RUBRICS

A Tale of Two Crises

Fixed Income Macro View

rubricsam.com

Two Crises

Rarely do the same market participants experience not one but two era-defining crises in a little over a decade. For many, the Global Financial Crisis remains fresh in the memory. Not only for the seismic impact it had on the global economy and financial markets, but also in respect of the extreme (and some might say distortive) policy decisions taken in the aftermath. Decisions that shaped the economic, financial and political landscape thereafter and led the global economy to another tipping point some 12 years later.

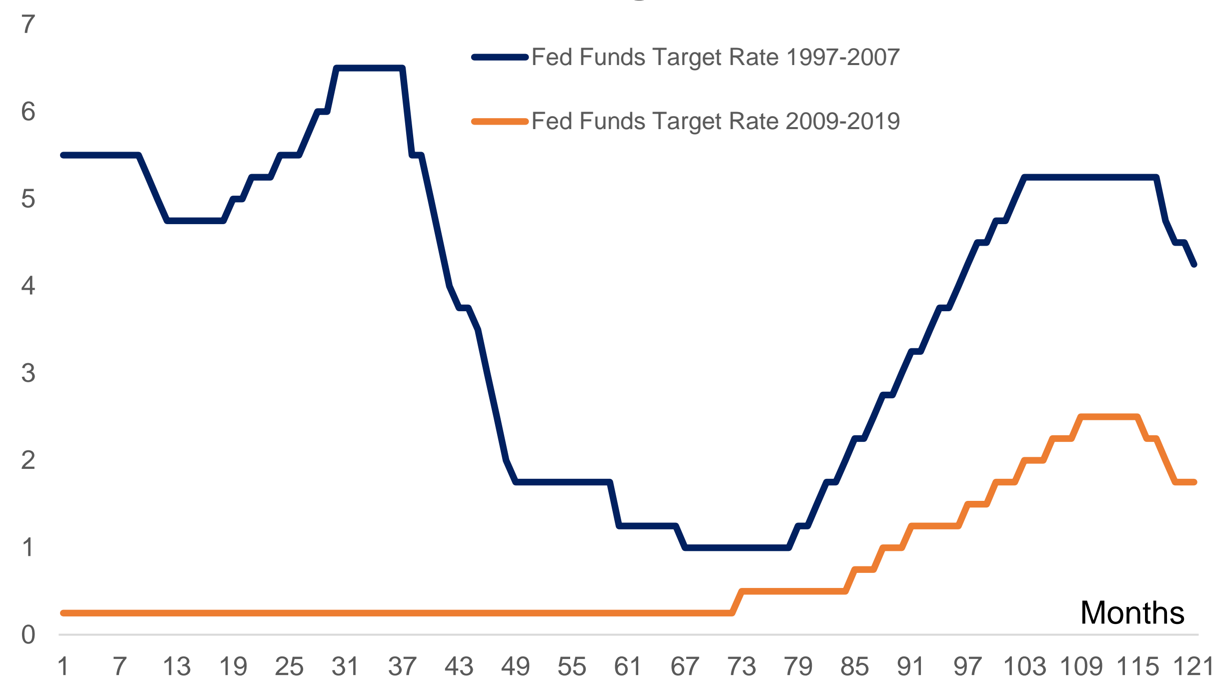
While the COVID crisis has thrown up a different set of problems, in many ways it has produced more of the same in terms of response – inordinate amounts of stimulus. This has led to many market participants expecting a broadly similar outcome to that of the last decade. There are however major differences in the nature of support provided over the respective periods. ***Whereas 2008 was mostly about top down monetary stimulus, this time around policy makers have gone "all-in" from both a monetary, and critically a bottom up perspective too.*** It is this departure from the post GFC playbook which will result in markedly different outcomes for financial markets, economies, and geo-politics over the coming years.

Crisis Response

Historical Recessionary Periods				Stimulus as % of GDP		
Peak	Trough	Length (months)	Drop in Real GDP	Monetary	Fiscal	Combined
Aug-29	Mar-33	43	27.0%	3.4%	4.9%	8.3%
May-37	Jun-38	13	3.4%	0.0%	2.2%	2.2%
Nov-48	Nov-49	11	1.7%	-2.2%	5.5%	3.3%
Jul-53	May-54	10	2.7%	0.0%	-1.4%	-1.4%
Aug-57	Apr-58	8	3.2%	0.0%	3.2%	3.2%
Apr-60	Feb-61	10	1.0%	0.7%	1.0%	1.7%
Dec-69	Nov-70	11	0.2%	0.3%	2.4%	2.7%
Nov-73	Mar-75	16	3.1%	0.9%	3.1%	4.0%
Jan-80	Jul-80	6	2.2%	0.4%	1.1%	1.5%
Jul-81	Nov-82	16	2.6%	0.3%	3.5%	3.8%
Jul-90	Mar-91	8	1.3%	1.0%	1.8%	2.8%
Mar-01	Nov-01	8	0.2%	1.3%	5.9%	7.2%
Dec-07	Jun-09	18	4.0%	7.7%	5.0%	12.7%
Feb-20	Apr-20	2	10.1%	11.8%	14.8%	26.6%

Source: Bloomberg as at 20/10/21

Tightening cycles had ended before both crises



Source: Bloomberg as at 20/10/21

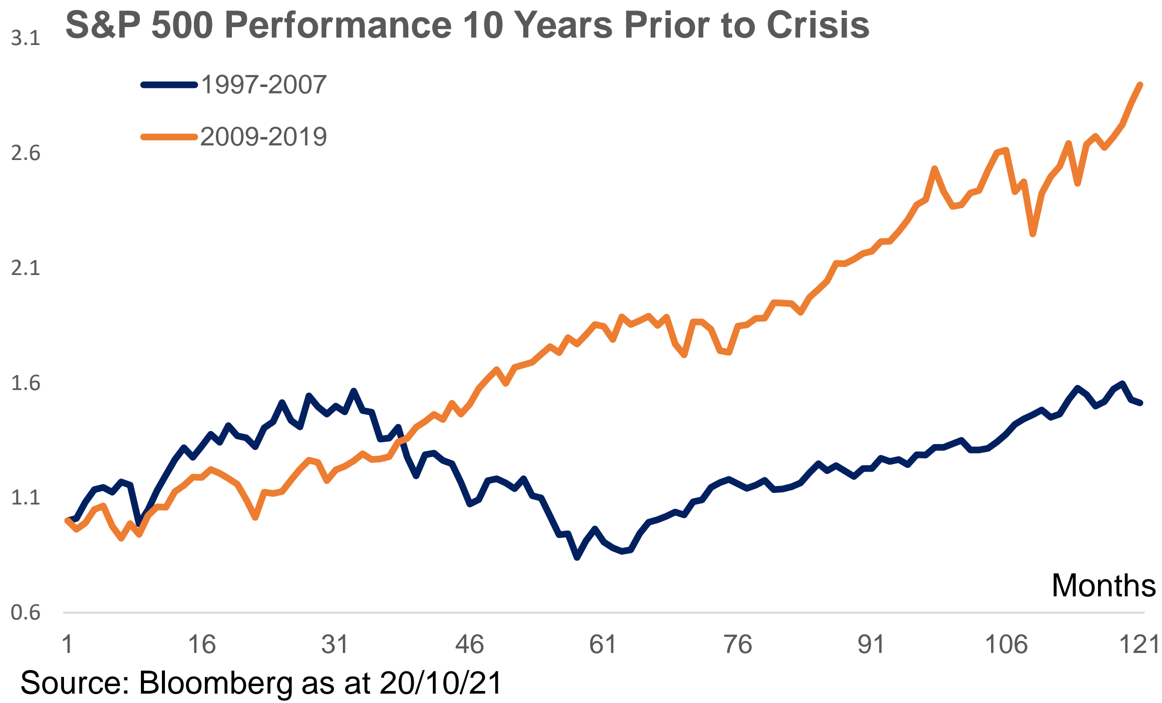
Pre-Crisis Comparison – Weak Footing

In terms of similarities, heading into both 2008 and 2020, financial markets were showing signs of excessive speculation and leverage. By the beginning of 2008 the banking sector was indicating growing stress as the housing market had started to crack. This was reflected in the fact the Fed had begun cutting rates, a little over a year after the previous hiking cycle had ended. In a similar vein, coming into 2020, not only had the Fed had stopped its hiking cycle and its programme of balance sheet reduction, it had also begun expanding the balance sheet again on account of the Repo market problems in late 2019.

There were also key differences between the two periods, most notably in terms of the financial market and political backdrop. For a start, widespread QE and zero/negative interest rate policy had spurred a largely uninterrupted rally for the best part of a decade in the run up to 2020. Although financial markets in 2007 had staged an impressive ascent from the lows of the dot com bust, they were comparatively a lot less richly valued. Furthermore from a market infrastructure perspective, much of the regulatory

Rubrics Fixed Income Macro View

Pre-crisis equity market performance



Source: Bloomberg as at 20/10/21

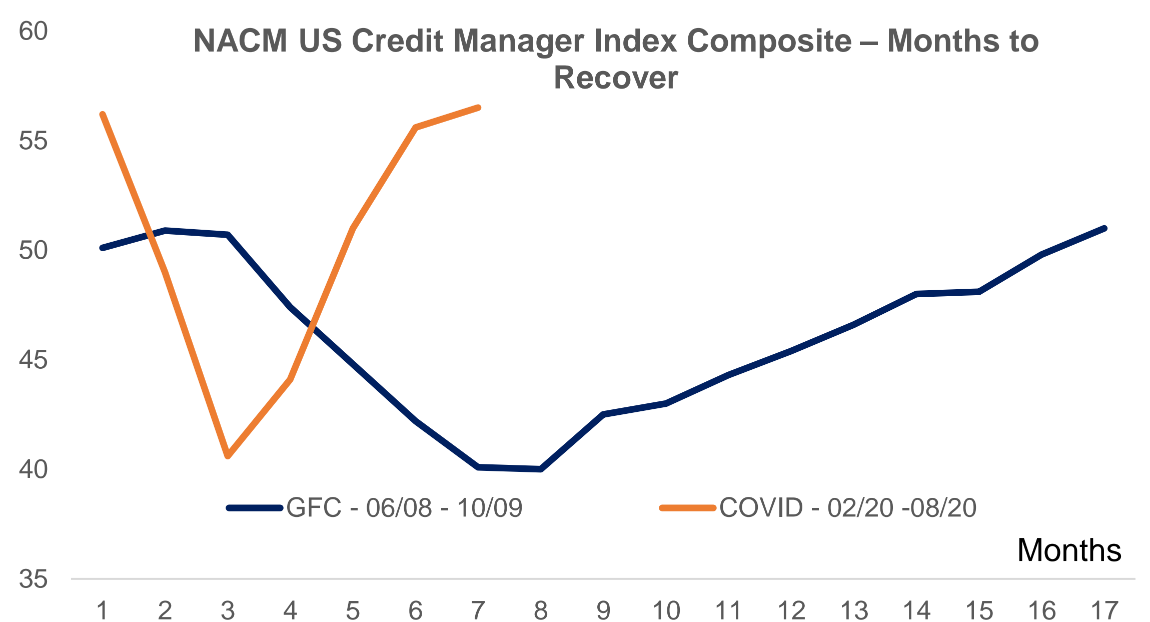
burden post 2008 was concentrated on de-risking banks' balance sheets. As a result, by the time 2020 came around, banks looked very different in terms of risk, as much of this had shifted to large asset mangers, facilitated by the rise in passive strategies. Lastly and perhaps most significantly was the extremely fragile nature of global politics in 2020 when the pandemic hit. Excessive stimulus exacerbated inequality leading to the rapid growth in populist policies on both the left and the right. This copper fastened the political imperative for an explosive policy response to COVID, with economic support for lower socio-economic causes essential.

Response Comparison – Financial Markets

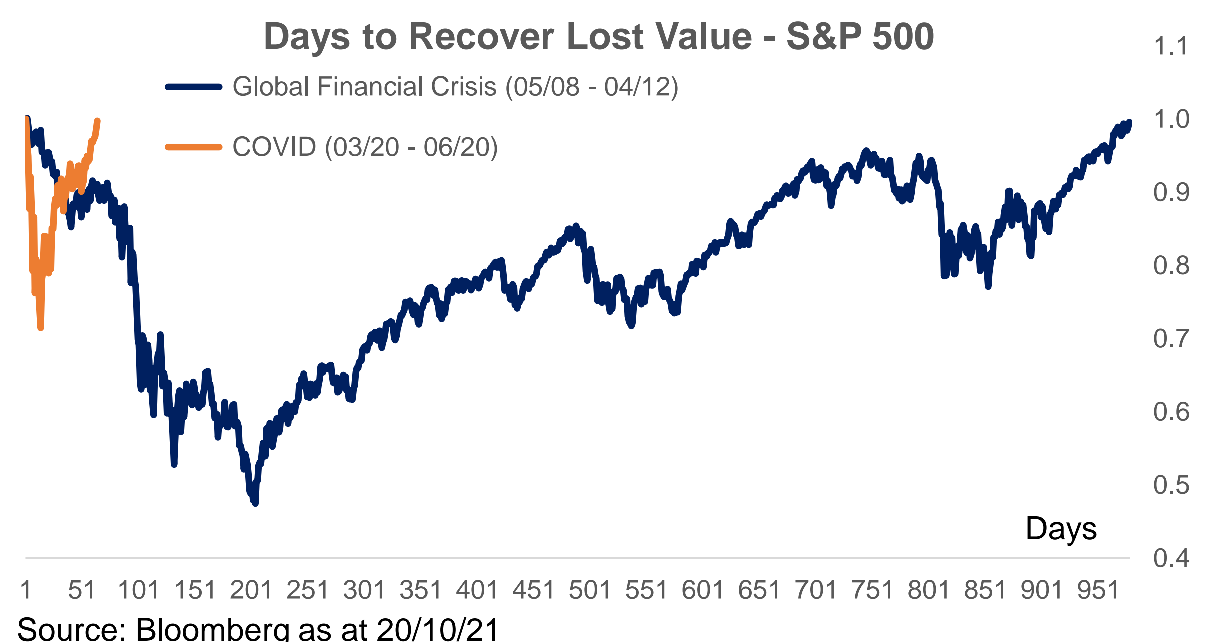
Balance sheet contraction was a major part of the 2008 crisis. With banks at the epicentre of the problem, and no pre-existing tools in place to act as quick remedy, the malaise in the mortgage market quickly morphed into an economy wide liquidity crunch with widespread aversion to any kind of credit risk. In the end it took emergency support in the form of the introduction of TARP, suspension of mark-to-market rules for banks and a largely untried policy called Quantitative Easing to eventually restore confidence, along of course with the pivotal bailout of AIG. In spite of all this it still took the market some 6 months post the Lehman default to eventually find a bottom.

Thanks in part to the aforementioned regulatory actions, banks were in a far healthier position going into 2020 than they were in 2008. Much of this risk however had been transferred (broadly) to the asset management industry. This meant that targeting the banking system was not going to solve the problem, rather central banks had to go directly to the source of the volatility, namely fund outflows. As a result the Fed's programme of direct corporate bond and ETF purchases was borne. Perhaps more important however, was the ***extensive nature of the fiscal stimulus that took place after the onset of the pandemic. A combination of direct cash injections, furlough schemes, and government***

US Credit Conditions – 2008 vs 2020



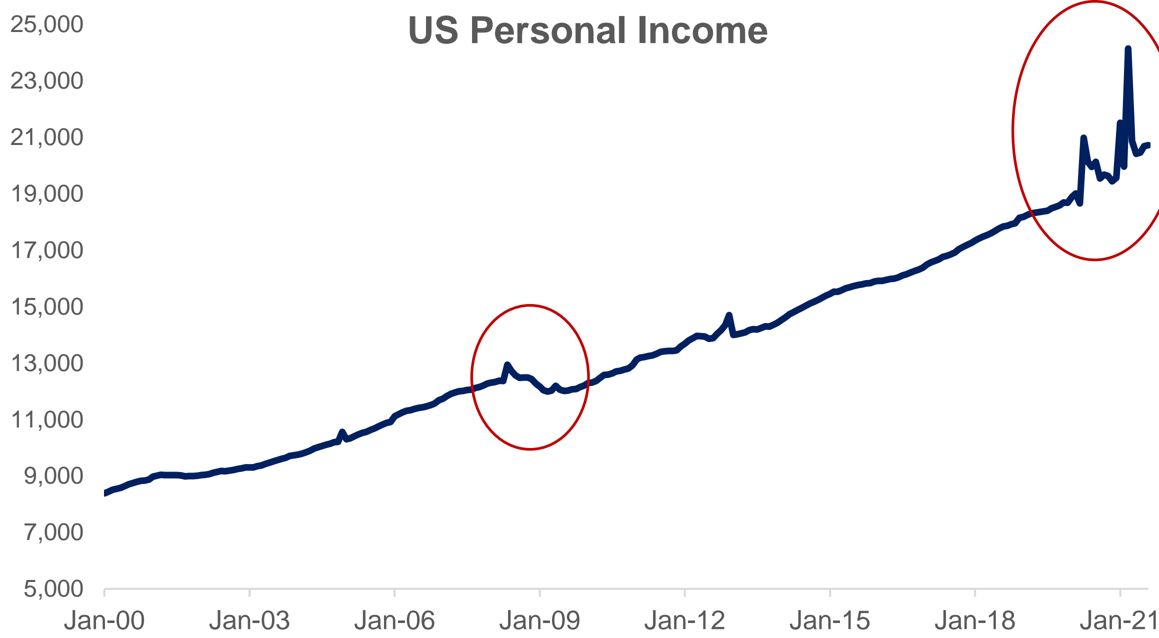
S&P 500 – 2008 vs 2020



Source: Bloomberg as at 20/10/21

guarantees remarkably led to an expansion of aggregate balance sheets - a decidedly different outcome to the Global Financial Crisis. Allied to the muscle memory of a decade plus of extremely accommodative monetary policy, it wasn't long before 'animal spirits' returned to financial markets.

Personal Income Growth



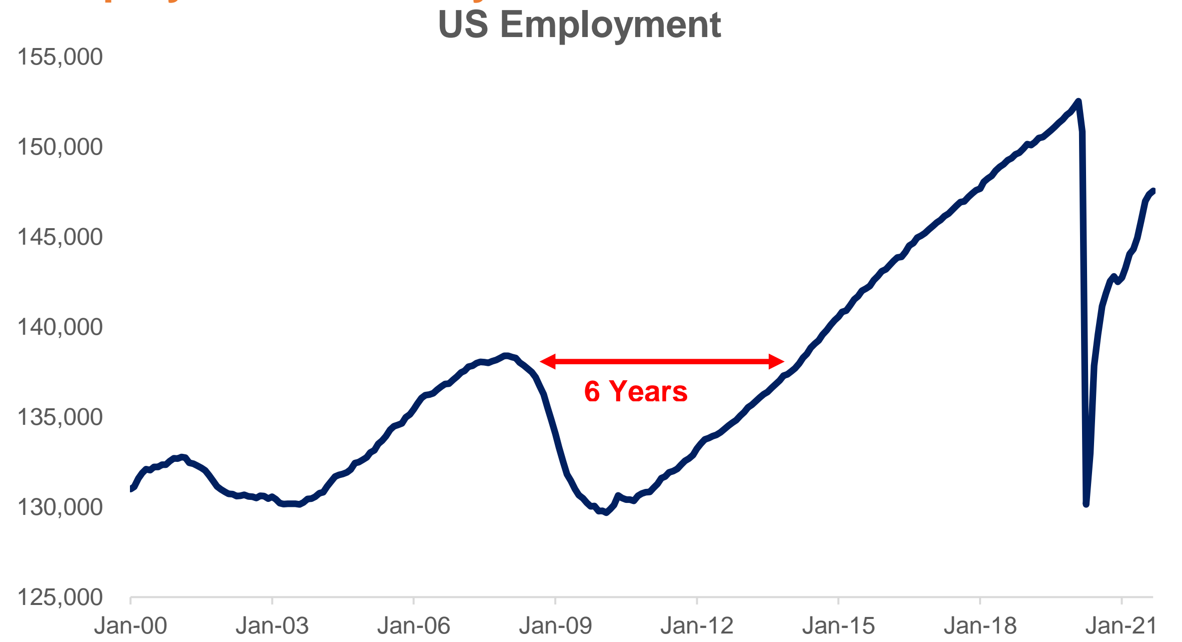
Source: Bloomberg as at 20/10/21

Accordingly the shift in risk appetite sparked a sharp reversal in spreads across the credit spectrum. This also meant that fears over corporate and/or mortgage default were extremely short-lived as access to capital markets was effectively guaranteed.

Response Comparison – Real Economy

Paramount in helping avoid a protracted recession in 2020 was the fact that incomes actually rose during the pandemic. As a result of the aforementioned schemes and government assistance programmes, income and savings levels skyrocketed over the period, with record levels of excess savings sitting in many checking/deposit accounts. As a corollary, factors like unemployment and job openings recovered much quicker than they had in the period post 2008, while assets such as house prices exploded higher as the hunt for yield saw investors

Employment Recovery

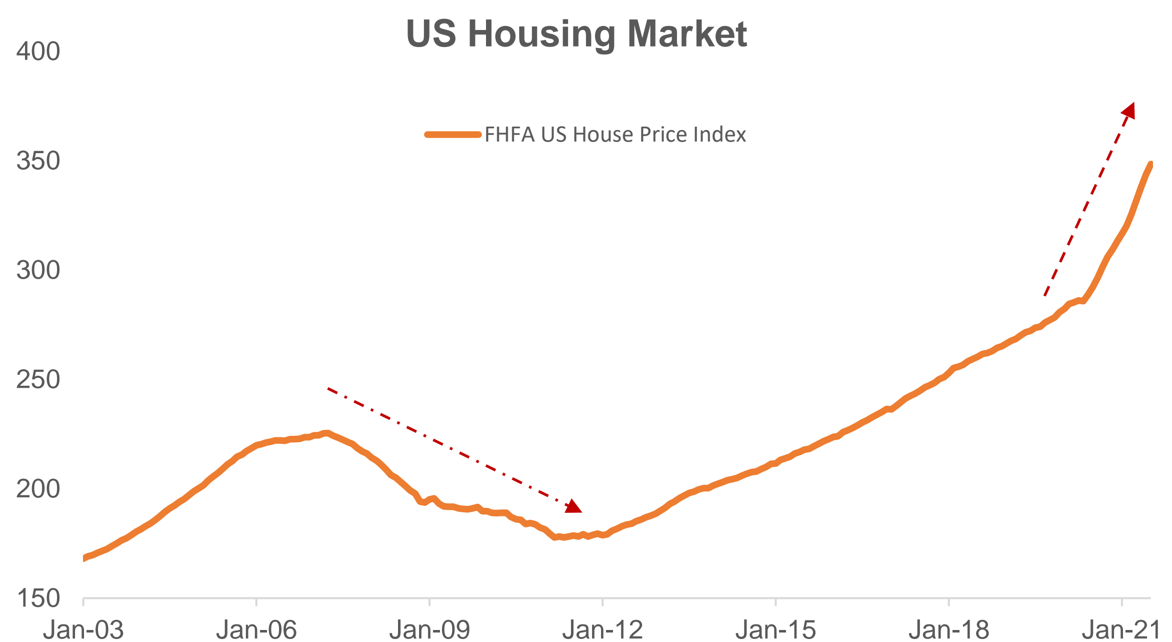


Source: Bloomberg as at 20/10/21

move farther out the liquidity curve. This stood in stark contrast to what was seen in the post '08 period where fiscal austerity was already being touted among developed market governments coming out of the crisis.

While the overwhelming response to the pandemic meant that many of the traditional recessionary outcomes like balance sheet contradiction, capacity destruction or long-term unemployment were avoided, a number of troublesome by-products have begun to emerge. Chief among these are the much publicised supply-linked shortages currently plaguing the global economy. Although the onset of COVID has been the predominant driver of the protracted supply bottlenecks, the fact that these disruptions have not been met with a corresponding fall in demand

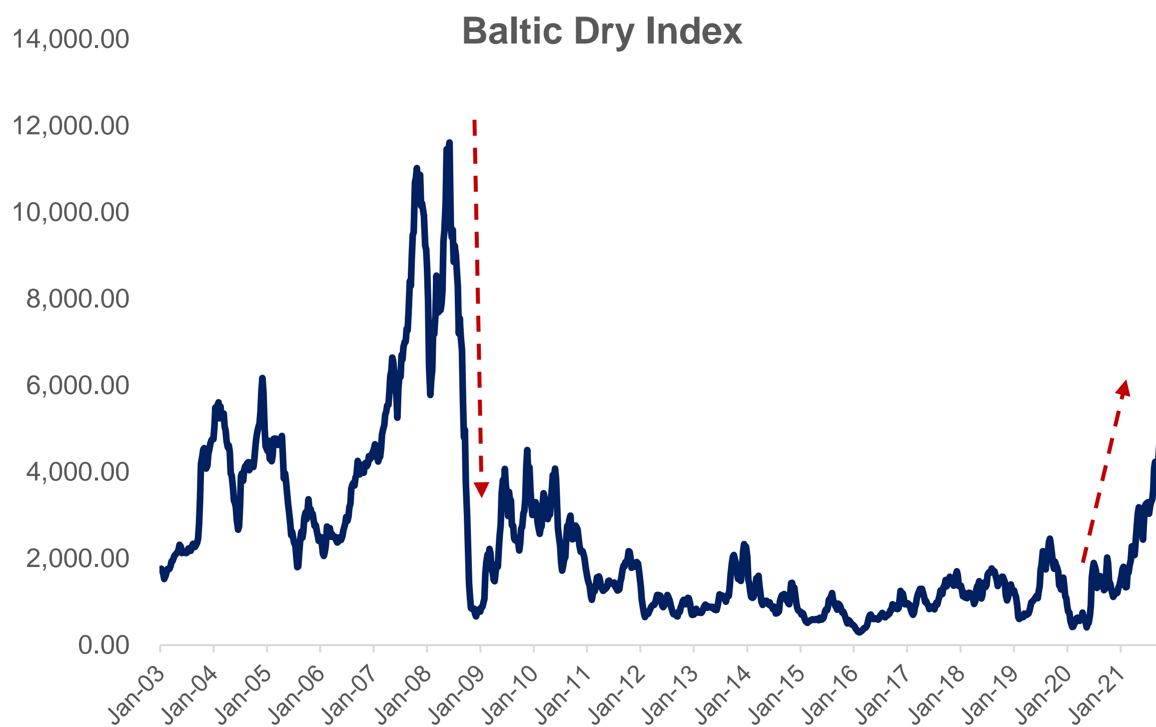
Housing Recovery



Source: Bloomberg as at 20/10/21

- thanks to extraordinary levels of stimulus - has resulted in widespread shortages in everything from food and energy to microchips and even labour. The resulting inflation, now at 30+ year highs, is beginning to ask very difficult questions of central banks in their commitment to maintaining price stability on the one hand and their desire to keep financial conditions loose on the other.

Global Trade/Demand

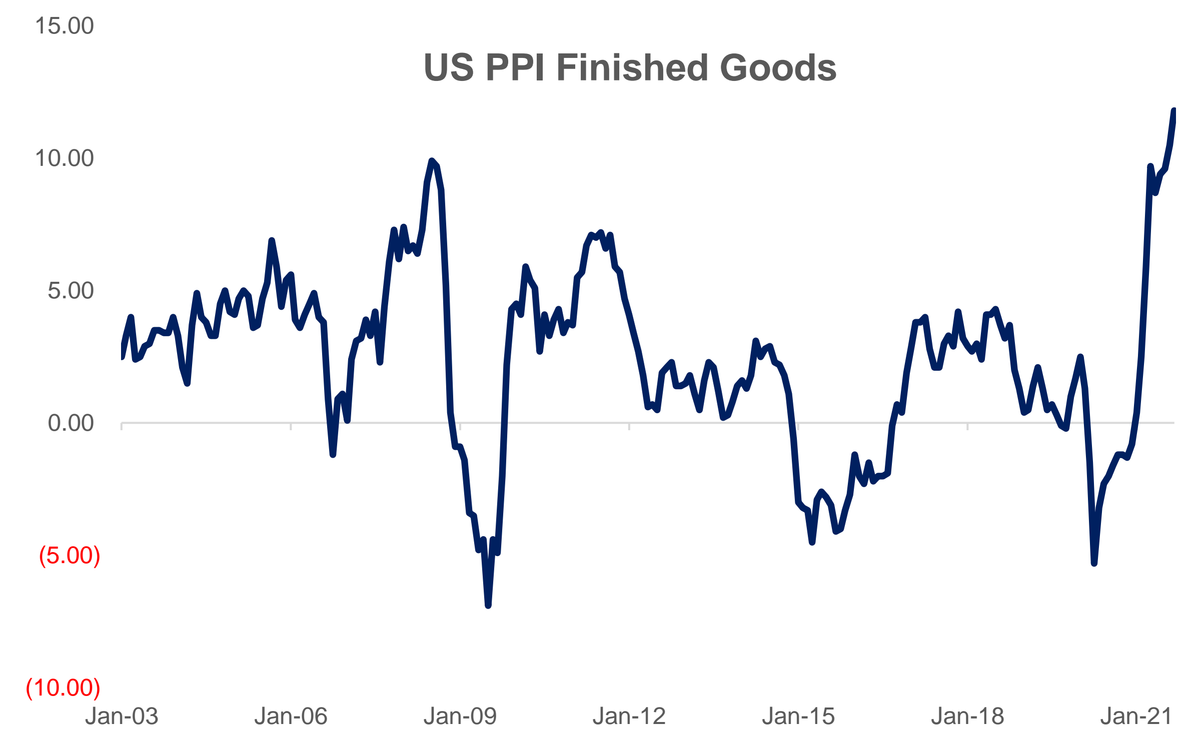


Source: Bloomberg as at 20/10/21

Aftermath - Structural Differences

Away from fiscal and monetary policy, two of the most influential tailwinds of the past 30 years – globalisation and political stability – have begun to dissipate. While it can be argued that the former negatively impacted the latter over time, we can also say with some conviction that policy making has played a significant role in creating an increasingly fractured political backdrop. Globalisation too has been a key contributor to deflation in the developed world, which has in turn supported central banks in their ever-loosening monetary policy bias. Has this cycle now been disrupted? Reliance on global supply chains is likely being re-modelled across a range of industries with the potential re-shoring of

Surging Inflation



Source: Bloomberg as at 20/10/21

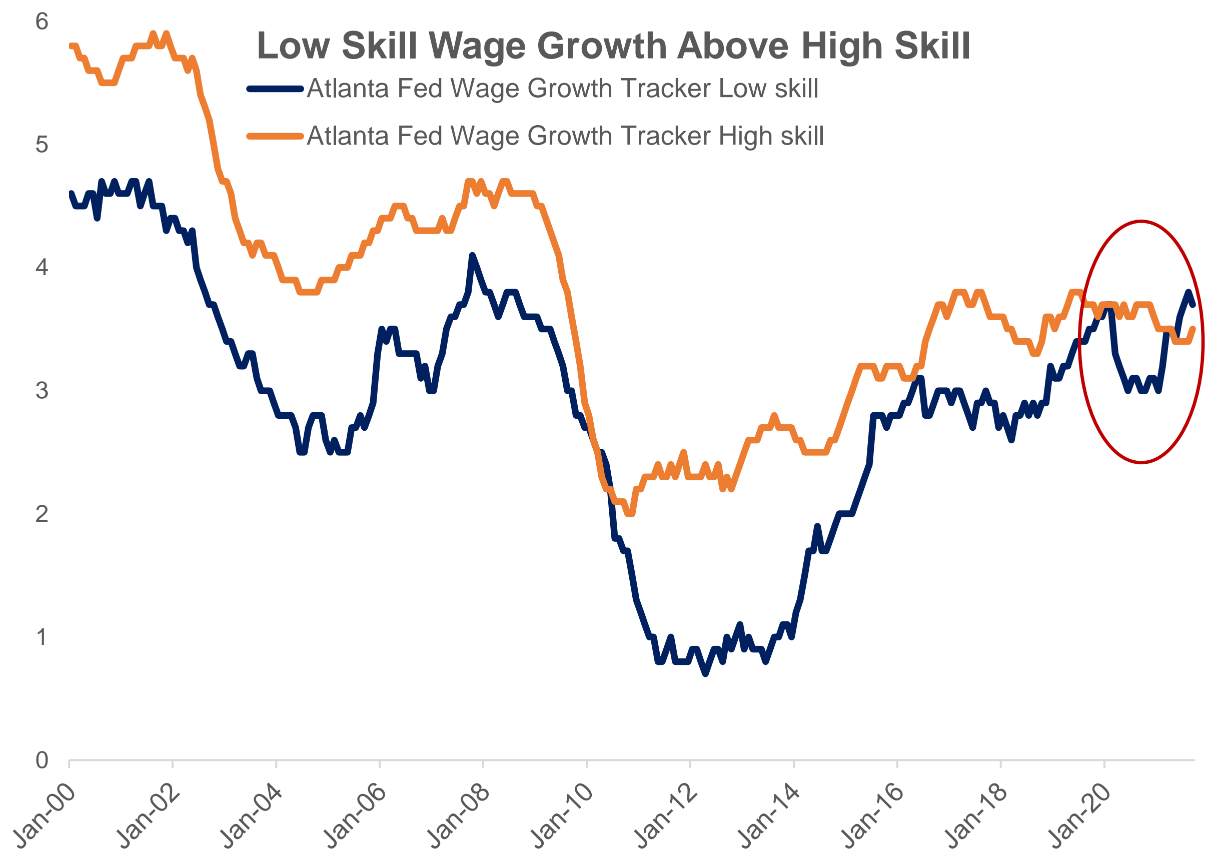
various functions firmly on the horizon. All things being equal, this can lead to higher prices, in itself rarely a recipe for political stability. Setting this aside however, perhaps the greatest contributor to social and political unrest is the policy decisions of the last decade plus that have consistently favoured the top 1%. This pattern is unlikely to continue in an era of higher real-world prices, which can have real consequences for prices of financial assets. Indeed, since the pandemic the “Great Resignation” has seen people decline to accept jobs for the wages on offer, resulting in the paradoxical situation where there are millions of job openings and millions of idle workers.

Unfilled Jobs at Record Highs

Source: Bloomberg as at 20/10/21

***__This may be the beginning of a shift in the power dynamic between labour and capital in favour of the worker__*.** Data on relative wage gains show that lower paid workers are seeing larger improvements in pay than their higher paid equivalents, supporting this idea of a nascent shift towards labour. While central banks will fight tooth and nail to keep financial conditions as loose as they can, at what cost to political stability? As Sir Isaac Newton taught us, energy cannot be destroyed but only transformed from one form to another. The read across for financial markets is clear. Risk cannot be destroyed – only moved from one area to another – central banks would do well to heed the advice.

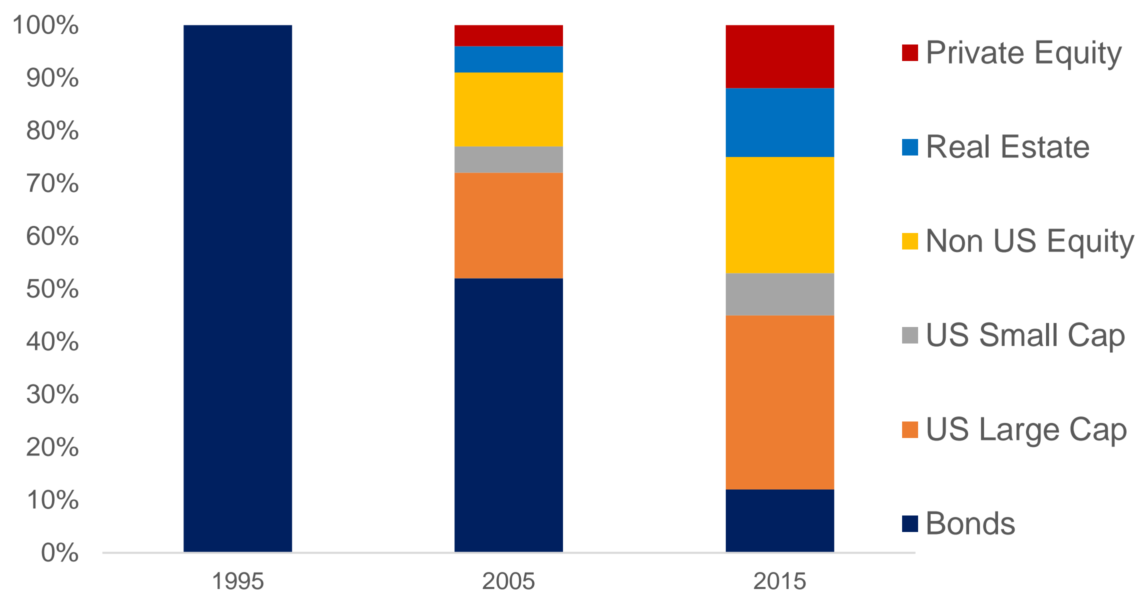
Low Skill Wages Ticking Up



Source: Bloomberg as at 20/10/21

Moving out the Risk Curve

Estimates of what Investors Need to Earn 7.5%



	1995	2005	2015	2021
Expected Return	7.5%	7.5%	7.5%	7.5%
Standard Deviation	6.0%	8.9%	17.2%	?

Source: Wall St Journal as at 21/10/21

IMPORTANT INFORMATION

Rubrics Global UCITS Funds Plc is a variable capital umbrella investment company with segregated liability between sub-funds; incorporated with limited liability in Ireland under the Companies Acts 2014 with registration number 426263; and authorised by the Central Bank of Ireland pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011, as amended). This document is for information only and does not constitute an offer or solicitation to deal, whether directly or indirectly, in any particular fund. Nothing in this document should be taken as an expressed or implied indication, representation, warranty or guarantee of performance whether in respect of income or capital growth. No warranty or representation is given as to the accuracy or completeness of this document and no liability is accepted for any errors or omissions that the document may contain. The Key Investor Information Documents ("KIIDs") and prospectus (including supplements) for Rubrics Global UCITS Funds Plc are available at www.rubricsam.com. The management company of Rubrics Global UCITS Funds Plc is Carne Global Fund Managers (Ireland) Limited (the "Management Company"). The Management Company is a private limited company, incorporated in Ireland on 16 August, 2013 under registration number 377914. The investment manager of Rubrics Global UCITS Funds Plc is Rubrics Asset Management (Ireland) Limited (the "Investment Manager"). The Investment Manager is a private company registered in Ireland (reference number:613956) and regulated by the Central Bank of Ireland in the conduct of financial services (reference number:C173854). Details about the extent of its authorisation and regulation is available on request. Rubrics Asset Management (UK) Limited is an appointed representative of Laven Advisors LLP, which is authorised and regulated by the Financial Conduct Authority of the United Kingdom (Reference number: 447282). Laven Advisors LLP is not authorised to promote products to retail clients, all communications originating from either Laven Advisors LLP or Rubrics Asset Management (UK) Limited is therefore intended for professionals and eligible counterparties only. Data Source: © 2020 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. www.morningstar.co.uk.
For South African investors: In the Republic of South Africa this fund is registered with the Financial Sector Conduct Authority and may be distributed to members of the public. In addition to the other information and warnings in this document, the Financial Sector Conduct Authority of South Africa requires us to tell South African recipients of this document that collective investment schemes are generally medium to long-term investments, collective investment schemes are traded at ruling prices and can engage in borrowing and scrip lending and that a schedule of fees and charges and maximum commissions is available on request from the manager. Because foreign securities are included in the investments within this collective investment scheme, we are also required to disclose to you that there may be additional risks that arise because of events in different jurisdictions: these may include, but are not limited to potential constraints on liquidity and the repatriation of funds; macroeconomic risks; political risks; foreign exchange risks; tax risks; settlement risks and potential limitations on the availability of market information.

Additional Information for Switzerland: The prospectus and the Key Investor Information Documents for Switzerland, the articles of association, the annual and semi-annual report in French, and further information can be obtained free of charge from the representative in Switzerland: Carnegie Fund Services S.A., 11, rue du Général-Dufour, CH-1204 Geneva, Switzerland, tel.: + 41 22 7051178, fax: + 41 22 7051179, web: www.carnegie-fund-services.ch. The Swiss paying agent is: Banque Cantonale de Genève, 17, quai de l'Ile, CH-1204 Geneva. The last share prices can be found on www.fundinfo.com. For the shares of the Funds distributed to non-qualified investors in and from Switzerland and for the shares of the Funds distributed to qualified investors in Switzerland, the place of performance is Geneva. Carne Global Fund Managers (Ireland Limited reserves the right to terminate the arrangements made for the marketing of this product in any EEA jurisdiction in accordance with the UCITS Directive.