



RUBRICS

New World Order

Implications for Global Financial Markets



Fixed Income Macro View

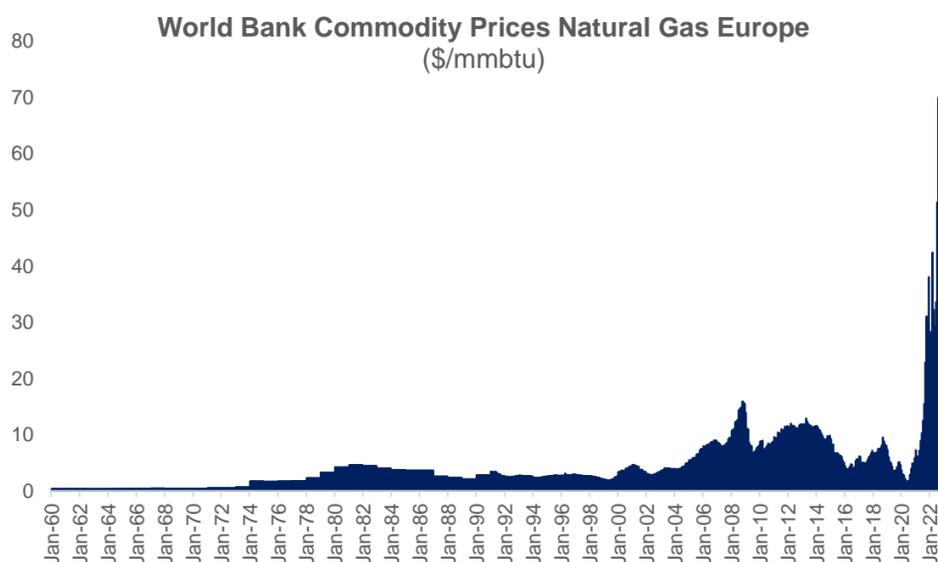
rubricsam.com

State of Play

Certain shocks, if seismic enough, can spark a chain reaction of negative events. COVID felt like the kind of jolt to the system that shook the once unshakable faith in the control of governments/central banks over the market/economy. The fallout from the pandemic has led us down an increasingly uncertain path with the Russia/Ukraine conflict, China's property crisis and the re-emergence of global geopolitical turmoil firmly part of our daily discourse. This is to mention nothing of the increasingly polarised political backdrop in the US and Europe.

From an economic perspective, the challenge is manifested by the resurgence of inflation for the first time in almost four decades. The implications this may have for our highly leveraged, highly financialised western economies is what is keeping many policymakers/CEOs/investors awake at night. In the following analysis we examine the inflation question and how we see it playing out as it pertains to financial markets. In addition, we attempt to examine the current geopolitical backdrop from a historical perspective in an attempt to try and understand in broader terms where we might go from here.

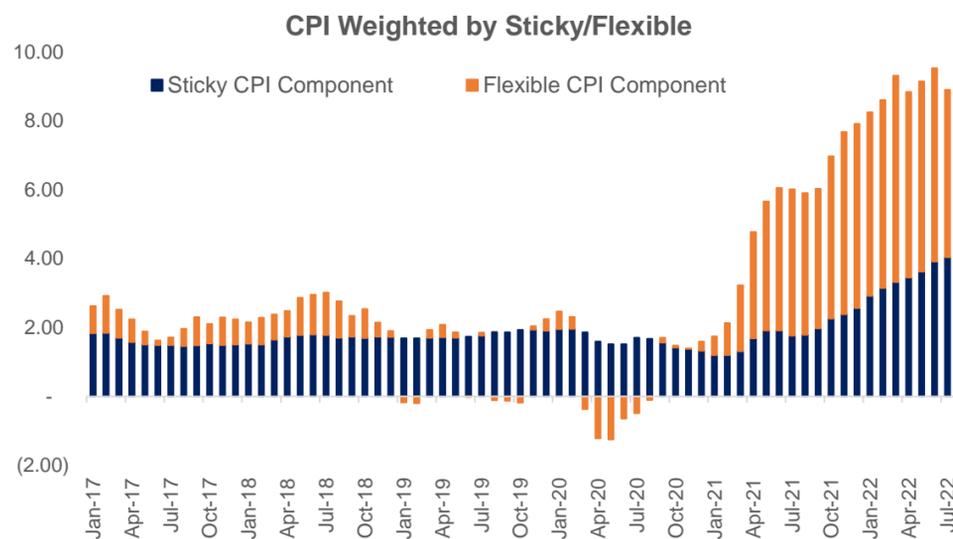
Chart 1: Eye of the Storm – European Natural Gas



Breaking Down Inflation

The battle against broadening inflation, undertaken belatedly by central banks, can be broken down as follows: (1) the price pressures that can be controlled, and (2) the ones that cannot.

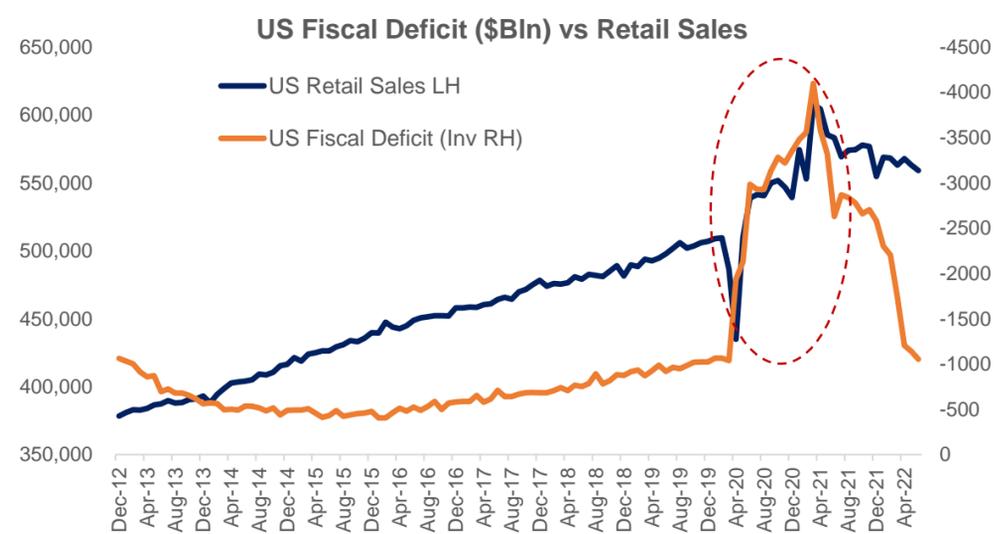
Chart 2: CPI Breakdown – Sticky vs Flexible



Source: Bloomberg as at 31/08/2022

(1) Demand Pull Pressures – The initial COVID period saw a fiscal shock not seen in a generation combined with severe supply side constraints. The result was an extreme mismatch between the supply of goods and demand that was borne out in unprecedented price pressures across a number of areas (used cars, lumber, housing etc). Then, as global economies emerged from lockdowns a wave of pent-up demand was unleashed which, coupled with persistent labour shortages, perpetuated the

Chart 3: Fiscally Driven COVID Spending Boom

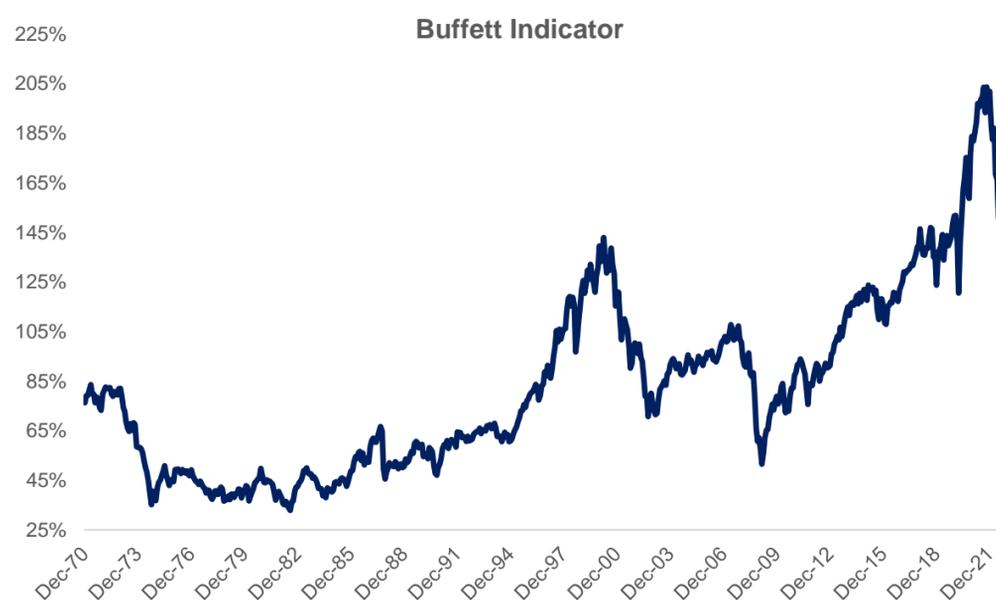


Source: Bloomberg as at 31/08/2022

inflationary momentum. In spite of this, and as evidenced by recent price trajectory, it is not difficult to envisage the combined efforts of central banks (despite being late to the party) curbing demand-led inflation in a highly leveraged (financialised) economy. A big part of this is likely to involve tightening financial conditions via the asset market (equities) channel.

jobs to the East, technological advancements in the West sparked a new industrial age which for a time delivered an increase in productivity. Combining these factors with increasing debt levels and an ageing workforce meant inflation stabilised at extremely low levels – particularly with respect to goods, offset somewhat by the rise in non-tradable service inflation.

Chart 4: Overleveraged Financial Markets – Buffet Indicator

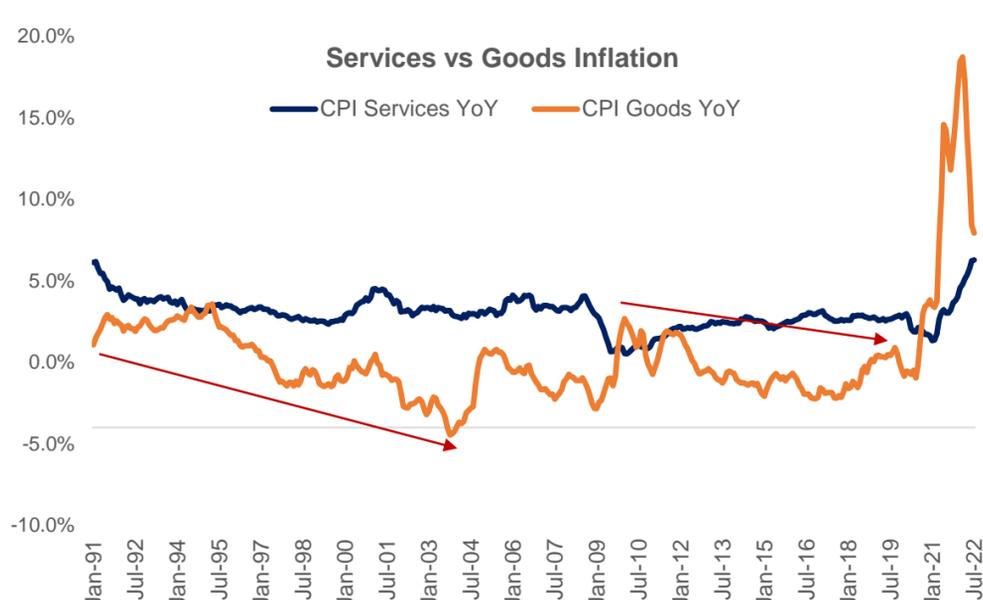


Source: Bloomberg as at 31/08/2022

On its own, however, this is unlikely to achieve a reduction in inflation to target. In the 1980s it took a major tightening in financial conditions and subsequent recession for then Fed Chair Paul Volker to get inflation down to 4%. The rest of the move lower happened later, due in the most part to a variety of structural deflationary tailwinds. The worrying problem for Jerome Powell, and other central banks, is that similar structural elements are now moving against them.

(2) Structural Inflation - Outside of the control (and understanding) of central banks. From the time of the Soviet collapse and China's accession to the WTO, globalisation has flourished. More than demand it provided access to cheap labour and significant excess savings. Added to the offshoring of blue collar

Chart 5: Goods vs Services Inflation Historical



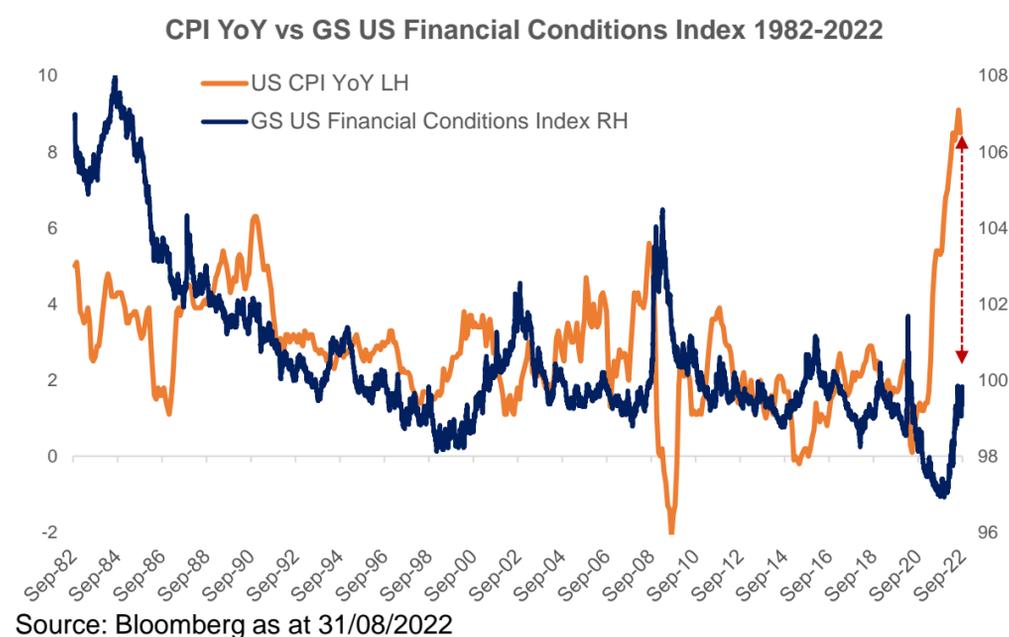
Source: Bloomberg as at 31/08/2022

Today, the current geopolitical backdrop has seen many of these factors moving into reverse. Increasingly fraught US/China relations has raised the spectre of a significant re-shoring of 'cheap' jobs from East to West, the Russian/Ukraine war has highlighted the fragility of Europe's energy dependencies and on top of that we have the emergence of climate change as a real inflationary force. While demographics have historically dampened inflationary pressures with aging populations exhibiting lower demand, recent dynamics in the labour market in respect of shortages have shown the potential for a net inflationary impulse from a shrinking workforce. The good news? Structurally the debt overhang remains a significant headwind and will likely limit the extent of price/interest rate increases longer term.

Central Bank Messaging

All of this has made the Fed's communication with the markets more difficult. As seen over the summer, a stabilisation in CPI is not the end of the story – contrary to initial optimistic assumptions. The considerable easing in financial conditions from mid June has hampered Fed efforts to stamp out inflation quickly. This is not ideal as the longer inflation stays around, the further it spreads and the more difficult it becomes to eradicate. BoE Governor Andrew Bailey admitted as much himself when acknowledging he would be willing to induce a recession in order to stop second round effects taking hold, an insurance premium well worth paying in the long run.

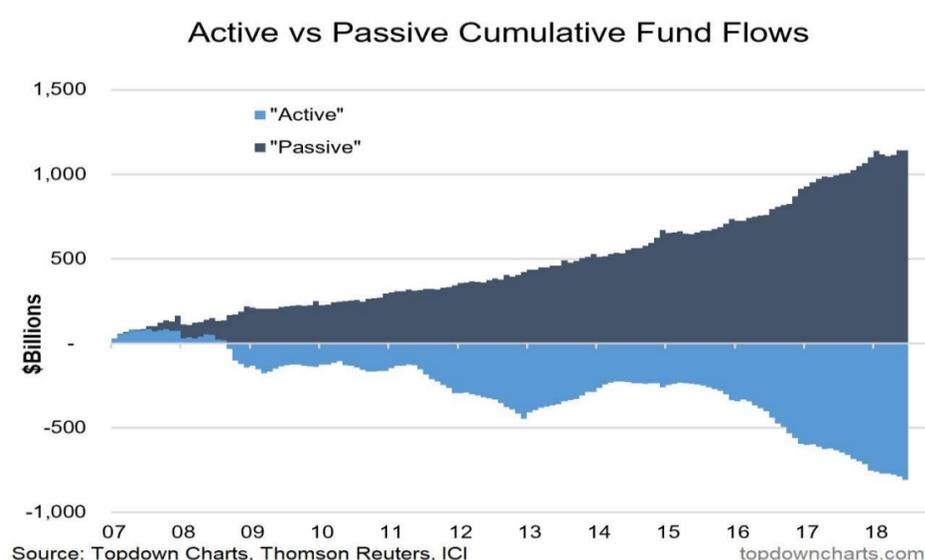
Chart 6: Financial Conditions and Inflation



The reality of higher structural inflation has yet to hit financial markets, in spite of the likes of Pimco and Bridgewater belatedly waking up to the fact. Investors have been conditioned by Central Banks to always believe in the best outcome, because since the GFC they have effectively ensured its eventuality – irrespective of the long term costs to financial stability. Today the Fed needs to convince the market it has changed. How much more hawkish rhetoric is needed before the penny drops?

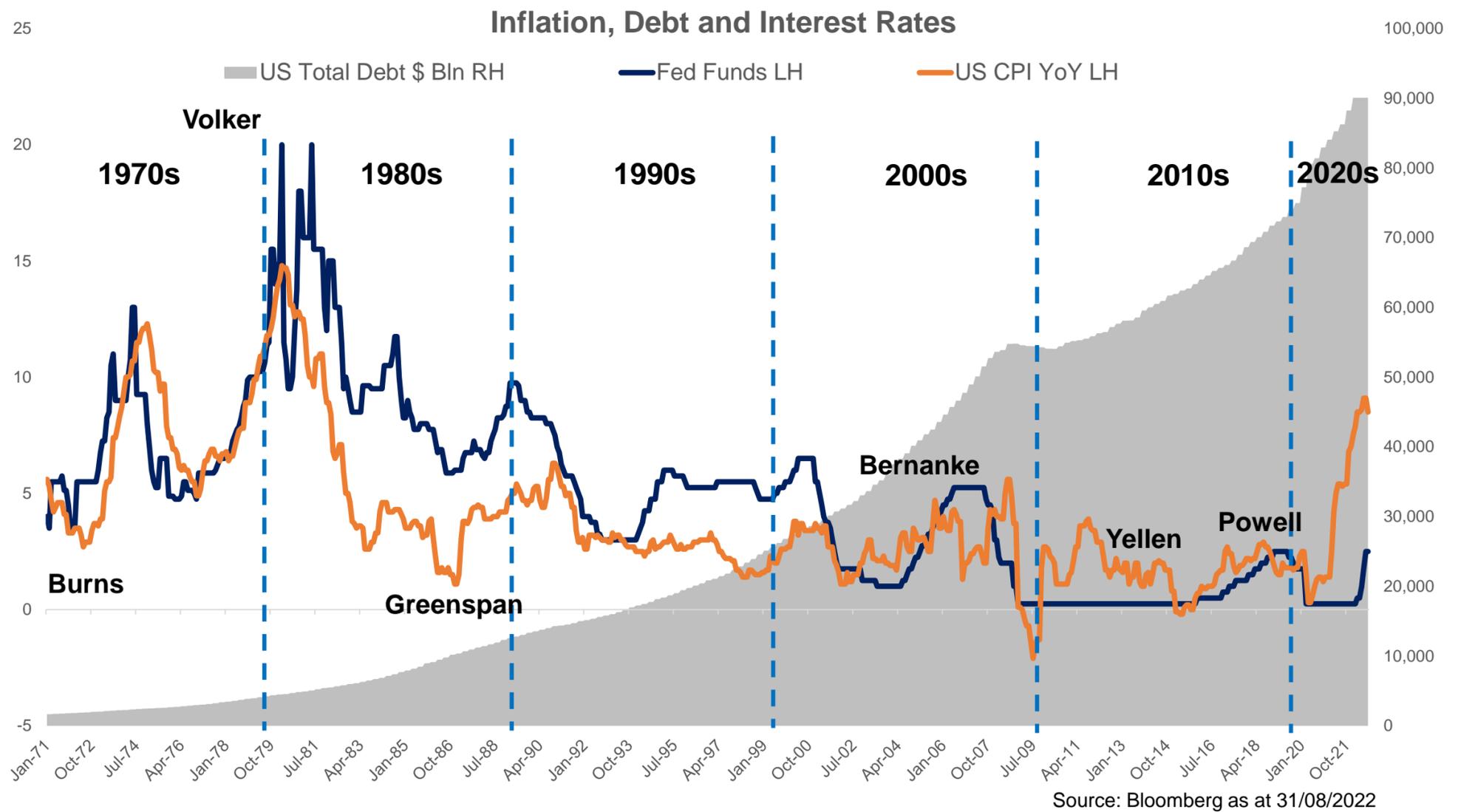
It is our belief that this readjustment process will not be pain free. After over a decade of unfettered money printing and sub-zero interest rates the sudden tightening we are about to see will likely represent a shock to the system. All the more so given the shift in emphasis towards flow over fundamentals, leaving markets exposed to greater gyrations.

Chart 7: Active vs Passive Flows



Source: Bloomberg as at 31/12/2019

It is conceivable that central banks will be forced to abandon their fight against inflation in order to prop up distressed markets/economies. Critically though, the pain threshold for such an intervention will be significantly higher than what markets have become used to. Monetary policy will represent only part of the solution as fiscal will also play a major role. For fixed income investors the obvious benefit is that yields will be considerably higher than they were over the last decade. Unlike the start of 2022 where there was scant protection from higher yields, today fixed income investors are finally receiving some compensation. TINA is well and truly dead and intelligent fixed income allocations can once again play a critical role in constructing a portfolio and building a return.



How Did We Get Here?

1970s – The post WW2 New Deal (Keynesian) era ended in stagflationary bust. A period of improving living standards came to an end as unemployment rose and inflation failed to respond ‘correctly’ to government interference in the market and a new approach was desperately required.

1980s – The shift to Friedrich Hayek’s neoliberalist free market ideology was supported by monetarist Milton Friedman and championed by Ronald Reagan and Margret Thatcher. Paul Volker ended inflation by driving an economic recession only to be replaced by Alan Greenspan who ushered in an era of Laissez Faire financial market regulation and increasing levels of monetary accommodation for financial markets. The ‘Big Bang’ unleashed an unprecedented period of economic financialization and what began as a difficult decade ended in real hope around the growing impact of financial market innovation on everyday lives and

business decision making. The failure of the communist ideology hastened the policy emphasis shift from labour towards capital. The growth in inequality began in earnest.

1990s - Bill Clinton shifted the Democratic party towards neoliberalism as deregulation and the collapse of the Soviet Union accelerated globalisation. Britain’s Tony Blair did the same to the UK’s Labour Party. Innovation and technology captured the attention of the financial markets and through growing deregulation newly developed derivative markets enabled an exponential increase in financial market leverage. The inevitable bust was controllable given the then manageable scale. Unprecedented asset price performance was supported by real productivity and innovation sponsored by excess savings from China. The end of the decade saw negative externalities like Russian crisis and Y2K spark an uncontrollable wave of central bank liquidity and asset price bubbles.

2000s – The decade started with the first asset bubble bust of the neoliberal age. This was quickly followed by extremely accommodative central bank policy. Unlike the 1990’s the growth of financial markets was not supported by a period of significant productivity and less productive assets like housing started to boom on the back of low rates. Emerging market central banks facilitated this cycle by heavy purchases of treasuries and mortgage backed securities. The continued innovation of the financial sector helped expand liquidity into supply constrained markets. The 00s was a period of full blown globalisation which drove goods inflation to the floor, fooling central bankers into believing their own hype and ignoring the warning signs of enormous asset price bubbles and financial market corruption. The growth of corporate lobbying challenged the original ideals of free markets with a few monopolies holding a lot of sway. Kleptocracy had taken root. The end of the decade saw the biggest financial market collapse since the 1930’s. Bankers and traders were bailed out while the ‘average Joe’ lost his house and ability to afford retirement.

Chart 8: United States Gini Coefficient

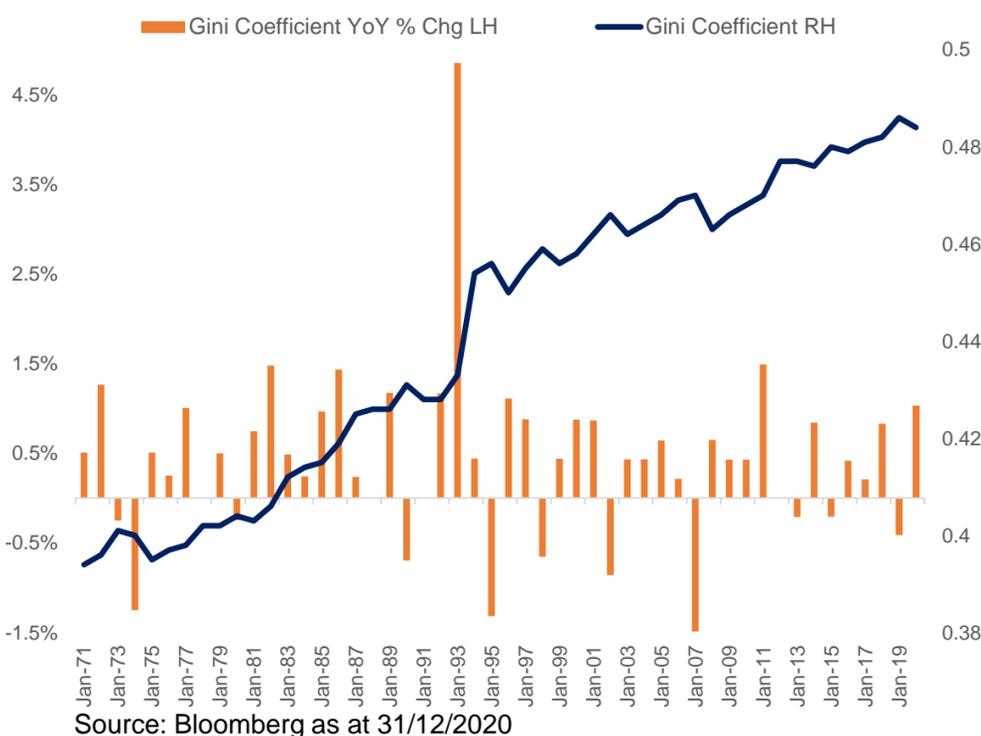


Chart 9: Key Metric Overview

Metric	1970s	1980s	1990s	2000s	2010s	2020s
Avg US CPI	7.1%	5.6%	3.0%	2.5%	1.8%	4.2%
Avg Fed Funds Rate	7.2%	9.8%	5.1%	2.7%	0.8%	0.6%
Avg (Total) US Debt/GDP	152%	193%	247%	322%	349%	379%
US Equities TR (Ann) ¹	5.9%	17.5%	18.1%	-0.8%	13.5%	9.5%
US Fixed Income TR (Ann) ²	5.3%*	12.2%	7.7%	6.3%	4.0%	-2.0%
Commodities TR (Ann) ³	21.3%	10.7%	4.0%	4.9%	-5.3%	13.4%

Source: Bloomberg as at 31/08/2022

2010s – A period of renewed neoliberalism personified by the bailout of the banks and ultimately financial markets. Obama rehires the team that effectively blew up the financial system in 2008 disregarding the need for a change in direction. Attempts to regulate aspects of the financial system (banks) only presented an opportunity to shift many of these risks from bank balance sheets to asset managers. Unfettered market support via money printing and negative rates produced minimal real economy benefit. Western inequality continued to grow as corporates grew more powerful than ever. Western populations began turning their backs on centrist neoliberal parties – as Trump and Brexit show a newfound appetite for populist ideals. Social cohesion began to deteriorate setting the backdrop for the Jan 6th attack on Congress. Numbed by a decade of extreme monetary support, financial markets lose the ability to be negatively impacted by almost anything.

1. S&P 500 2. Bloomberg US Govt/Credit Bond Index 3. S&P GSCI TR Index
* 31/01/1973 -12/31/79

■■■■

2020s - As the old political order has faded somewhat and new radical ideas emerged (e.g. MMT), the Covid pandemic has exposed populism for its lack of a real alternative to the ultimate failure of the neoliberal system. Factors which allowed for the constant provision of free money - de-globalisation, dominance of capital over labour – and effective underpinning of the ideology itself, have begun to move into reverse (as earlier highlighted). Additionally, the anti-climate change corporate lobby is doing untold damage to the environment and at some point will surely get its comeuppance. All of these factors combined with a renewed impetus for Keynesianism has created the perfect stagflationary storm.

So it seems Western Economies have come full circle back to where we started. However this time, as social cohesion is coming under threat, just as it did in the 60s and 70s, debt levels are significantly higher with the demographic outlook significantly more challenging. Climate change is also a real threat in ways it simply wasn't back then. Further change is coming, and understanding the nature of it will be critical in successfully plotting where financial markets will go next.

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’Île, 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.