

THE IMPACT OF THE COLLAPSE OF THE PRODUCER ECONOMY

Ask **the** PORTFOLIO MANAGER

Are all the deflation risks really behind us?

Transcript of a video recorded on May 30, 2018.

I think it's important to recognize there were actually three major waves of deflation post-2008. The first was the collapse of modern credit led here in the U.S., and we have truly put that behind us.

The U.S. had what I call a first mover advantage in many respects, partly because policymakers remembered the experience of the 1930s and were committed to staying ahead of that.

The second major wave was similar. It was in Europe, again, due to a collapse in credit, but it was combined with a sovereign debt crisis. That problem is certainly behind us, although there are other issues that we need to talk about with respect to Europe.

The third major wave, which is less discussed, and I think the world will still be to a degree shadowed by this wave, was the collapse of the producer economy.

What is the producer economy? It's the long commitment of capital that began in the late 1980s after the opening of China, after the fall of the Soviet Union, which led to a flow of capital investment into the emerging economies and into China. That wave began in the late 1990s. It peaked in 2011 and '12, and that wave is not coming back.

That has led to a decline in profitability across all producer assets, and it's why the emerging economies in China in particular have underperformed. That's not coming back anytime soon, in part because of politics.

What Trump says on trade and the details of trade are relatively minor in actual economic terms, but it's the psychological consequence that's important, and that's this: that major corporations are no longer willing to build global supply chains.

If they want to supply the consumer here in the United States, they will build here. That's very positive for the U.S. It's pretty negative for those emerging economies, which have to compete for capital.

One of the consequences of this third wave is a growing disparity of the growth of the U.S. versus other parts of the world. We think in the next downturn, for example, rather than think of quality versus risk, your portfolio is better off thinking in terms of domestic versus international.



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Video recorded 5/30/18.

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