FORSTRONG
GLOBAL

2021 SUPER TRENDS REPORT

THE YEAR AFTER THE EARTH STOOD STILL

CONTENTS

Dear Reader,

This planet we call home whirls around the center of our galaxy at some 220 kilometers per second. Yet in 2020, a virus one-millionth the size of a needle tip brought the world to a standstill. National borders, once free and frictionless, suddenly froze. Commutes were cut. Bedrooms converted to offices. Parents (bless them) became schoolteachers. Time itself felt motionless.

The human impulse is to think all of this is permanent. It isn't. Pandemics are a feature, rather than a bug, of the past's longer running rhythm. Yet covid has unleashed a new world, sending the earth spinning faster and further into the future. Perhaps paradoxically to some, most of Forstrong's Super Trends have accelerated — rather than stopped or reversed.

Where to from here? Today's outlook is a high voltage one, charged with potential scenarios that make typewriter keys twitch with possibilities. What is certain is that the highly stimulative policies introduced to address this year's economic fallout will linger far longer than the virus itself. A key lesson from the past is that when policy turns, especially during a crisis, it turns in a big way. We should not underestimate the power of this decisive shift.

Many are still misreading this. In fact, sweeping changes are washing over the investing climate that make many vulnerable to missing important signals. This observation reflects two strains of analysis. The first is fundamental: the economic slump triggered by covid is completely different from any previous downturn in recent history. We have never been here before. Covid is more of an exogenous shock rather the typical bust driven by monetary tightening or a deflating asset bubble. What precedents can we use as a guide?

The second type of analysis is behavioural. The great filmmaker Martin Scorsese once said, "Cinema is a matter of what's in the frame and what's out." Investing is the same. There is what we see and what we do not see. What appears outside the frame is often more important. Yet, today, people can plug into digital platforms that systematically exclude sources of information, enclosing members in an intellectually impenetrable layer of like-minded peers and biased blogs. A potentially rich, textured subject stays one dimensional. And so, the world can look completely different depending on the type of media consumed or group one identifies with.

All of this can be excitingly subversive or, on the opposite end of the spectrum, impervious to unconventional perspectives. Of course, it's all a trap. Inhabiting one distinct mental world presents a clear and present danger. The individual is chronically deprived of any new information. But beyond the individual's regular sightline, where the world could be perceived from a different angle, less innocuous trends may be quietly surfacing. It is there, in the wilder edges of the margins, where the best insights often occur.

Looking ahead, the pandemic's chilling effect on mass movement is thawing. People, information and capital are starting to churn, even if the trajectory of those pathways have been permanently altered. At some point, the world will spin freely again. More than ever, investors need to look out further and lean into long-term secular themes. Wide-angle global perspectives will be crucial to discern the path ahead and set the right investment roadmap.

We aim to do just that in the pages that follow. Forstrong's investment team, a collective with over 150 years of combined global experience, shares our best ideas about the world's most important Super Trends — those enduring themes that will have the largest impact on capital markets. Our hope is that this report will help investors make sense of the unfolding macro landscape.

A special thank you to our partners and clients for joining us on this journey. It is a distinct privilege to steward your financial futures.

Warmly,

Tyler Mordy

Chief Executive Officer and Chief Investment Officer
December 2020

SUPER TREND 1

YOU SAY YOU WANT A (FISCAL) REVOLUTION

Fiscal stimulus will lead to higher global growth in the coming years.

Tyler Mordy
CEO & CIO

Speed Read:

- A regime shift in global policy thinking is happening.
- Most importantly, monetary policy is being demoted, while fiscal policy is being promoted.
- Global growth will be higher in the coming decade than the last one. A big shift in investment leadership is now underway.

"The thing the sixties did," John Lennon observed near the terminal point of his life, "was to show us a glimpse of the possibilities." Apart from the two world wars, the Beatles were living through the most explosive and divisive time of the twentieth century. In 1968 alone (the year *Revolution* was released), France came perilously close to civil war, Soviet tanks stormed the streets of Prague and humanity witnessed the assassination of Martin Luther King Jr. The summer of love had mutated into a winter of discontent.

Regime changes may look like a single event in retrospect, but they are never experienced that way. Instead they are protracted periods, decades even, where the existing order disintegrates and is replaced with a new way forward. This is always messy. Old regimes never fall apart neatly and completely — things are taken apart piece by piece. Different people and different institutions with different agendas, however, eventually become fused into a more or less stable constellation. Radicalism ultimately wins.

It is this backdrop — the early stages of an unstable and stealth regime change — where investors stand in the closing days of 2020. The issue at hand is how to create higher and more sustained economic growth. The revolution taking place is in the realm of global policy thinking. How should policymakers respond to a persistently slow growth era and one where coronavirus will cast a long shadow?

The History Of Global Policy Thinking: You Tell Me That It's Evolution

Amidst a global pandemic, moderation suddenly seems inappropriate. This should not be surprising. An urgent desire for change — for fast resolution to turmoil — is characteristic of any crisis. It always takes a trauma to shake up economic thinking. The Great Depression set policy on a far different path, ushering in a Keynesian era where governments used budgets to fine-tune growth and inflation. That orthodoxy came crashing down in the raging inflation of the 1970s. From there, central bankers emerged as the leading macroeconomic managers. By the mid-2000s, they would boast of having achieved a "great moderation": economic and inflation variability had been tamed. Everyone agreed that monetary policy was the most effective tool for managing the economy.

All that changed after 2008's global financial crisis. To fight the downturn, worldwide central banks pursued near unfettered monetary expansion: an additional USD $16 trillion amassed on their collective balance sheets. That largesse did not work out as planned: central banks consistently fell short of both their inflation and growth targets. Yet governments flatly refused to engage the fiscal lever in a meaningful way. Deleveraging, austerity and balanced budgets were in vogue. Monetary policymakers

By the mid-2000s, they would boast of having achieved a "great moderation": economic and inflation variability had been tamed. Everyone agreed that monetary policy was the most effective tool for managing the economy.

were forced to carry the entire policy burden — grumbling the entire way and becoming the world's leading fiscal stimulus evangelists.

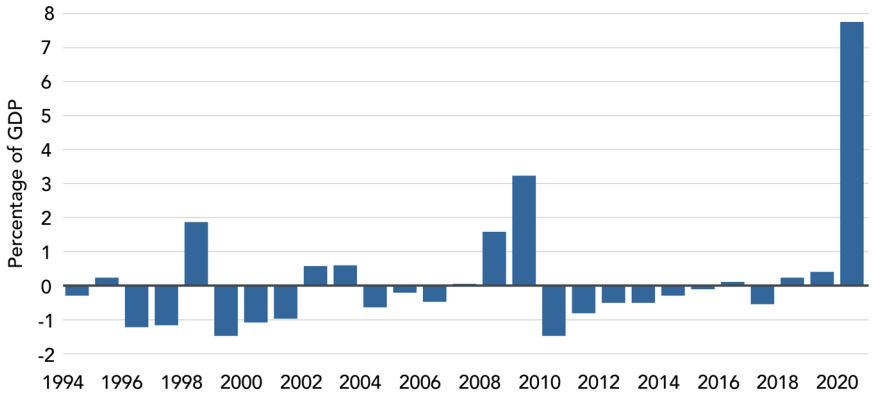
A New Policy Approach: You Say You Got A Real Solution

All of which brings us to today. The pandemic may not yet be a moment of reform, but it is certainly one of revolutionary break. Fiscal stimulus has arrived fast and furiously. More fiscal spending was announced in the month of April than the entire 2008-2009 global financial crisis. Globally, over USD $12 trillion in fiscal support has been pumped into the economy to fight the impact of covid, leading to soaring budget deficits and setting in motion a Super Trend with a durability to last several years.

Have governments done too much? Apparently not. Plans for additional fiscal spending are still widespread, ranging from tax cuts to infrastructure projects to initiatives that move the world further away from its carbon intensity. And, a consensus amongst policymakers has emerged: the risks of doing too little greatly exceed the risks of doing too much. In Canada, the deficit this year is on track to be six times greater than the largest one in the country's history. Elsewhere, fiscal levers are decisively being engaged. Even the Eurozone — long stuck in an ideological fiscal logjam — has abruptly broke free. The €750 billion European Union recovery fund ratified in July is a historic agreement, smashing through two major taboos: explicit fiscal transfers across member countries and the large-scale issuance of common EU bonds.

COVID-19 OPENED THE FISCAL FLOODGATES

G20 Countries - Annual Change in Government Expenditures



Sources: Macrobond, IMF, Forstrong Global Asset Management

Underpinning all of this is a rapidly ascending school of thought called Modern Monetary Theory (MMT). Its central premise is that federal governments are unlike households because they have the power to issue their own currency (read: money printing). Therefore, all the handwringing and ink spilled over governments going broke are misplaced. When governments try to manage their finances like households, they miss out on the opportunity to harness the power of their currency. Above all, MMT is a new way of thinking about the potential for higher fiscal spending. As one of its leading proponents, Stephanie Kelton, has noted: "austerity is a failure of the imagination."

Now whether investors agree with these statements or not is irrelevant. Policymakers are steadily moving toward the adoption of its ideas. And, MMT arrives at a ripe time. An enormous appetite exists for new solutions to the issues facing modern economies. The rolling crises of the last two decades have shaken the public's trust in established ways of thinking. MMT provides support for a new policy approach.

Looking ahead, the big surprise will be the persistence of government spending. Once turned on, fiscal taps cannot be shut off easily. As Milton Friedman once wryly observed, "nothing is so permanent as a temporary government program."

Investment Implications: Don't You Know That You Can Count Me Out (In).

Just as Lennon's conflicted lyrics conveyed in 1968, investor can feel powerless during regime changes. And for good reason. The rules of the game are changing. The world we once knew is falling apart. History feels like it is out of our hands.

In reality, however, a fiscal policy revolution has been stirring for some time. Investors should not lose sight of the bigger picture. The last decade was characterized by slow growth, deleveraging, dis-inflation and skittish investor sentiment from 2008. Secular stagnation was the dominant narrative. In this environment, investors aggressively bid up assets not linked to broad economic growth: technology disruptors, growth stocks and fixed income. The US dollar was also chronically strong, perceived as the safest house in a post-crisis neighbourhood. The problem is that all these assets now trade at a large premium, also quickly pricing in their advantage in a covid world.

But what could change this situation? Growth — and a return of some inflation. Investors should not lose sight that fiscal thrusts pack a bigger punch than the monetary variety. Importantly, the transmission effects are much more direct, boosting consumption, investment and liquidity. More money immediately enters circulation. Inflationary pressures increase.

Many may protest fiscal policies which can lead to currency debasement or simply steal growth from the future. Those are worries for another time. At this point, markets are nowhere close to pricing in higher growth. Cyclicals and value stocks, nearly left for dead by most investors, are starting to show life. US assets will falter relative to other countries as capital becomes braver in its search for alpha. Make no mistake, this is the beginning of a massive shift in investment leadership. The coming spectacle, in the parlance of another era, will be quite a trip.

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SUPER TREND 2

ZERO INTOLERANCE REVISITED

Investors will not tolerate low interest rates forever; new income sources must be found.

Wilfred Hahn
Global Strategist

Speed Read:

- Ever-lengthening longevity and plunging birth rates globally cause the cost of future retirement income to soar. It is a form of inflation that is generally overlooked by economists.
- Investors must increasingly rely upon non-renewable capital as "peak income" is reached.
- No matter that nominal income yields are near record lows, one must nevertheless continue to search the world for positive real interest rates.

We have been tracking a "global income crisis" for well over two decades. New confirming symptoms are appearing. Therefore, it is essential that its impact should be understood by all retirees present and future.

Originally, we recognized that ever-lengthening longevity and plunging birth rates would lead to the onset of what we called "Zero Intolerance". Interest rates would plunge to the zero bound and "zero" intolerant investors would therefore begin to look for escapes and alternatives. The consequent frenzied dash to accumulate future income played a facilitating and reinforcing role in driving down interest rates and channelling enormous inflation into asset markets.

There are additional causes of slumping interest rates to be sure. However, without the aforementioned demographic shifts, Zero Intolerance would not have occurred. And so, declining interest rates around the global began to reduce the income yield of retirement portfolios. More and more capital would therefore need to be saved in order to maintain a level retirement lifestyle. For example, it takes more capital at an average of 1% yield than a 2% yield … in fact, twice as much. We have pointed to this rising cost of future financial income as the greatest inflation of our era. The yield inflation in the example above is equivalent to 100%!

Therefore, actuaries and their employers (pensions and insurance companies mostly) have been pummelled by the unexpected this past half century. Populations began to age rapidly and households began to shrink. Time after time experts underestimated these trends. Actuarial forecasts of future longevity were plain wrong … repeatedly; and the social shifts to lower population growth were not well understood.

The result? Interest rates have plummeted these past five decades. In fact, many government bond yields have fallen to levels of 0% … and below. The face value of negative-yielding debt has soared to $17 trillion worldwide (representing 70% of world sovereign bonds outstanding).

Predictably, financial income is now so low that other sources of future cash flow must be found.

Consider the plight of the financial planner today. Perhaps only a decade ago, many households could plan their retirement expecting to solely live off the income proceeds of their retirement portfolios. For many, that is no longer possible.

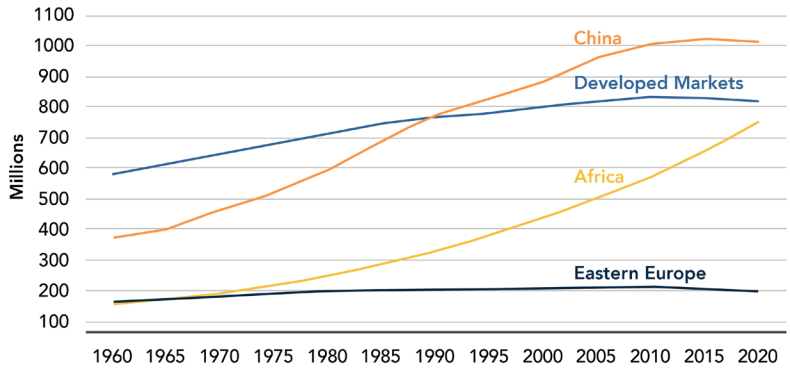
Consider that the "post-WWII baby boom cohort" is now going through a 180-degree about-turn.

Where once this retiring generation was the legendary conspicuous consumer, driving economic growth and personal expenditures (PCE) as a share of GDP, today they are needing to become consumers of capital instead. Out of necessity, they must start to run down their capital in order to generate cash for their retirement expenditures. A serious turn of mind has therefore unfolded.

While the world today likes to disapprove of the use of non-renewable energy, at the same time it finds itself backed into the situation where it must depend on "non-renewable capital!

And so, declining interest rates around the global began to reduce the income yield of retirement portfolios. More and more capital would therefore need to be saved in order to maintain a level retirement lifestyle.

WORKING AGE POPULATION GROWTH SLOWDOWN IN WORLD'S LARGEST ECONOMIES



Sources: Macrobond, FT, United Nations, Forstrong Global Asset Management

Income yielding investments (i.e. a high-yielding equity) produce renewable income and capital. That counts as renewable capital. Also, dividend payments recurrently provide renewable income and cash flow. But, given plummeting interest rate levels (this generally also applying to dividend yields to an extent) renewable income is becoming a dying specie … and expensive.

Therefore, with declining renewable income, investors must increasingly rely upon non-renewable capital. Portfolio holdings are therefore being liquidated to generate sufficient cash to pay for retirement costs. This is a perspective not well explained to the public.

Geologists may talk of "peak oil" (this notionally meaning the point at which oil demand has terminally outstripped supply). In a way, a similar phenomenon is occurring with financial income. Peak income has been reached. This implies that demand for income (renewable income) now exceeds supply. Therefore, non-renewable capital must be sourced to make up for the insufficiency in renewable income. Non-renewable flows of capital must be accessed to generate cash sale of an asset in order to fund the cost of one's lifestyle.

Past the Point of No Return

To make matters more challenging, lately, monetary policymakers, too, have forced markets down the road of lessening renewable income (lower interest rates). It is one thing to have no income returns, quite another that policymakers can no longer reverse their interventionist polices.

It presents a double whammy. As already discussed, there is declining "renewable return" … i.e. lower interest rates.

And now, monetary and fiscal policies find themselves are past the point of "no return." Given the increase in debt levels globally ($15 trillion alone in the first three quarters of 2020), policymakers must now manage capital market valuations, too.

Investment Implications.

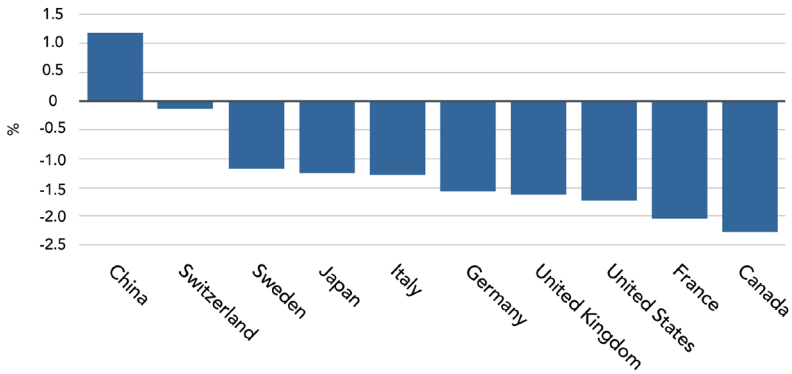
No matter that nominal income yields are near record lows, one must nevertheless continue to search the world for positive real interest rates. Admittedly, these are rapidly disappearing. Yet, they are still available. Go global. Consider that China's real 10-year rates are positive. It is one reason why we think that Chinese (and other Asian) government bonds will be a source of above average income yield … and also act as anti-fragile assets.

Equities that pay good dividends are the clear-winner asset. That said, investing globally or in stocks may seem risky to investors who have been conditioned to rely upon fixed-income investments for their retirement. However, as long as one focuses upon stocks that have earnings yields that are 2 or more percentage points in excess of a sovereign 10-year yield, this recommended strategy has a high probability of boosting overall income and returns.

Finally, it is likely that some investors will consider themselves unsuited to pursue the strategy of buying equities because they are wary of volatility. That is a trade-off that must be considered in order to generate sufficient returns.

SEARCHING FOR POSITIVE REAL YIELDS: CHINA STANDS ALONE

Real 12 Month Government Bill Yield (Using IMF Deflator Estimate)



Sources: Macrobond,Gavekal Research, IMF, Forstrong Global Asset Management

SUPER TREND 3

ZOOM AND THE ART OF REGULATING BIG TECH

Regulators can "move fast and break things" too.

Ka Lam Tsang

VP, Trading and Investment Operations & Portfolio Manager

Speed read:

- Big tech's era of "moving fast and breaking things" is over.
- Antitrust regulators have caught up with this ethos. They have a history of overshooting.
- Silicon Valley's disruption engine has been a big prop to US equity outperformance over the last decade. This previous tailwind is now a stiff headwind.

Silicon Valley's scrappy attitude of "move fast and break things" has not only become standard startup advice, but quickly evolved into a global movement for Big Tech. On the surface, this approach is all about testing new ideas, iterating quickly and aiming for more frequent points of learning. But, don't be fooled, the overriding philosophy is simple: more is always better. More clicks. More downloads. More eyeballs. And faster — anything less than warp speed, hair blown-back velocity is unacceptable.

Yet, a rich irony is emerging. It turns out that regulators, too, can move fast and break things. The first significant shot across the bow for the tech industry came on October 20, 2020 when the Department of Justice sued Google parent Alphabet for anti-competitive conduct. The lawsuit claims that Alphabet's payments to Apple Inc. to make Google its default search engine contravenes US law (Alphabet remits some USD $10 billion annually to Apple for this privilege). Then, in December, Facebook was sued by the Federal Trade Commission and 48 state attorneys-general for anti-competitive practices. The key allegation here is that Facebook's purchases of WhatsApp and Instagram were strategic targets to neutralize their respective threats and entrench its own position as the dominant social networking platform.

But these individual cases are really about a much bigger issue: a shift in the regulator's worldview. Increasingly, they view Big Tech through a different world lens — not as individual companies operating in efficient markets, but as winner-takes-all monopolists abusing their power.

This reflects a deeper understanding of Big Tech's business models, where the preferences, exchanges and interactions of users are monitored, leveraged and ultimately pushed and promoted across business lines through behaviourally-targeted algorithmic methods.

Looking ahead, regulators show no signs of slowing down. And why should they? The pandemic has hyper-charged the world's movement to digitization. Data, not oil, has become the lifeblood of the modern economy. Google, Facebook and Amazon now account for some 70% of online advertising globally. There are legitimate concerns that Big Tech will stifle innovation and continue to swallow younger competitors.

It's not just an American issue. Authorities all around the world have Big Tech in their sights. And they are gaining momentum. Companies like Amazon are facing growing hostility in Europe for paying low levels of local tax, invading privacy and crushing their rivals. An EU commission recently announced that it had reached a preliminary view that Amazon has violated their competition rules, pushing consumers toward its own products and away from unaffiliated marketplace sellers.

Brussels has also published draft papers of two new proposed regulations. Both papers aim to tackle unfair competition in the tech sector and represent the first significant overhaul of the EU's approach to tech in over two decades. The proposed rules are an acknowledgment that existing antitrust law is inadequate and too slow-moving in the digital age. If passed into legislation, the laws would represent one of the most stringent set of regulations on Big Tech in the world and carry huge fines for offenders.

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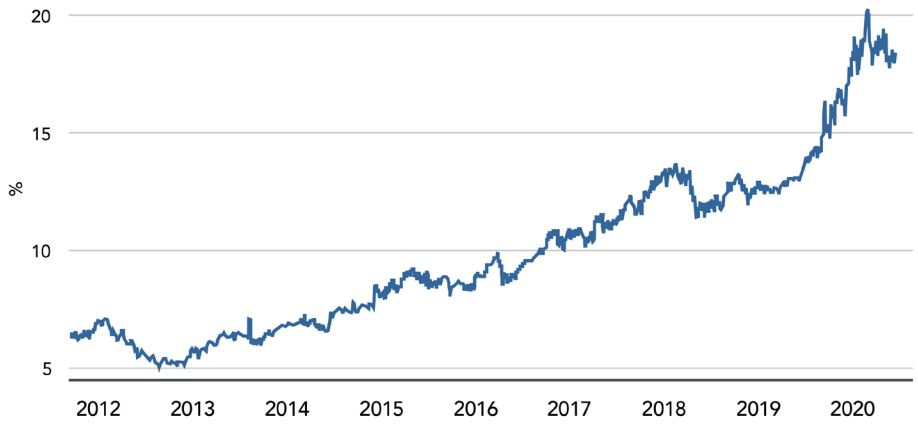
Investment Implications.
Silicon Valley's disruption engine has been a big prop to America's equity outperformance over the last decade. When most companies slashed spending in order to boost earnings, tech provided a rare shot in the arm — an inoculation against a growth-deficient world.

The problem is now twofold. First, everyone is in on the trade. Valuations are very rich. The FAANGs recently accounted for more than 20% of the S&P 500's market cap. Apple alone commands a bigger weight in the MSCI World equity index than any other single country apart from the US and Japan. A related issue is that several companies have tried to get in on the party, positioning themselves as tech unicorn plays. Through a combination of clever marketing and the willingness of shareholders to look the other way, many of these companies have, to put the most charitable spin on it, inflated expectations (perhaps a company that straps an iPad to a stationary exercise bike should not have a market cap of over $60 billion dollars?).

But it is the regulators who will throw a big stick in the spoke of Big Tech's business model. Future acquisitions will face far more hostile scrutiny. Some of the incumbent tech giants could even be forced to breakup. In almost every way, tech companies will face a far more adverse regulatory environment over the coming years. The air has already started to go out of the most overstretched valuations. But there is plenty of room for further deflation — and for things to be broken.

FAANG STOCKS' INCREASING DOMINANCE OF THE US EQUITY MARKET
FAANG Market Cap as % of S&P 500 Market Cap



Sources: Macrobond, S&P Dow Jones Indices, Forstrong Global Asset Management

SUPER TRENDS 4

LEGENDS OF OIL'S FALL: A DECARBONIZED FUTURE?

Peak oil demand may not be upon us yet, but covid has accelerated its inevitability.

David Kletz
Vice President, Portfolio Manager

Speed Read

- Over-investment and the North American shale revolution have morphed the oil market from a price-fixing regime to a more volatile market-dictated regime. Prices now orbit around US producer marginal costs.
- The proliferation of renewable energy sources has driven down costs and drastically improved the economics of "green" policies.
- The energy sector will face significant upheaval over the coming years. Oil will still experience cyclical rallies; but global asset allocators should remain structurally underweight.

Jim Harrison's 1979 novella "Legends of the Fall" references the biblical fall from innocence. The epic tale, further popularized by the 1994 film of the same name, chronicles the Ludlow family lineage; unfolding over numerous time periods and geographies. Comparing Brad Pitt's depiction

of the protagonist Tristan Ludlow to the modern history of oil in the global economy may be a rather "crude" comparison, but, stay with us, both have experienced a multi-generational degradation of virtue.

A legendary transformation

Despite the resoundingly negative connotation now attached to oil, gas and the broader fossil fuels complex, these energy sources were once celebrated for powering the industrial revolution which greatly enhanced the global standard of living. The oil market has experienced numerous regime changes and regional centers of influence, as corporations and governments wrangled for control of the lucrative commodity.

In the early 1900s, the oil market was dominated by a handful of "super-major" companies (which have amalgamated into the oil majors still present today such as ExxonMobil, Shell and BP) concentrated in the US and Europe. The formation of OPEC in 1960 did not initially have a major impact on the market, but by the mid-1970s, the Middle East had become oil's epicenter and trans-governmental price-fixing became an overriding industry fixture. A resurgence in US production brought us to where we are today, which is a fractured and volatile market seemingly still in search of equilibrium. Focusing specifically on this last regime change, it is critical to understand the underlying drivers and their implications for the future.

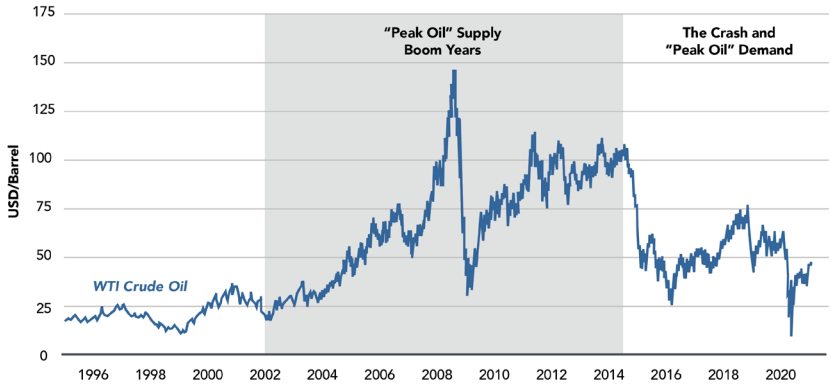
Peak oil and the shale revolution

The term "peak oil", now commonly the central debate surrounding the trajectory of global oil demand (more on this later), once referred to concerns that the world was running out of oil supply. This belief helped underpin a structural rise in oil prices from 2002 to 2014 (albeit with a short-lived but severe crash during the Global Financial Crisis in 2008). Predictably, capital investment was deployed in droves. The oil and gas industry's capital budget increased nearly ten-fold from 1999 to 2012 to approximately USD $1 trillion.

Critically, this explosion of investment occurred simultaneous to (and was further enabled by) the development of new techniques of hydraulic fracturing or "fracking", which allowed oil and gas in large US shale deposits to be economically extracted. US production soared; increasing over 60% to approximately 9 millions barrels per day between 2010 and 2014. This rapidly rising incremental supply source was a key contributor to the oil price crash of 2014-2015.

Despite the collapse in prices, the US continued to ramp up production, hitting an all-time high in 2019 of over 12 million barrels per day. The nation is now viewed as the world's "swing producer", meaning that it is the supplier with the greatest spare capacity and thus has the greatest influence over oil prices. West Texas Intermediate (WTI) crude oil prices have essentially orbited around the average US producer's marginal cost of production, which the Federal Reserve Bank of Dallas survey shows is currently near $USD 50 per barrel.

THE OIL MARKET'S NEW REGIME



Sources: Macrobond, Forstrong Global Asset Management

The Fall

Major trend changes are always triggered by a catalyst. The death of Tristan Ludlow's younger brother during World War I not only caused him to become temporarily unhinged, but also represented a turning point in his overall psyche and outlook on life.

Oil's transition from darling to pariah was not quite as straight forward. However, the aforementioned surge in fracking activity was certainly a contributor. While oil extraction was never an environmentally friendly pursuit to begin with, fracking is particularly harmful, with widespread concerns about ground and surface water contamination, methane leakage, seismic activity and numerous others.

Additionally, resource depletion, air quality and global warming concerns are not a new phenomenon for carbon intensive industries. However, alternative energy sources were previously either prohibitively expensive or, in the case of nuclear energy, tarred by previous catastrophes and anxiety towards radioactive waste disposal.

The tide began to turn over the last decade, as technological proliferation in renewable energy generation (particularly solar), battery storage and electric vehicles (EVs) led to sharply improving efficiency and falling costs. Solar consumption has increased from approximately 21 terawatt-hours in 2009 to 724 in 2019. While subsidies have been heavily relied upon to stimulate demand, unsubsidized solar energy is reaching cost parity versus fossil fuel-generated electricity in a growing number of markets.

Both the solar and EV markets continue to benefit from advances in battery storage efficiency, which has improved solar economics and the range EVs can travel on a single charge. EV global market share has more than quintupled since 2015, from 0.6% to 3.2% in 2020.

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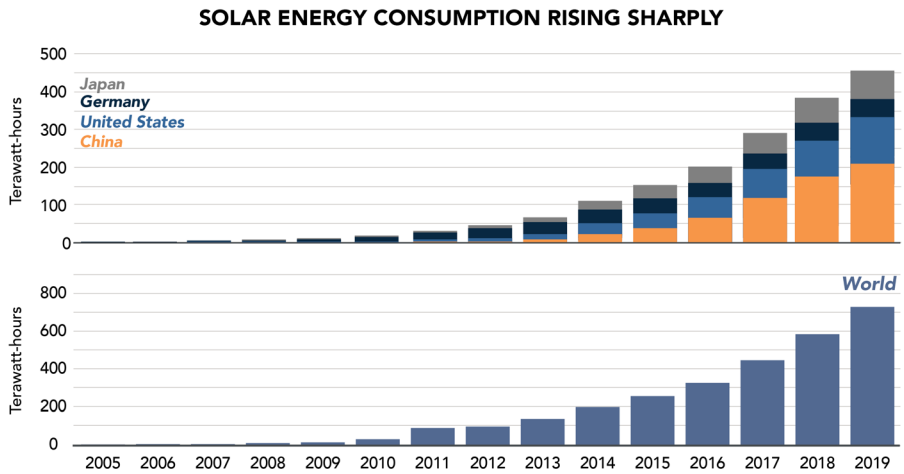


Sources: Macrobond, BP, Forstrong Global Asset Management

Taken together, the breakthroughs in renewable energy and EVs now provide tangible alternatives on both the supply and demand side of the energy market. This has enabled significant commitments from governments (such as the 2016 Paris Agreement) and corporations alike to reduce their respective carbon footprints.

COVID-19 the accelerant

The slowdown in global economic activity triggered by COVID-19 lockdowns caused major distortions in the oil market in 2020. Falling demand and rapidly shrinking storage capacity caused an unprecedented dislocation in the futures market, with oil temporarily trading near negative $USD 40 per barrel. While order has since returned to the market, prices remain sharply lower than their pre-pandemic highs.

In recent years, falling oil prices have been a reliably troubling indicator for renewables and EVs; effectively decreasing their competitiveness for cost-sensitive consumers. However, it appears that 2020 will buck that trend. Remarkably, despite a sharp downturn in automobile sales this year, EV sales actually increased by approximately 6% to 2.3 million units. Investors have clearly taken notice, bidding Tesla's stock up over 700% year-to-date; making its market capitalization greater than the next five biggest automakers combined.

On the political front, Joe Biden's victory in the US presidential election should see the nation (the world's second largest producer of fossil fuel carbon dioxide emissions) quickly re-join the Paris Agreement. COVID-19 fiscal stimulus packages (particularly in Europe) have been structured to prioritize low-carbon investments. Approximately 30% of the European Union's combined EUR 1.07 trillion 2021-2027 budget and EUR 750 billion recovery package has been earmarked for "green" projects.

Industry giant BP has revised its oil demand forecast, predicting that annual consumption will never surpass the level reached in 2019. Time will tell if this is too aggressive. Other estimates of "peak oil" demand range from 2028 (Rystad) to 2040 (OPEC) to a "long plateau" from 2030 onwards (International Energy Agency). Regardless of exactly when peak oil is reached, with increasingly favourable alternative energy economics, widespread policy support and a continuing move away from internal combustion engines from both automakers and consumers, the trend towards a decarbonized future is irreversible.

Investment Implications

Tristan Ludlow returned home from the war a broken man. Unable to resume his life on the homestead, he decided to travel the world, in hopes of reinventing himself and finding new meaning for his existence.

Today, it is the energy sector in need of reinvention. We are not suggesting the imminent demise of the sector, but that it has arrived at a pivotal turning point. Companies that have the foresight to divert their free cash flow from oil and gas capex to purchase and develop renewable energy assets should survive and even flourish. But inevitably, many companies will not act quickly enough.

Similarly, peaking demand is not an immediate death sentence for oil. From a cyclical perspective, oil prices will remain sensitive to global growth expectations. If falling capex sufficiently tightens supply conditions, one could even make a medium-term case for oil upside. But we would advise investors against getting too lathered up. Caution is still in order. ESG investing is gaining momentum with institutional and retail investors alike, and carbon intensive investments have fallen out of favour. COVID-19 has caused behavioural shifts which will accelerate demand impairment (including reductions in business travel and commuting which will endure longer than the pandemic). Investor fears of stranded reserve assets will also overhang the market. Accordingly, we view oil as a potential tactical exposure to position for a cyclical upturn, but longer-term, we remain structurally underweight.

In recent years, falling oil prices have been a reliably troubling indicator for renewables and EVs; effectively decreasing their competitiveness for cost-sensitive consumers. However, it appears that 2020 will buck that trend.

SUPER TREND 5

EUROPA: A VISIT TO THE AESTHETICIAN

A big turn in EU policy will lead to a structural re-rating of Eurozone stocks.

Mark Arthur

Advising Member of the Investment Committee

Speed Read

- For Europe, we identify long-running trends. However, they must be seen as retro rather than super.
- This cumulation of retrograde trends and urgent Covid support programs have finally triggered some major pan-European changes over the intermediate term.
- The stimulus effects of free-running budget deficits and new free-reigning central bank policies will lead to a strong economic rebound.

From a geopolitical point of view, we see the world as falling into three main sections — the Americas, Europe and Emerging Asia. Their interactions are essential to monitor and anticipate. These regions are like three separate tectonic plates — grinding and pushing against each other. Every now and then, a pyrotechnical event may occur … a pyroclastic steam burst … or some tremors.

Indeed, the geopolitical changes in respect of the three orbs mentioned, have been massive and rapid over the course of the past few decades. Critically, however, the tectonic plates are again shifting quickly. This has major implications for Europe. How so? Crucially, Europe's situation must be viewed through the prism of the other two jostling juggernauts. What is a new development is that China is mounting a common response to both Europe and America … in fact, the entire western world. Whereas the EU could let America pursue aggressive actions against China on its own, Europe will not have any immunity to the fall-out of China's policy actions.

Without a doubt, China is in the process of setting up a counter universe to the US-led world system. This initiative is already well advanced. In view of the comments above, the implications for Europe seem fairly clear. There will be no kid gloves or special relationship for Europe with China.

China's response to the Covid crisis sends a bright signal that geopolitical strategies are changing. China is being far less interventionist in its economy and financial system than in reaction to either the 2003 Sar's virus outbreak, the 2008 global crisis or its own 2015 stock market bubble. China's current economic policies are now starkly different than that of the West. While the West has slashed interest rates, marshalling huge economic and monetary support programs and massive boosts in debt levels, China has not. It has not needed to do so. Its actions, we believe, are deliberately intended to contrast with those of all Western policymakers.

As interest rates have plunged below the zero-bound around the world, China maintains positive real rates on its sovereign debt. As COVID related support programs sought to forestall corporate failures, bankruptcies in Europe have since fallen by 10% are more (year-over-year) even as conditions worsen. In contrast, China is allowing the markets to naturally cleanse itself of its zombie companies. High profile companies are being allowed to fail in China. These policies will promote higher productivity over time. Not so in Europe.

The EU Endgame

From its inception, the main strategy of the European Union has been to continue to build out its country membership and increase its size (both in terms of GDP and population) by acquisition rather than organic growth. To continue the gambit, the union needs to continue to expand its country base, and then work to converge their policies, whether monetary or fiscal.

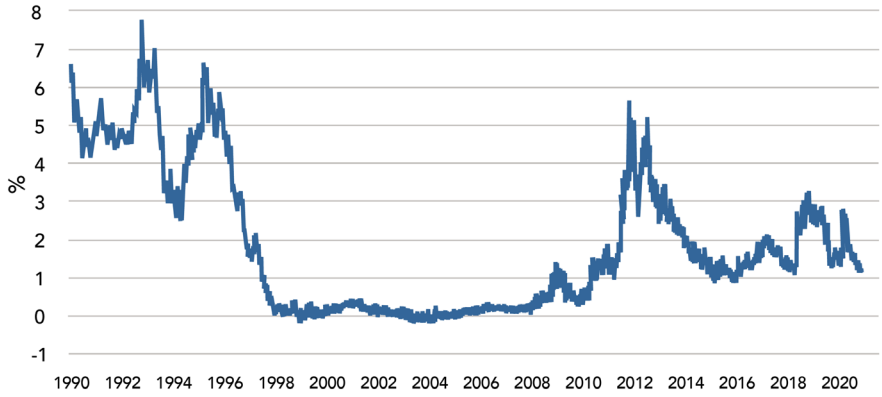
As such, the major investment play in Europe for the past two decades or so has been make gold out of dross … this most certainly applying to the European bond markets. Consider, for example, that Italian 10-year government bonds at one time traded at a yield spread of more than 8% to German Bunds. Today? The yield spread is not much more than zero and select Italian government bonds have even sported negative yields. What has happened, in effect, is that Italy (through institutional means, of course) has heisted the fine credentials of the more austerity-minded members of the European Union (i.e. Germany and the Netherlands … etc.) for its own benefit. The investment quality of Italian bonds certainly did not improve in tandem with its soaring bonds prices.

We would posit that the main geopolitical and structural strategies of Europe have come to an end of their effectiveness. Growth though country member admission is over. This could not be any clearer with the advent of Brexit. No matter the nature and terms of the final deal between the UK and the EU, country expansion of the EU is passed. Actually, largely attributable to the UK, it has begun to reverse. It is not just a minor bump in the road. The UK represents a relatively large population (67.8 million, representing 15.2% of the EU) and pays almost 10% of the EU budget.

Indeed, many of its member countries are influential purveyor of "soft power" (i.e. France). However, with negative net population growth, and a gaggle of member countries that are on EU life support of one kind or another, economic growth would remain slow seen over the long-term.

ITALIAN BONDS HAVE BEEN A MAJOR BENEFICIARY OF EUROPEAN INTEGRATION

10 Year Government Bond Yield Spread: Italy vs. Germany



Sources: Macrobond, Forstrong Global Asset Management

However, the crisis born of the Covid-19 pandemic has indeed triggered the breaking of some kitchen pottery. Past EU limitations have been relaxed. Most notably, the pandemic has pushed fiscal transfers across member countries and allowed the large-scale issuance of common EU bonds. The ECB also announced that it would increase its asset purchases to Euro 1.85 trillion as an extension of Pandemic Emergency Purchase Programme (PEPP). Its programs are seen to be in force until at least March 2022. These policies, along with fiscal deficits expansions now being allowed beyond an equivalent of 3% of GDP to twice that, are sure to stimulate economic rebounds.

However, the crisis born of the Covid-19 pandemic has indeed triggered the breaking of some kitchen pottery. Past EU limitations have been relaxed.

Investment Implications

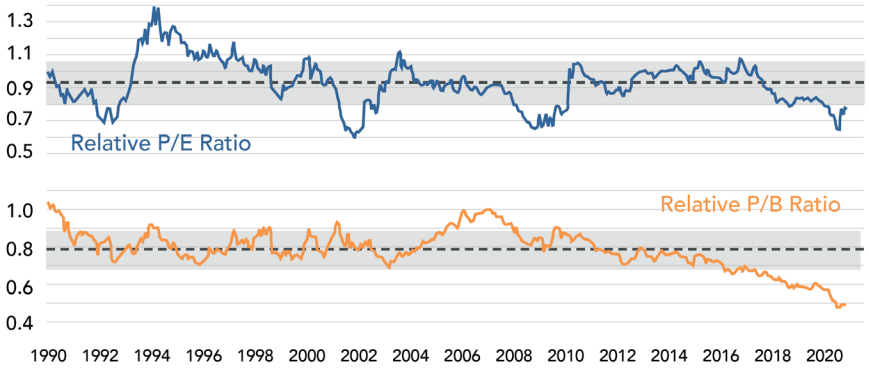
We identify one main investment play in Europe. As already intimated, the term Super Trend could be considered a malapropism as applied to Europe. Neither word seems appropriate to Europe at large over the long haul. As explained, Europe has no viable long-term strategy to boost its global influence nor to advance its economic footprint relative to the world.

However, over the medium term (and within the scope of our Super Trend's 3 – 5 year timeline), we expect a strong economic recovery starting in 2021. Institutionalized roadblocks to monetary and fiscal stimulus have been significantly removed. A lease on life has been extended. In fact, we give Europe a modest over-weighting in our portfolios. We expect the Euro to continue to strengthen against the U.S. dollar.

Finally, we find no enthusiasm for European bonds. Interest rates are low … much of it with negative yields. There are far better places to secure positive "real" rates in the world.

MSCI EUROPE VS. MSCI USA:

Depressed Relative Valuation Multiples



Both ratios rebased to 1 as of December 31, 1989
Sources: Macrobond, MSCI, Forstrong Global Asset Management

SUPER TREND 6

THE UNTOLD STORY: CHINA'S SHIFT TO HIGH QUALITY

Chinese assets are becoming a new safe haven.

Tyler Mordy
CEO & CIO

Speed Read

- Much misinformation still dominates China narratives.
- The year of coronavirus has revealed many strengths of the Chinese economy and its financial markets.
- Looking ahead, Chinese assets — stocks, bonds and the renminbi — are now experiencing a structural re-rating to higher quality. We are only in the foothills of a long journey.

In 1927, Edmund Morgan Forster, the great English novelist, explained the difference between a story and a plot. "The king died and then the queen died" is a story, he wrote. But that is simply a sequence of events. A plot is needed to make the story come alive: "the king died and then the queen died of grief." In this case, chronology is preserved but a sense of causality overshadows it.

Investors all too often fall for stories with flimsy plots. Nowhere is this more evident than China. Many Westerners continue to impose superficial narratives on the country, based on scant observation. When China joined the World Trade Organization in 2001, most thought they would rapidly liberalize. Japan, Taiwan and South Korea had followed a similar path to democracy — why couldn't China? Then, since 2008's global financial crisis, the conventional wisdom has been that a China crash, complete with the toppling of a precarious structure of credit, is imminent.

Those outlooks have been wrong. In fact, China has consistently surprised investors at every turn. All of which begs the question, what is the alternate script?

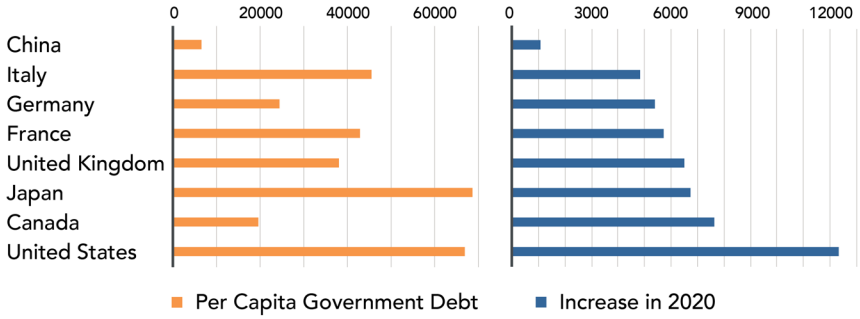
This Year's Turning Point

Coronavirus has thickened the plot. It may seem rash to draw lessons from a pandemic that is not yet a year old, but the signs are already clear: China has made a huge leap forward relative to North America, Europe and the weaker emerging markets.

This can be seen most clearly in China's policy response relative to America. To combat the impact of the virus, the US spent more money per capita than any other government in the world ($12,797 per capita and rising). And, the US Federal Reserve, already well into a type of monetary dark age, was by far the most active among major central banks, pumping an extra USD $3.2 trillion into its system.

By contrast, China remains solidly conventional. The country's per capita government debt in 2020 increased by just $1,191. Its central bank also still runs very traditional monetary policy. The list of countries doing so has dramatically shrunk since 2008, and then, completely cratered during coronavirus. And while the world watches much of the developed world stagger to its ugly year-end, China is a bright spot. Next to Sweden and South Korea, China is the only economy the OECD forecasts to overtake their pre-pandemic economic size in 2021.

GOVERNMENT DEBT VS POPULATION SIZE IN MAJOR ECONOMIES



Sources: Macrobond,Gavekal Research, IMF, Forstrong Global Asset Management

China also remains one of the few major sovereign borrowers that offers positive real yields (while most of the developed world's bloated bond markets have been sucked into a black hole of negative interest rates). And, Chinese stock markets have outperformed their developed peers with less volatility this year.

Stories We Don't Tell

Looking ahead, most investors understand China's baseline story of relentless and eye-watering growth. In speed and scale it is unlike any other. Measured in US dollars, the Chinese economy is 30 times larger than 30 years ago and will almost certainly surpass the US over Forstrong's Super

But those are just stories in statistical enumeration. A more durable narrative lies in the way China has transformed in recent years and the impact that has had on its domestic financial markets.

Trend cycle (3 – 5 years). And, yes, the country's growth pace is moderating. But China's growth calculus has changed. Growing roughly 6% on a USD $14 trillion dollar economy contributes far more to global GDP than two decades ago when it was growing at 10% on USD $1 trillion.

But those are just stories in statistical enumeration. A more durable narrative lies in the way China has transformed in recent years and the impact that has had on its domestic financial markets. Beijing has long promoted four transitional imperatives: the shift from export and investment-led growth to an economy driven increasingly by domestic consumption; the shift from manufacturing to services; the shift from surplus saving to saving absorption in order to fund a broader social safety net; and the shift from imported to indigenous innovation.

Broadly, urbanization and industrialization will remain the fundamental driving forces behind China's productivity gains and income growth. The country's urbanization rate is just 60% while other developed countries typically are in the 80 – 90% range. China's rapid productivity gains are supported by its high domestic savings rate that has allowed the country to rapidly improve its capital stock without reliance on foreign capital. And, a steady rise in domestic consumption will make the Chinese economy less vulnerable to global shocks. All these trends have a long way to run.

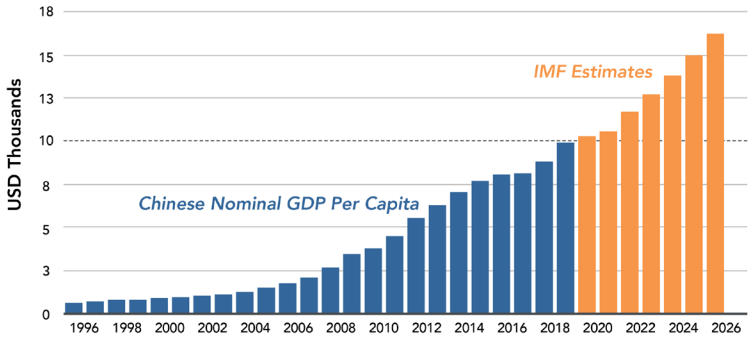
Risks To China's Outlook

The next five years will be critical in lifting the country toward becoming a high-income economy. To be sure, this transition is happening during a far more hostile global environment than at any time in the country's post-reform history. Multiple stories cloud the outlook. Two key risks, however, stand out: avoiding the so-called "middle-income trap" (which ensnares most emerging economies that rely on cheap labor for growth) and avoiding a cold war with the US.

Risks in both these scenarios are to the upside. First, China has already long recognized the need to rebalance away from export and investment-led production toward private consumption. GDP per head in China is now around USD $10,000. To move beyond this level, policymakers know productivity must dramatically improve. That requires a litany of change — reduced corruption, middle class rights and an improved operating environment for the private sector. A critical next step is to establish a robust social safety net and thereby reduce fear-driven high household savings rates. This will lead to a virtuous cycle of consumption, job growth and, ultimately, higher real wages and corporate profits.

As for a new cold war, one thing is obvious: it is clearly in the best economic interests of both Beijing and Washington to maintain a

CHINA GDP PER CAPITA BREAKING THROUGH $USD 10,000 THRESHOLD



Sources: Macrobond,IMF, Forstrong Global Asset Management

functioning bilateral relationship. Unlike the previous cold war with the former Soviet Union and the US, with near-zero economic integration, China and the US remain tightly linked. American allies are also strongly connected with the Chinese economy through trade and investment flows. In fact, China is a much larger trade partner with many major economies other than the US, particularly in Europe and Asia. These countries would be extremely reluctant to decouple with the fastest growing market for nearly everything in the foreseeable future, even if pressured by the Americans.

What's more, unlike the US and USSR's push to divide the world into two ideologically-driven blocs, China is pursuing the opposite strategy. This is seen in the way China has continued to slash tariff rates on select imports amid the trade war and substantially reduce restrictions for foreign investors (for example, by allowing them to run wholly-owned businesses in the mainland). The benefits of this policy can be seen in the still healthy trend in foreign direct investment into China, including from America.

Ultimately, the market is more likely to focus on the practical reality of what China is — the economy with the highest growth in the world, accounting for 21% of last year's global GDP growth. Foreign business and the international financial community will act accordingly, and capital will flow to where returns and growth are higher.

Investment Implications.

Investors live in a world of storytelling. This is helpful because stories can lend structure to complex issues. But they can also easily mislead and distort one's worldview. In the case of China, chronic "crash" false alarms have diverted attention from the ongoing positive transformation. The most important facts about China today are not past problems of slowing growth, heavy-handed intervention and rising leverage. Rather they are the shift away from exports and capital spending to consumer-led growth, improving margins and financial liberalization. These developments take time.

Looking out further, the ascent of China as an independent economic center of gravity is an enormous advantage for global investors. With diverging economic trajectories and monetary policies (especially from the United States which, in the post-war period, has functioned as the de facto leader of world order and economic stability), macro trends in China are highly diversifying. Chinese assets reflect this showing among the lowest correlation to rest-of-world stocks and bonds. And, the corollary of macro stability, lower inflation and positive yields is a structural multiple-expansion and re-pricing of China's financial assets.

Unfortunately, many investors continue to lean on past China narratives when powerful secular changes are underway. But the queen need not die in grief. Investors should stay alert to changes in the plot.

SUPER TREND 7

INFLATION CALLING

The seeds are sown for a period of higher inflation.

KEN HAWKINS
Research Manager

Speed read:

- After 40 years of declining inflation, almost no one expects rising prices.
- Yet the conditions for higher inflation are gradually surfacing.
- A transition to an inflationary regime carries profound ramifications for several asset classes in the years ahead. Most notably, investments that have been bid up on the "lower forever" inflation thesis will increasingly be at risk.

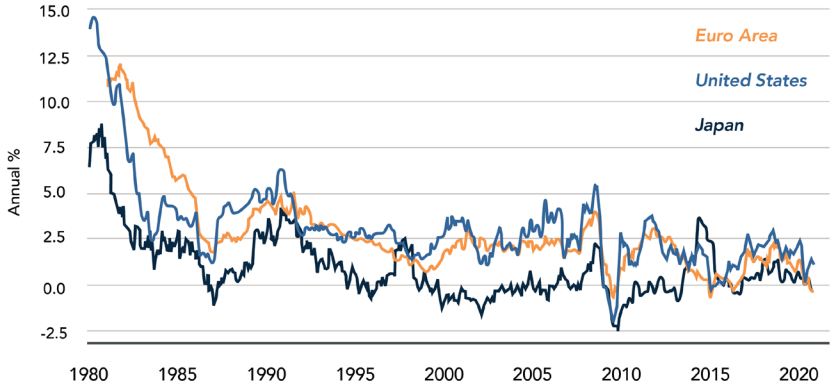
One would have had to blown out a certain number of birthday candles to recall the frenzied heyday of the British punk rock band The Clash. Their seminal 1979 track, *London Calling*, captured a feeling in the UK that the world as everyone knew was ending. And it was. Britain's three postwar decades of economic growth and the era of big government spending were over. The politically charged song panted and fretted about nuclear errors, impending ice ages and other apocalyptic angst.

Turns out that year was The Clash's creative apex. It was also the apex of inflation around the world. Soon after, both interest rates and inflation would start a multi-decade decline to the present. The ominous outlooks of that period — whether economic or other — never materialized.

We are now at a similar inflection point in history. Yet, this time, almost everyone fears persistent disinflation and everlasting low interest rates (apparently set to burrow deeper into subterranean levels). Most have forgotten that rising prices are possible. Need evidence of collective amnesia? Never mind the trillions sunk into negative-yielding sovereign debt. Stand in wonder of the more bizarre bonds of the world, now priced for eternal stagnation. Peru recently brought back its century bond — riddled with interest rate risk — at a whopping 3.2% (prompting one strategist to sneer that the yield was lower than the number of coups the country had in the last 100 years).

Allow us to venture out on the shakiest of limbs to toss out a non-consensus idea: the conditions for a long period of higher inflation have arrived. Note that we are not calling for rampant 1970s style inflation. Rather, a gradual uptick in overall inflation will glacially play out over many years. It will be nearly imperceptible at first. In the same way that investors took more than a decade after 1981 to believe that inflation would not rise again into double digit figures, today's investors — conditioned by 40 years of disinflation and declining interest rates — will take years to become convinced that the secular environment has changed.

A 40 YEAR DECLINE IN CONSUMER PRICES



Sources: Macrobond, BLS, Eurostat, Japan Statistics Bureau, Forstrong Global Asset Management

A New Inflation Era Quietly Surfacing

Today, the inflation conversation is all about secular stagnation, new normals and other dire outlooks. These perspectives always reference the impact of demographics, automation, digitization and other disruptive forces on prices.

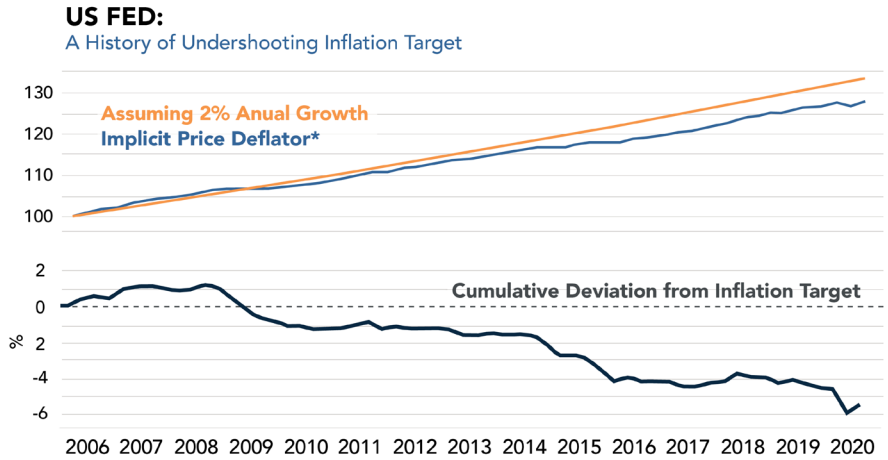
But classic mistakes are often made in the analysis. For example, automation does lead to faster productivity growth and falling prices in several industries. But this will also boost real incomes, leading to more consumption elsewhere. Rising spending lifts prices in other sectors of the economy.

In fact, 2020 will be the year when the global spending power of millennials will be greater than any other generation. As the lead consumer cohort, they are set to shape the direction of the global economy in the coming years.

What about the favorite domain of deflationistas: demography? This mainly applies to the developed world. Most emerging countries have far young demographic profiles. Consider that the global millennial generation is now the world's largest generation — some 1.8 billion strong and nearly a quarter of the world population. Nearly nine in every ten millennials live outside developed markets. And, especially in Emerging Asia, they are experiencing rapid income growth. In fact, 2020 will be the year when the global spending power of millennials will be greater than any other generation. As the lead consumer cohort, they are set to shape the direction of the global economy in the coming years.

Looking ahead, several cyclical, policy and structural factors point to higher inflation. Many are misreading the long-term implications of coronavirus. The key is to differentiate an exogenous shock from a classic recession. The latter always sparks a longer-running trend change because deep financial imbalances must be worked out over years. Comparatively, the terrain upon which covid landed is much different. Heading into 2020, no major global imbalances were evident (with some exceptions like Canada, which continues to cling to its status as a country with an epic consumer debt bubble). The private sector deleveraging that needed to happen in the US and Eurozone after 2008 was largely complete. And, worldwide banking systems were generally healthy. Global systemic risks were in fact low.

Now that vaccines are secured a return to growth is imminent. Yet global central banks remain clearly focused on the last battle, assuming a long and shallow recovery and a complete lack of inflationary pressures. The Federal Reserve has now made major modifications to its monetary policy framework, shifting to an "average inflation targeting" approach. Based on past undershoots of inflation (roughly 500 basis points in the last 10 years for those counting), inflation can run as hot as 7% in a year without breaching the average inflation target. The financial implications of this policy shift will be far reaching. In fact, with the Fed's capitulation to deflationary pressures, they have effectively given a green light to rising prices.



*Rebased to 100 as of January 1, 2006

Sources: Macrobond, Alpine Macro, US BEA, United Nations, Forstrong Global Asset Management

And, it's not just the Fed. All major central banks are terrified of making a policy mistake. No surprise then that they are all committed to erring on the side of caution, arguing for more collaboration with fiscal authorities. They are being indulged. This is the biggest shift toward a more inflationary environment: the arrival of big government spending. As we wrote in Super Trend 1: You Say You Want A (Fiscal) Revolution: "a consensus amongst policymakers has emerged: the risks of doing too little greatly exceed the risks of doing too much". Everywhere in the world, fiscal levers are decisively being engaged after a long period of austerity.

Crucially, the impact of monetary stimulus is far different than fiscal thrusts. Most misread the transmission dynamics of quantitative easing. What is now clearly known is that QE does not work during deleveraging periods. More available liquidity does not automatically lead to more credit creation and higher inflation. This is the classic "pushing on a string" metaphor Keynes originally used during the 1930s depression.

Fiscal stimulus is a different beast altogether. Importantly, the transmission effects of fiscal thrusts are much more direct, boosting consumption and investment. More money immediately enters circulation and leads to pricing pressures. All of this will quicken the transition toward a more inflationary environment.

Investment Implications

The conditions for a sustained rise in price inflation have arrived. The transition will be gradual and bumpy, allowing many investors a period of denial until underlying pressures are more evident. This is typical during regime changes, as it takes time to release old narratives.

The above scenario carries profound ramifications for several asset classes in the years ahead. Most notably, investments that have been bid up on the "lower forever" inflation thesis will increasingly be at risk. This includes growth stocks (which thrive on low discount rates) and, of course, Western government bonds (in the grim words of one analyst, "where money goes to die").

On the positive side, secular headwinds for value stocks are waning. US and European banks have become well capitalized and will thrive on higher net interest margins. Industrials will do well. Commodity prices have largely completed their secular downturn. That means many cyclicals and other sectors that can pass through rising costs will outperform.

Not many are ready for this change in the investment climate. But make no mistake, inflation is calling.

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