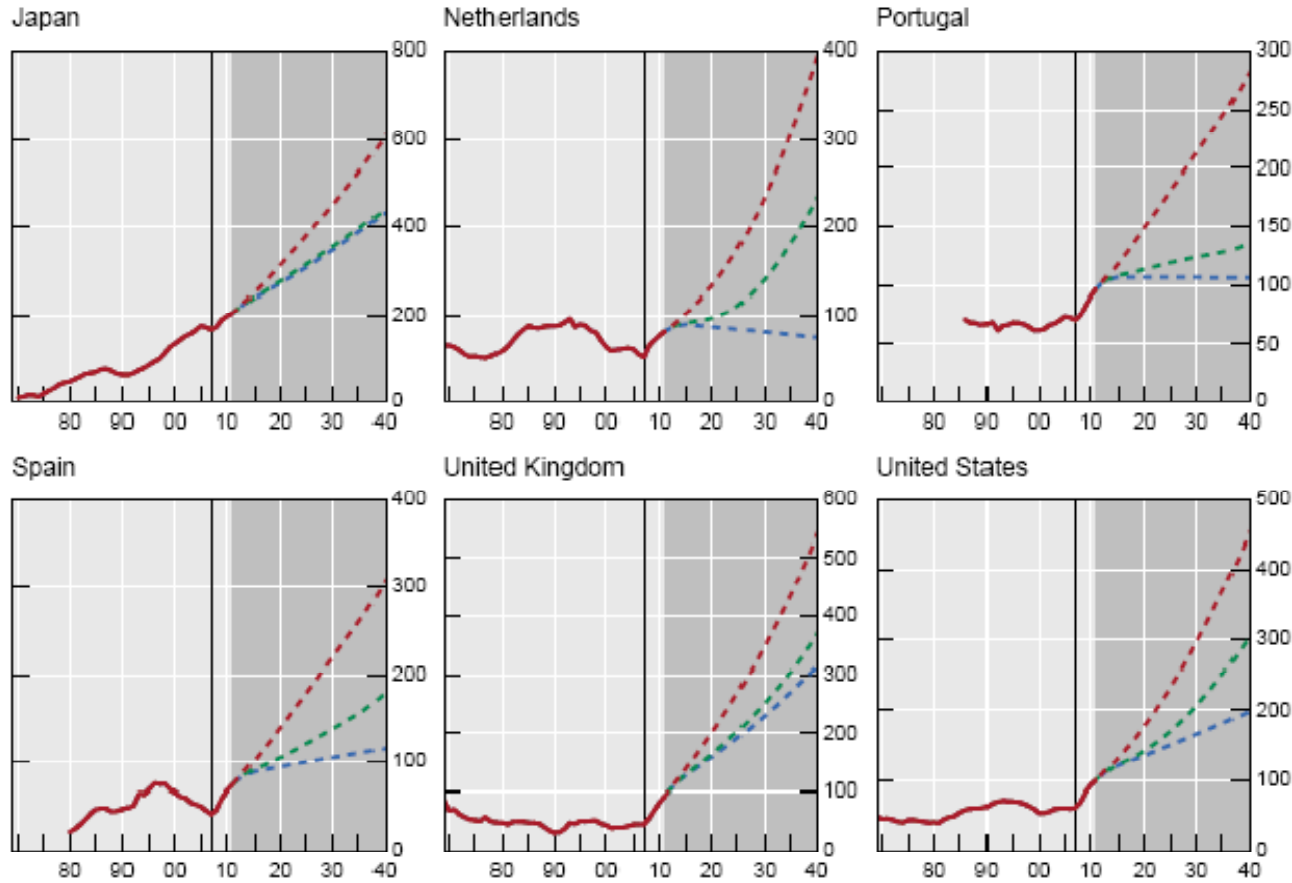
Advanced Economies: Required structural fiscal adjustment

Required Fiscal adjustment – primary balance – as % of GDP to return public finances to sustainable path



Ageing populations => Rapid Rises in Age entitlement government Spending

Public debt as a % of GDP
OECD estimates



Sources: OECD; authors' projections.

Source: BIS
WP300, March
2010

The Financialisation of the US/West

Fig 1: US Domestic Financial sector profits as a % of Non Financial sector profits (%)

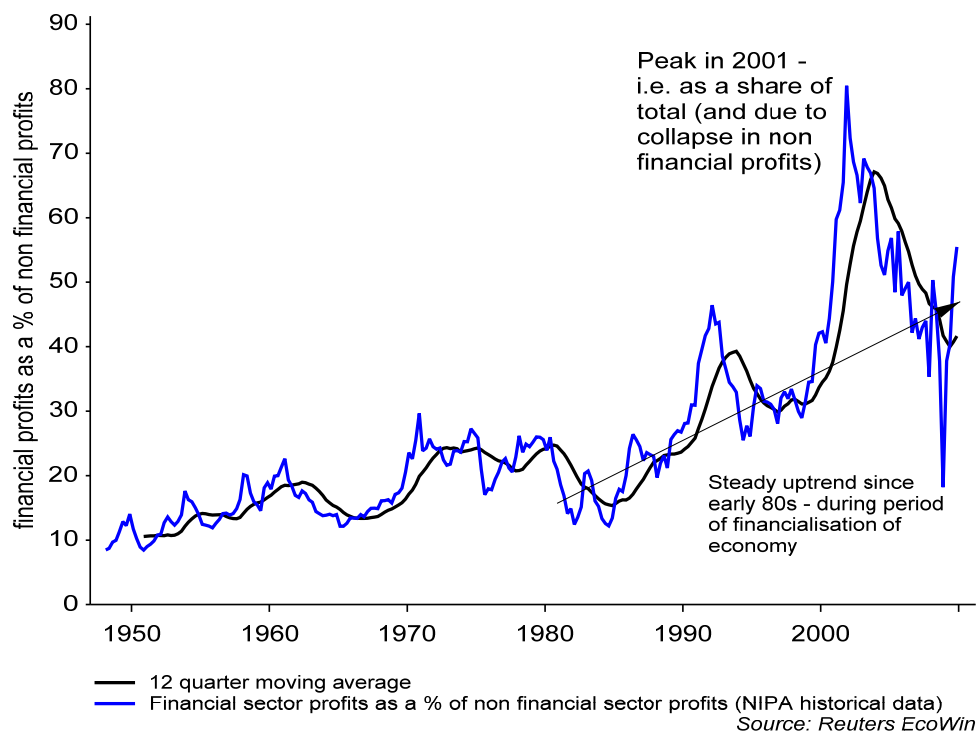


Table 5: Notional outstanding Derivatives Total (US\$bn) – Global market

	June 1998	Q4 2009
Total notional outstanding	72,134	614,674
Equity & Commodity	1,717	9,535
Credit	NIL	32,693
Foreign Exchange		49,196
Interest rate	42,368	449,793
Unallocated	9,330	73,456

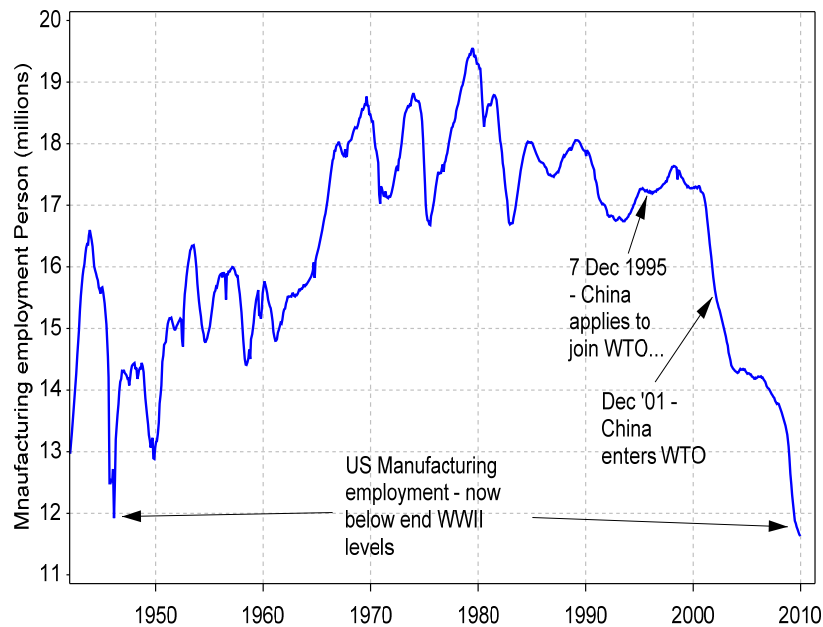
Source: BIS, Semiannual OTC derivatives statistics

US Structural Employment issues

Hollowing out of US manufacturing

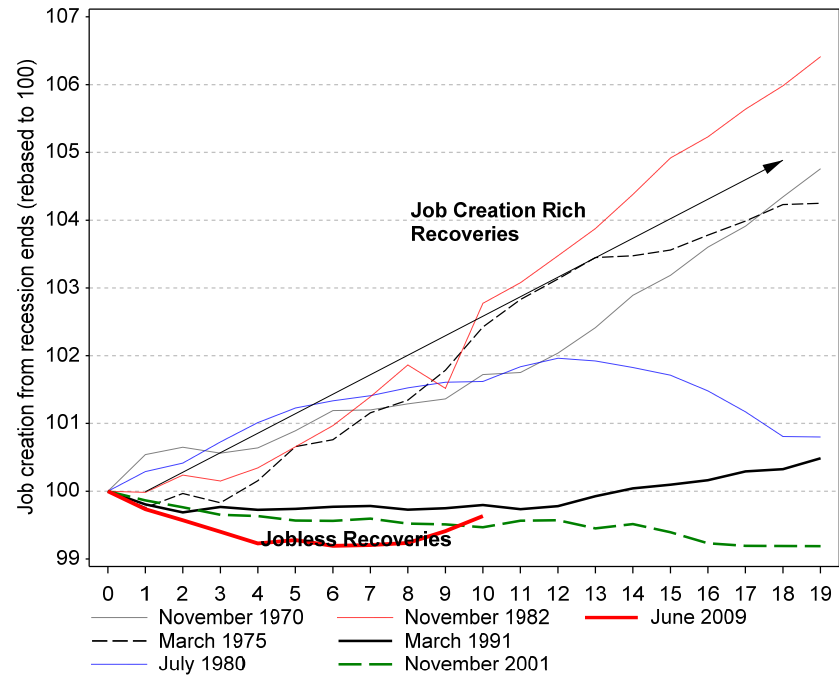
US Manufacturing sector employment (absolute no. employed)

US manufacturing employment levels



Source: Reuters EcoWin

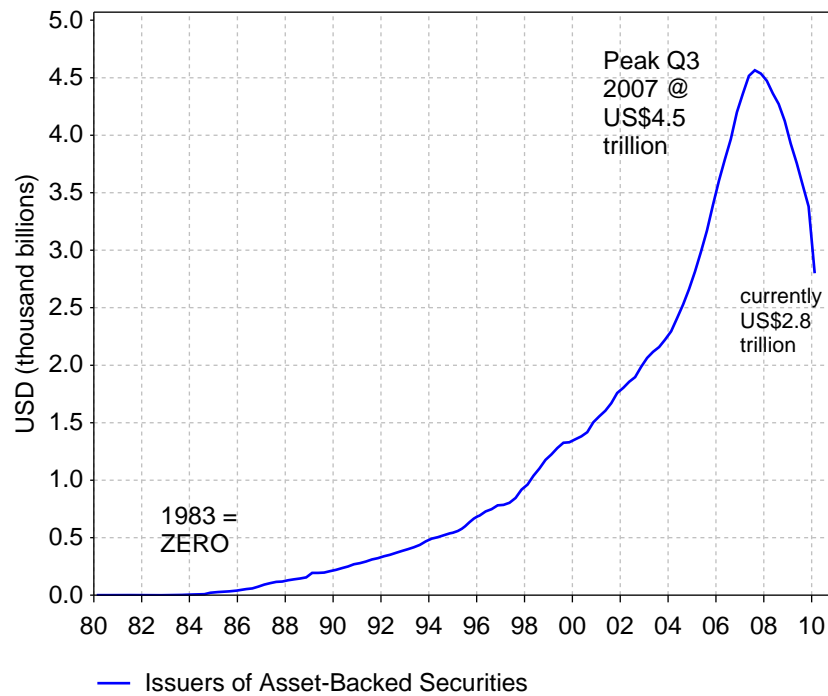
Job creation during recoveries



Source: Reuters EcoWin

Structural DM Headwind: Western & US Deleveraging

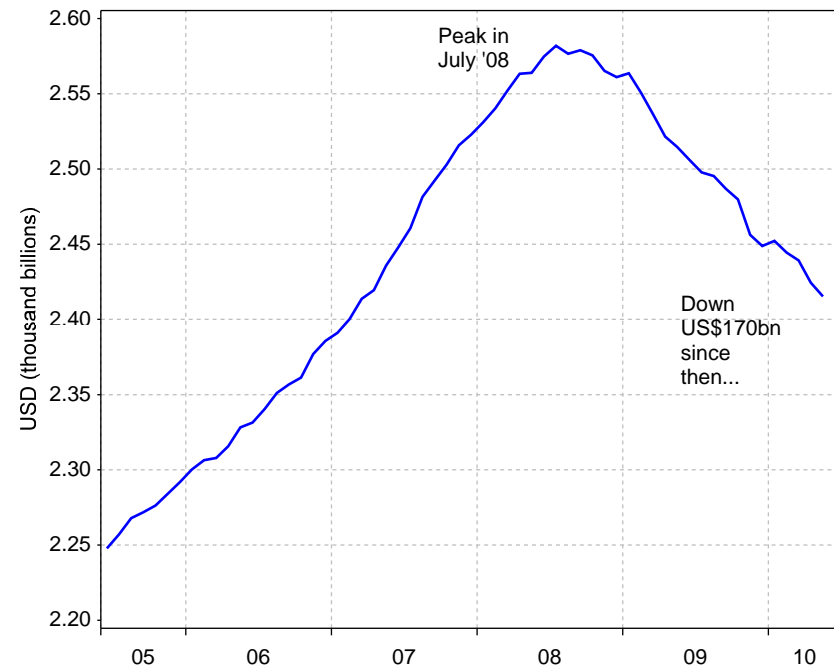
US ABS issuers indebtedness
(US\$tr)



Source: Reuters EcoWin, US Federal Reserve

www.longvieweconomics.com

US Consumer Credit O/S US\$trn



Source: Reuters EcoWin

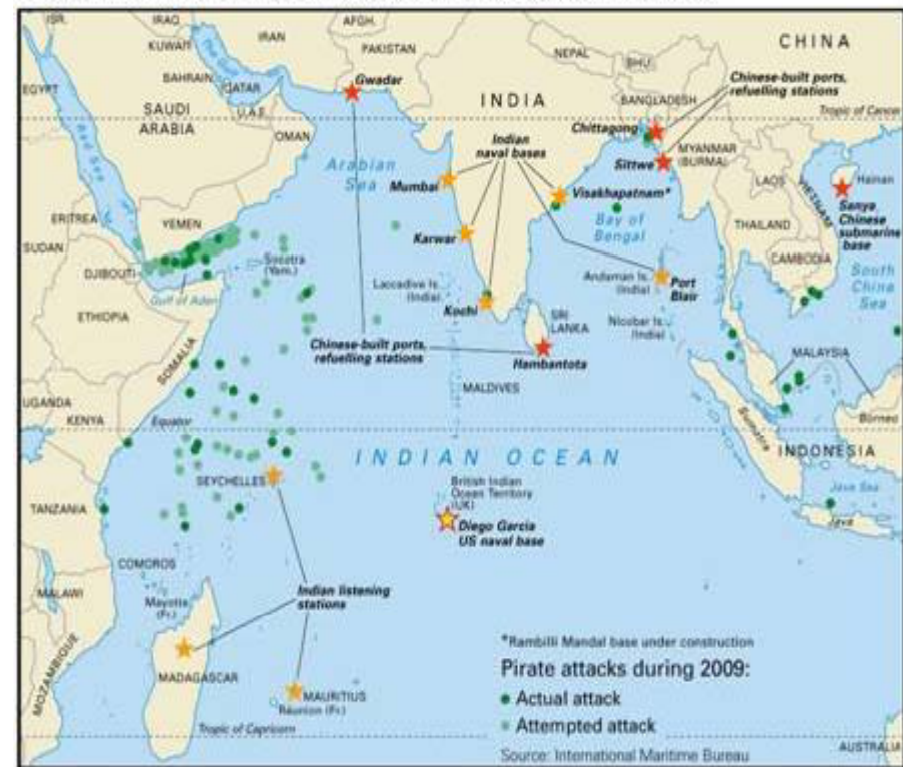
3. Potential Geopolitical Challenges

Resource Bottlenecks – Potential Conflict Flashpoints

Global trade chokepoints/bottlenecks

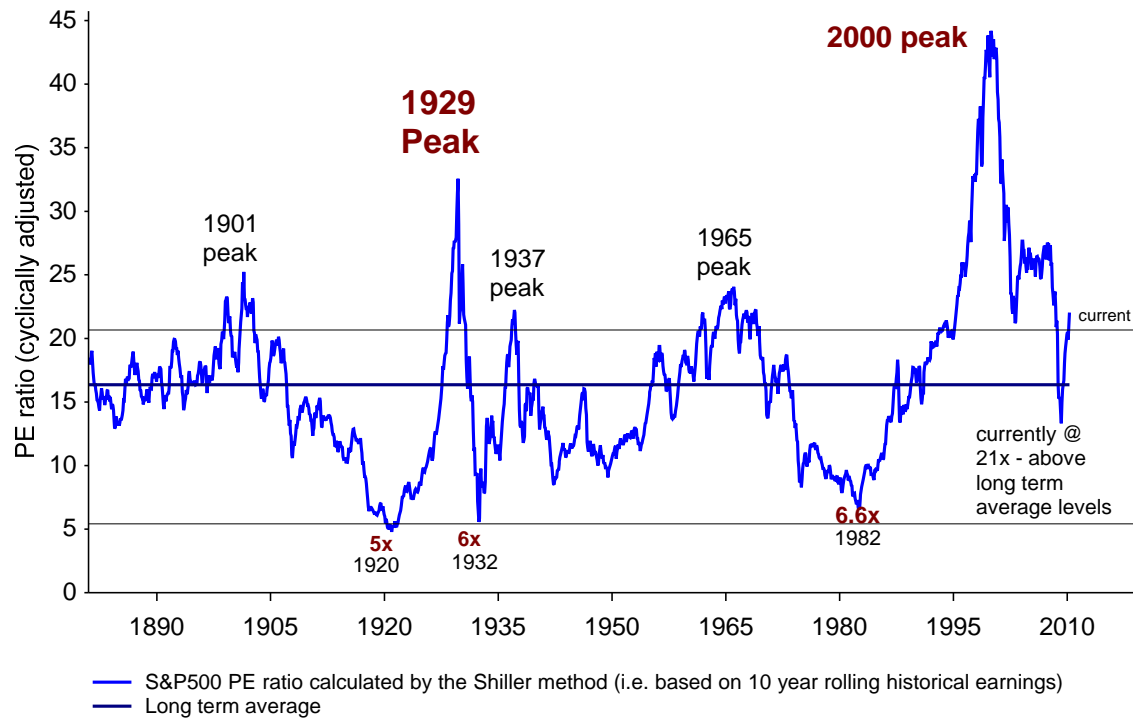


GREAT POWER COMPETITION IN THE INDIAN OCEAN



4. US Long term cyclically adjusted PE: not @ secular bear market lows

US Shiller PE Ratio



Source: Shiller, Reuters EcoWin



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