

THE GREAT

ACCELERATION



THE CORONAVIRUS CRISIS HAS ACCELERATED PRE-EXISTING TECTONIC SHIFTS THAT ARE CHANGING WORLD ORDER.

Four interlinked areas deserve the attention of long-term investors: greater geopolitical instability; the digital revolution; domestic political changes in the advanced economies; and the rise of environmental, social and governance (ESG) considerations. Together, these make for a more volatile and inflation-prone regime, one that is less favourable to capital. In short, we're moving from a world where profit trumped politics, to one where politics trump profit.

THE OSTRICH EFFECT DESCRIBES A REFUSAL TO ENGAGE WITH NEGATIVE INFORMATION.

Pre-pandemic, much of the investment world was in denial about the reality of Cold War II and the geopolitical regime change it entails.

Little wonder. Several decades of Great Power peace supercharged globalisation and the integration of cheap Chinese workers with the world economy. Both have been key drivers of the falling inflation, interest rates and volatility which have underwritten a Golden Age for capital. But unfettered Sino-Western entanglement only made sense if history had died with the first Cold War. It hadn't, and a new East-West schism guarantees at least a partial unravelling of this profitable settlement.

With covid-19 fallout sending US-China relations to their lowest ebb since formal ties were established in 1979, a fundamental change in world order is now harder to ignore. Trade tensions quickly became a footnote as the tech war escalated, morphing into outright hostility and nakedly ideological competition.



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Rhetoric and reality began to elide. US firms have been encouraged to de-couple their supply chains from China, especially those involving advanced technology. Or consider the pressure on Thrift, America's largest public-pension scheme, not to use investment benchmarks incorporating Chinese or Russian stocks. Or the ban on US entities holding shares in Chinese firms linked to the People's Liberation Army. These are merely amuse-bouches for greater capital conflict to come.

Von Clausewitz's oft-misunderstood formulation that "war is simply the continuation of policy... with other means" reflects an eternal truth about conflict: it is a dial, not a switch. This is truer today than ever before thanks to the proliferation of capital markets, cyberspace and globalised businesses. These novel battlefields place investors in the firing line. So the historic challenge of a twenty-first century Cold War – and the return of Great Power politics more broadly – is that there are well over 50 shades of grey between (hot) war and peace.

BAYONETS AND MUSH

So where next? In Joe Biden, there's a new sheriff in town. The style has already changed materially, of course – less tweeting from the hip – but the substance is unlikely to. Democrats' traditionally tougher line on human rights and deep Sino-scepticism across the political spectrum will limit room for manoeuvre. Indeed, Biden may be able to exert more sustained pressure by refocusing on US alliances.

For Beijing's perspective, recall first that the 2008 financial crisis emboldened China's elite. It was the moment that many no longer assumed convergence with a Western model was inevitable. The events of 2020 reinforced

this idea, with Xi Jinping declaring that "the pandemic once again proves the supremacy of the socialist system with Chinese characteristics."

Seen from Zhongnanhai – China's White House – America's botched pandemic response, civil unrest and turbulent election fallout provide further evidence of inexorable US decline whilst affirming China's gradual restoration to the pinnacle of world order as 'first under heaven'.

President Xi has already used covid-19 chaos as cover to advance China's interests in its near-abroad, from Hong Kong to the Himalayas. Lenin once opined that "you probe with bayonets: if you find mush, you push. If you find steel, you withdraw." To date, Xi has found only mush in his periphery, and perceived US weakness may encourage Beijing to test the new administration sooner rather than later.

On Taiwan, for example, the 40-year-old status quo is crumbling fast and Xi has said that reunification issues "cannot be passed on from generation to generation." Markets should take him at his word. Beyond the obvious risk of direct conflict between the world's two largest economies, the global economy is extraordinarily dependent on Taiwan for the most advanced semiconductors. Any crisis there or over other disputed territories in the South China Sea threatens the significant proportion of global maritime trade sailing through it whilst potentially catalysing broader-based economic de-coupling.

BALKANISATION ADVANCES

Cratered relations have accelerated China's efforts to wean itself off American tech, dollars and foreign oil. Beijing's renewed push on 'dual circulation' – a more autarkic

domestic economy – runs alongside efforts to expand its sphere of influence using the Belt and Road Initiative and its newly-minted South and East Asian regional trade deal (RCEP). Meanwhile, the Sino-EU trade deal – purposefully consummated just before Biden beds in – aims to keep the West divided, and politics subservient to profits.

Geo-economic blocs with different trade, regulatory and currency ecosystems centred on China, America and the EU – where enthusiasm for ‘strategic autonomy’ has grown in parallel to US-China tensions – will be a defining feature of the new landscape. So will a more interventionist industrial policy in the West, as it tries to re-build its domestic production capacity.

So the impetus for further de-coupling is clear. It will become harder to run supply chains through strategic adversaries. Separate China and non-China supply chains will increase the cost of doing business. Market access will become more restrictive. And the more decisive the schism, the lower the bar to Chinese adventurism.

Taken together, tectonic geopolitical shifts will drive greater volatility, higher inflation and will privilege politics over profit.

BLACK SWANS, GRAY RHINOS

In the zoological pantheon of market dangers, coronavirus was less a black swan – something impossible to predict – and more a ‘gray rhino’. Coined by Michele Wucker, gray rhinos are “highly obvious, highly probable, but still neglected” risks. Think of a black swan crossed with the elephant in the room.

Climate change is a classic gray rhino. A warmer world promises more frequent and extreme weather events. With that comes crop failures, commodity price volatility

and mass migration alongside wars over water and other resources. Geopolitics and economics become less stable. Compounded with existing weather super-cycles such as La Niña, the disruption will put more emphasis on security of supply, not simply the cost of supply. Again, higher prices are likely.

A, B, C, D, E, S, G...

In recent years, growing climate consciousness has brought a greater focus on environmental, social and governance considerations within the investment and business communities. Known by the abbreviation ESG, these criteria aim to consider the wider impact of companies, looking beyond profitability. Considering greenhouse gas emissions, for example, or the treatment of workers.

Investors like to talk figuratively about the ‘investable universe’ of ideas. The reality, of course, is that there’s only one investable planet open to us, so long-term stewardship of capital must ensure that economic activity is sustainable.

For investors (including Ruffer), ESG criteria are invaluable when considering extra dimensions of risk and opportunity. But they



are also inherently more subjective than pure financial metrics: one man's terrorist is another's freedom fighter, yet both would recognise a profit.

Consequently, the greater long-term significance for markets of ESG measures may be to accelerate the dominance of politics over profit.

Take carbon border-adjustment taxes. In theory, these are designed to adjust for the climate impact of goods – so that, for example, a lower-emission domestic producer of steel is not disadvantaged against steel imported from a high-emission mill overseas. In practice, these taxes can also be a disguised form of protectionism for domestic industry. This may be politically, socially or environmentally desirable, but costs are going up whatever happens.

At the same time, geopolitical tension will draw more attention to the social and governance factors, the S and the G of ESG. Relative to carbon emissions, say, investors have focused little on China's human rights abuses, in Xinjiang and elsewhere. Running long supply chains through dubious regimes will become harder to justify, bringing reputational and financial risk. This will further encourage the post-credit crunch trend of de-globalisation in favour of regionalisation.

In time, governance considerations may come to include national security objectives. Stressed about the lack of truly independent non-executive directors on the board of a Western firm? Try investing in the corporate outriders of a one-party dictatorship.

THE POLITICISATION OF EVERYTHING

Geopolitics aside, the West is undergoing a broader cultural revolution towards the

'politicisation of everything'. The investment world is no exception. Beyond its considerable practical benefits, ESG will prove sticky both because it helps satisfy the deep human quest for meaning, and because it can be used to establish political preferences. Operating in concert with indexation and passive tracker funds – both financial superpowers of the twenty-first century – ESG judgement will be a force to be reckoned with.

All told, the growing focus on environmental risk and ESG issues will compound the effects of Cold War II and create huge new opportunities. But, relative to the benign settlement of recent decades, investors and businesses face more constrained choice over where to deploy capital. Expect increasing costs, new dimensions of risk, and the privileging of the political over the profitable.

THE SECOND MACHINE AGE

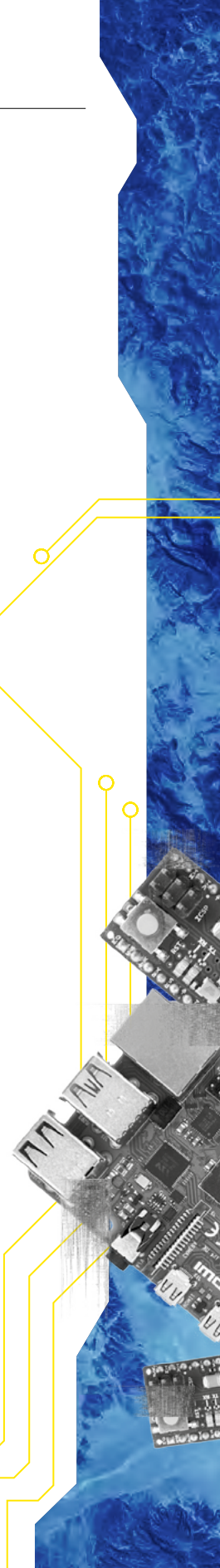
The relentless march of technology is another defining feature of our time. If the Industrial Revolution kick-started the first machine age, digital technology has birthed the second.

Andrew McAfee and Erik Brynjolfsson of the Massachusetts Institute of Technology observe that the digital revolution is doing for mankind's mental capacity what James Watt's steam revolution did for our physical capacity: side-lining it.

And, as with the first machine age, we can expect similarly dramatic political, economic and social dislocation this time.

By supercharging global digitisation, covid-19 just laid even more of the world economy at the feet of the tech titans, accelerating our advance into the age of data-driven 'surveillance capitalism'.

Networks create positive feedback loops: the bigger the network, the more useful it is,





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which draws more users, and so on. In this way, the digital era brings a winner-takes-all effect, favouring fewer, larger companies. The tendency is towards monopoly.

BIG TECH, BIGGER QUESTIONS

Digital technology's naturally disruptive and monopolistic tendencies will encourage greater government intervention in the economy: 'anti-trust' counter-monopoly measures are set to be a hardy perennial. Politicians are also stirring because of Big Tech's colossal political power, exemplified by Twitter's de-platforming of Trump. In China, the humbling of Alibaba founder Jack Ma sent its own pointed message: nothing is bigger than the Chinese Communist Party. But governments the world over are in a bind.

On the one hand, they need to stop the digital revolution fatally undermining political and social order as well as hobbling economic competition. On the other, they also need to harness the power of Big Tech to compete geopolitically. As in every previous era, superiority in next-generation technology and industry are essential foundations for global supremacy. Quantum computing, advanced semiconductors and space weapons are just a few of the battlegrounds. All have the potential to be world-altering technologies: in 2019, for example, Google claimed that its Sycamore quantum processor had performed in 200 seconds a calculation which a modern supercomputer would take 10,000 years to complete. Not to be outdone, China claimed in late 2020 to possess a quantum computer which performed, in just over three minutes, what would have taken the fastest conventional computer 600 million years to achieve.

The ultimate prize lies in the combining of advanced processing, artificial intelligence

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With the rise of digital money, how the world pays is firmly in play.”

and big data. China has a natural advantage in the data economy. Sitting atop the world's greatest natural information mine – a 1.4 billion-strong population without a privacy tradition – it aims to be for data what Saudi Arabia is for oil. Since big data is a competitive advantage, however, states – or geo-economic blocs – will guard it jealously. Unsurprisingly, who gets to set the global (or regional) standards on data and technology is a key axis of twenty-first century realpolitik.

And sitting at the intersection of digitisation, economic blocs and realpolitik is control of money itself. King dollar still reigns supreme in the realm of conventional currencies, but China hopes its novel digital yuan – the DCEP (Digital Currency Electronic Payment) – will help establish a financial sphere of influence free from dependence on the greenback. It marks China's attempt to revolutionise global finance in its favour. Is it only a matter of time before US tech titans provide the foundation for a rival to the DCEP? Like the guns of Singapore, those focused on threats to dollar hegemony may have been looking the wrong way, towards conventional rather than digital currencies. With the rise of digital money, how the world pays is firmly in play.

Digital mastery is central to Cold War II then, and will help decide the victor. But digitisation also poses a viral threat not unlike covid-19: a cyber Pearl Harbor – a crippling attack on critical national infrastructure that could make pandemic shutdowns look benign. This is another gray rhino, and it is surely only a matter of time before such an attack occurs.

Computer viruses embody one of the core features of (most) digital goods and services: infinite replication at virtually nil cost. This winner-takes-all dynamic creates extraordinary abundance – but also widens the jaws between the ‘have yachts’ and the ‘have nots’. They are contributing to what Joel Kotkin has called ‘neo-feudalism’: a twenty-first century version of the Middle Ages with a handful of (tech) barons and a superfluity of serfs.

Bringing these themes together, the digital revolution is exacerbating geopolitical instability and bloc formation, breeding gray rhinos and, through disruption and wealth inequality, fuelling demand for more active government.

BIG GOVERNMENT'S BIG COMEBACK

The pandemic itself has also accelerated the return of more interventionist governments in the West. Covid-19-induced shutdowns pushed government deficit spending to levels last seen in the Second World War. Powers assumed by government in wartime (or crisis) tend to be relinquished grudgingly, if ever. Financial repression - where interest rates are forcibly held beneath the level of inflation - and increased state intervention remained hallmarks of the UK long after 1945. Expect a similar lingering for the decade ahead. More broadly, the Overton window of what is

accepted – and expected – in terms of state involvement in everyday life has widened considerably. Post-covid, saying ‘no’ to switching on the printing presses and turning on the spending taps will be far harder. A more inflation-prone fiscal dominance has replaced monetarist orthodoxy. It is here to stay.

Appetite for more activist government had been growing for some years anyway. Recent decades may have been a Golden Age for capital on account of globalisation, technology and laissez-faire economic policy, but the gains accruing to China and the Western economic elite have come in part at the expense of Western working classes. Median wages, for example, have been stagnant since the 1970s despite significant gains in productivity.

In both the last UK and US general elections, the working class vote was a decisive demographic, from the Northern ‘Red Wall’ of England to the US rust belt. This influence is likely to increase demands for economic protectionism, not reduce it, and send the pendulum back from capital towards labour. This will probably include higher minimum wages and increased capital taxes.

And, in a digital world, demands for economic protection are likely to expand from blue collar to white. “Beware the Greeks even when bearing gifts” wrote Virgil in the Aeneid – perhaps today’s professional classes need an updated warning: beware the geeks bearing gifts. If you can do your job remotely, so can someone else. For many in the service sector, working from home is a Trojan horse, concealing the kind of disruption the working classes experienced with the offshoring of manufacturing 40 years ago.

More immediately, the pandemic has widened the already considerable gap

between beneficiaries of the new knowledge economy, and those whose fortunes are tied to the old, leading to a ‘K-shaped’ recovery.

This is a risk. Wealth is ultimately built and secured on stable political foundations, themselves established in a broader culture. The challenge of extreme wealth inequality to those stable foundations is as old as civilisation. Plutarch supposedly mused that “an imbalance between rich and poor is the oldest and most fatal ailment of all republics.” Wucker – who we met earlier – cites wealth inequality as another gray rhino of our time. The political classes will conclude that the ‘K’ is not OK, and investors should expect measures to narrow the gap.

The domestic political settlement within Western economies is thus under considerable pressure. Assumptions in favour of globalisation, de-regulation and laissez-faire policies are reversing, whilst geopolitical and environmental instability encourage governments to bring critical capacities closer to home.

As a result, a new age of government activism is upon us. From fiscal splurges funded by magic money trees to rebooted industrial policy, and higher corporate and capital taxes. It will not be so kind to the owners and managers of capital.

THE HEDGEHOG AND THE FOX

For investors, the key to success in this new era is resilience through genuine diversification. What may have diversified portfolios within a particular regime, may well not diversify them across others.

Archilochus’s “fox [knew] many things, but the hedgehog one big thing.” That one big thing? Knowledge of what has worked so well in capital’s Golden Age. But relying on the hedgehog’s single back-tested strategy in

a changing world is now dangerous. Instead, adopt a fox-like mentality: range across change.

The central challenge is that the multi-decade ‘everything trade’ driven by falling inflation, interest rates and volatility has also made conventional protections extremely expensive – and that’s before you consider the risk of inflation returning.

Instead, anything which can protect investors from the ravages of deeper financial repression are worth considering: inflation-protected bonds, real assets including gold and precious metals, perhaps a hard digital currency, too. All are ‘short’ positions on paper currency – in plain English, assets whose values increase in line with the authorities’ efforts to steal your savings by stealth.

If the authorities succeed in engineering higher nominal economic growth – the only plausible way to address both the debt and the inequality issues – commodities, infrastructure, cyclical and value stocks should perform strongly. So should emerging markets.

Desire for diversification may also make Chinese assets look irresistible, particularly if they march to a different beat as Cold War II drives further de-coupling. But geopolitical roadblocks and ESG restrictions are likely to make investing in China harder – and riskier – not easier. That said, every challenge brings a commensurate opportunity. Cold War II is creating winners every day, including economic spill-over beneficiaries such as Vietnam, Mexico and India. Japan looks interesting from almost every angle.



A white fox is shown in profile, sitting on a dark, textured rock. The background is a vibrant blue with a complex, organic pattern resembling a microscopic view of tissue or a digital landscape. Overlaid on this background are several yellow lines that form a circuit board or network diagram, with small circles at various points where the lines connect or terminate. The fox is positioned in the lower right quadrant of the image, looking towards the right.

Lastly, emergent economic-regulatory blocs centred on the US, China and probably the EU will shrink the available market for some global companies in high technology and will make it generally harder to access Eastern growth with Western stocks. National or bloc champions stand to benefit, both from reduced global competition and from more activist states championing their cause.

A NEW MAXIM NEEDED

For a generation of investors, a guiding principle has been “Don’t fight the Fed” – in other words, go with the direction set by the world’s major central banks. In the new, more-politicised era before us, central banks and commercial banking systems will be increasingly co-opted by governments. “Don’t fight the government” may become the new maxim.

The 2008 financial crisis and the 2020 covid crisis delivered a ‘one-two’ blow to the post-Cold War I order. That profitable regime rested in large part on ‘end of history’ assumptions, from geopolitics and human nature to inflation. But history hadn’t ended at all. It was just sleeping. The covid punch accelerated the return of great power competition, the rise of ESG, the digital revolution, domestic political shifts, the growth of debt, and the return of fiscal dominance. In turn, this has accelerated regime change for world order and markets.

Our New World Disorder will be characterised by greater volatility, higher inflation and deeper financial repression. This world privileges politics over profit, and favours the nimble, forward-looking fox over the backward-looking hedgehog who only knows ‘one big thing’ from an era that is ending. ●

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