Making a prediction in geopolitical uncertainty.

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I don't know when there's going to be a tweet about a tariff. I have no ability to get my head around that. We're broadly in geopolitics. We don't know when there's going to be a flare-up in the Middle East. Nobody predicted that we might be in the middle of a pandemic. These are all geopolitical factors that are becoming incredibly difficult for economists to forecast and incorporate. Some people try.

This is one of my favourites. It's the economic policy uncertainty index. This is produced by a few guys out of Stanford and taken on by the Federal Reserve as a way to measure how much uncertainty is truly in the economy. Here I have the United States, and I have China. I don't need to say much. If you feel like we're in a period of geopolitical uncertainty and economic uncertainty that is standard deviations above what we've experienced in the past, the ways that we can measure it would suggest that that is absolutely true.

Here's another one. This is from Bridgewater. This is publicly available. Bridgewater's developed world populism index. It tells us the share of voters who voted for what we might call populist parties in the developed world. It's at its highest since the 1930s. And it escalated again, very, very rapidly. This is not a slow trend change. When I get asked about income inequality, this is the first chart that comes to mind for me.

Now, I used to go around the world with my model outputs. I would show if you put X% tariff, this is what it does to exports and GDP, and I would show a variety of scenarios. But I stopped doing it because I think I was doing us all a disservice. Most of the problems associated with the rise of economic uncertainty are extremely difficult to measure. And my view is that a lot of the reasons that we misdiagnosed the 2018, the 2019 slowdown is that we failed to understand the behavioural changes that would come from this level of uncertainty.

This is U.S. CEO confidence. It plummeted following tariffs. It's consistent with growth that is probably around 0 to 1%. This was very difficult for us to measure, because we had no precedents. We had no way to know that this is how people will feel. But it turns out when business confidence plummets, so do business decisions. If you don't have clarity about the future, you don't know what your trade relationship will be, you don't engage in hiring and spending. You don't build the new plant that you thought about, you just say, "Give me a minute to find out."

We now have 2020 U.S. elections coming up that will add an additional layer of uncertainty, and it's probably one of the reasons that we continue to see depressed business investments in the United States and abroad. This is part of calling the cycle. This was part of saying, "Now we're going to be in a down-trend, now you can see some stabilizations" and this contributes to our view that the worst is over and we'll see some improvements ahead. This is the cyclical component.

But when I think about that down-turn line, what I see is a different story. So, I have two jobs. I am both an economist and a strategist. And a lot of the time, they're the same job. So, you know, I think the economy is doing this and therefore this is the trade. Sometimes they're very different jobs. And one of the things that's always weighed on me in having these two jobs is that if you look at manufacturing in the United States, it's only about 10% of the GDP. And it's less than 10% of employment. So, if you're an economist, and you have to forecast growth, you don't spend a lot of time talking about manufacturing activity. But if you're trying to get an estimate on the S&P 500 and you want to know where equities are going to go next, you better know manufacturing, because it's 45 to 50% of earnings in market cap. Basically, if you follow manufacturing in the United States, you can get a pretty good proxy for where the S&P is going to be over time.

And this always really perturbed me. How did we get to a situation where there was such a discrepancy between how the actual economy works and what happens in the S&P? And the reason came to me after we began looking into trade wars more aggressively. The left hand chart is your world average tariff rate. So, this is the price of doing business with you abroad, right? And it peaked in the 1930s. This was the Smoot-Hawley tariff, and it's been falling ever since. It's been falling for almost a century. This is the best picture of globalization that I can give to you. And over this almost century period, the companies that most benefited of the falling costs of doing trade or business abroad were your big multinational manufacturers. They were capable of growing much more quickly than the rest, and out-performing others. This is how they grew so much faster.

Our suspicion now is that we are at a tipping point, that we are moving from globalization to deglobalization. This is not just about U.S. and China, this is about the U.S. relationship with Europe. It's about Europe's relationship within itself. This is about a wave of focus on nationalist policies and away from this concept that globalization is the best thing for all of us. Is that right or wrong? That's not really for me to say. What I can say is that the world average tariff rate, when we forecast it out several years, is now starting to turn back up. And the companies that most benefited, the sectors that most benefited during the century long period of globalization are now those that are going to hurt the most on the way back.

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