Belt up for the coming 'Global Super Cycle' and a $100 trillion World by 2023

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We have heard a fairly large number of CEO's talking about the difficult situation the world is going though from a health and economic perspective, and the rather pessimistic outlook that many observers have for the future. While the health concerns for the world are something we sympathize with, our belief is that the pessimistic economic view is a rear view mirror influenced belief and the future is far brighter than most can imagine.

Core thesis –

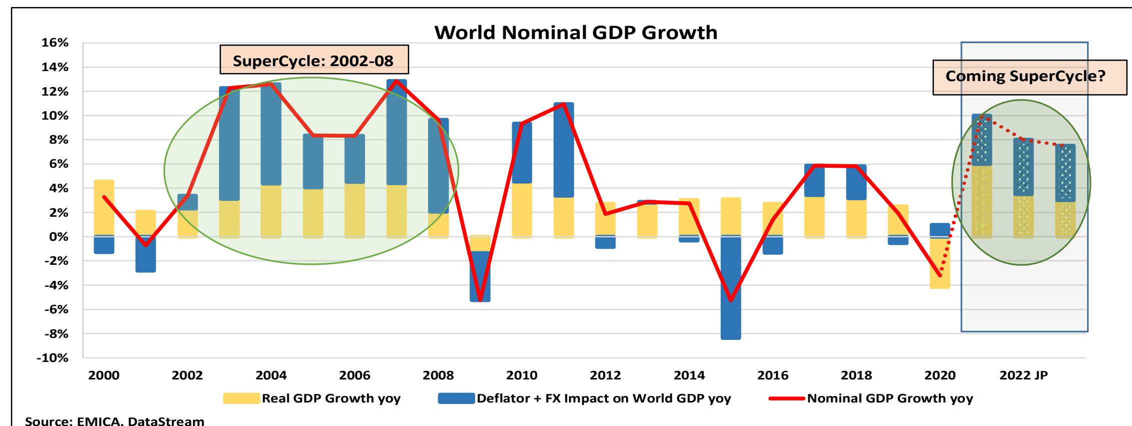
We believe that a brand new '*Global Supercycle'* was born last quarter. A *global supercycle* is defined as 7-9 year economic cycle with some years of 8-10% Nominal US$ GDP growth. Like the 2002-2008 global cycle, this will be a synchronous cycle coupled and catalysed with US$ weakness and an elevated deflator. It has all the makings of a *supercycle* measured thru synchronicity and potential implications on businesses in the Nominal World. The implications of this are that the *World Output* that bottomed at a $77 trillion annualized level in the June 2020 quarter, would grow at 8-10% per annum in Nominal US$ terms for the next few years and we should be sitting in a $ 100 trillion world before the sun sets in 2023. Asset Implications imply that you stay long Equities and especially so, the Emerging World should come back strongly in the coming years.

How do we get there –

Most economic views are biased around observing a *Real GDP* number for the world. The data has had little value to me as an Equity Investor where the deflator and the FX implications were far more relevant. In the last 20 years, the real world output grew in a narrow range of 2.5-4% most of the time. Essentially, the world grew about 3% per annum for the most period excluding the global financial crisis period in 2008. The Nominal World output however swung with between -10% and +13% through this 20 year period, which had huge implications on businesses. This also explains why 2015 felt so bad despite the real World GDP growing at 3.3%. The answer was visible in the Nominal GDP which collapsed to -5% driven by a weak deflator and strong US$ essentially driven by China.

The '2002-2008' period was a big *Supercycle* in recent memory, driven by the emergence of China and the integration of global manufacturing supply chains. It translated into a huge economic boom and strong corporate RoE's with great equity returns. The World output grew at over 10% per annum for five years between '2003-2008' taking world output from US$ 33 tn to US$ 61 tn in just six years.

Fig 1



The *Emerging Market (EM)* share of world output in the last 20 years doubled from 19% to 38% with the EM world growing at about double the rate of the Developed world (DM). This kept the total world growth at a 3-3.5% range over the last decade despite every region in the world growing a little slower than in the previous decade.

The implications of the swings in the global deflator and the FX on businesses and global incomes was much larger than most imagined which is visible in *Fig 1* above. It breaks down the nominal world output and its components showing that the world in real terms grew at a pretty even rate of 3-3.5% through most of the last twenty years, with the swing in the 'Deflator+FX component' creating the big booms or bust feel in the world.

We are entering another such '***Supercycle***' which was born about a quarter ago. Our definition of a supercycle is nominal World Output growing at 8-10% for a few years lifting most boats globally. Our view on the components of this global *Supercycle* are essentially building in a few key assumptions –

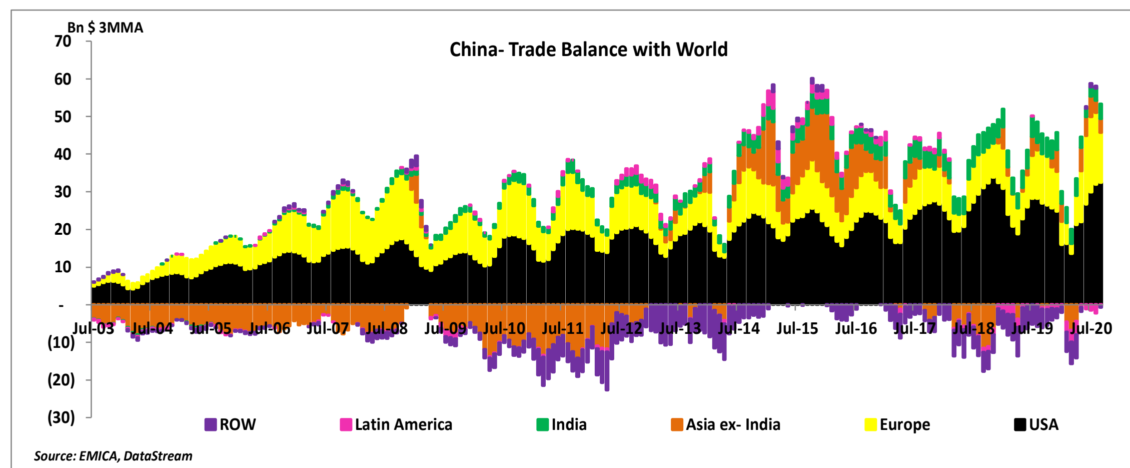
1. The World growth in real terms continues in the 3% +/- 1% range after normalizing to pre Covid levels in real terms by 2022. This is line with the *IMF* and many other estimates.
2. We expect the Global deflator to stay elevated in the 2-4% range for the next few years driven by stimulative fiscal and monetary policy by most large world economies. This would be aided by a weaker US$ and concurrent to it.
3. The US$ weakens 3-4% per annum for the next few years with rising deficits, with the *Chinese Yuan* doing the heavy lifting on the other side. The *Yuan* weakness in the previous few years had prevented this from playing out earlier. This paves the way for a strong Asian and EM FX basket which together account for about half of the world output. This is in a way similar to what happened in 2003-2005.

Putting this view into our Nominal World output model, we expect a global synchronous recovery which is typical when all parts of the world are in the same '*phase 0*' of their economic cycle at the same point in time. This is essentially catalysed through significant fiscal and monetary stimulus at work to bring back world growth. This in turn translates into a reflationary environment with positive tailwind for businesses. This coupled with a weaker US$ thesis results in Nominal World output growing at 8-10% for the next few years and the World GDP crossing $100 tn in 2023.

Two trends that we expect to see concurrent to this view are -

1. The global trade equilibrium continues despite a rhetoric to the contrary. The US-China trade deficit coming in at an all-time high which is shown in the *Fig 2* below confirming our view. We do expect Vietnam, Bangladesh and India to be beneficiaries from shifts away from China on the margin.
2. The world integration 2.0 continues through acceleration on the '***Data***' and '***Services***' side which then enables tier 2 and tier 3 layers of the skilled world to integrate with the developed economy without H1B barriers. Countries with large pools of skilled capital thus see their incomes grow faster and the ***130 mn kids that turn 20 each year globally*** are going to see their aspirations in this new world opportunity. India is a big beneficiary here.

Fig 2



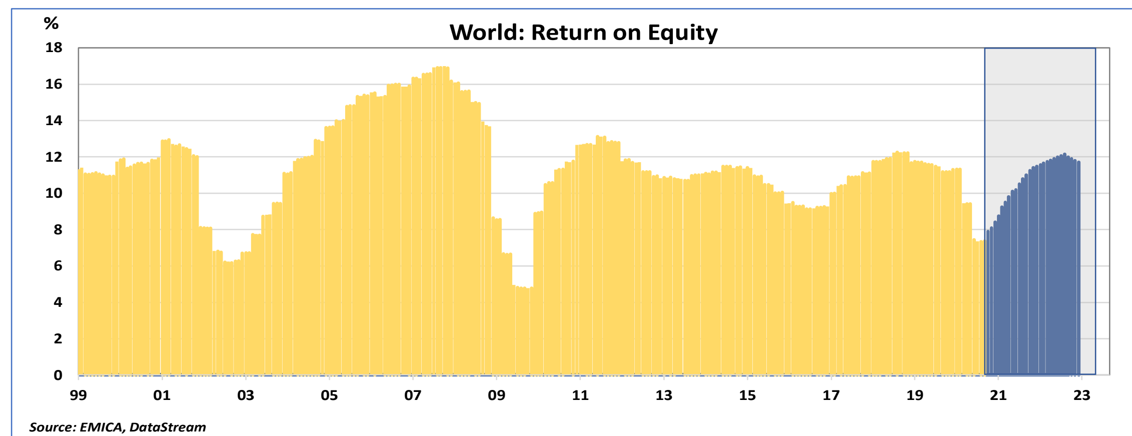
Source: EMICA, DataStream

What are the implications for businesses –

Businesses globally are just coming out of this extremely difficult period. We see aggregate RoE's for businesses turning up after the last quarter which is a classic turn that we have seen during the birth of previous cycles. This is visible in *Fig 3* below. We see the ***World RoE*** getting back to 12% in the next 18-24 months. There is fresh capital put to work to work with the quality companies presently, giving them the ability to get a larger piece of the cake. This embeds a view that Capex picks up meaningfully only a few years from now, which aids the RoE upcycle in the next couple of years.

We also believe that the qualitative abilities of companies has been stress tested to look for survival biases. It is now pretty clear which companies have the clarity of mind and strategy to navigate this crisis and possibly thrive in it. We can see a ***'K" shaped recovery*** at work in our analysis across 1000's of businesses. There are some that would never be able to get back while others who thrive in this chaos.

Fig 3



How would I invest thru this thesis?

As a business manager, I would be ensuring I have enough capacity and resources including capital to be able to monetize this coming opportunity. It may differ across businesses and also would have '*disruptive overlays*' to build in the analytics through the world we live in.

As an investor, I would stay long Equities and especially so Emerging Equities as the business transmission of this boom plays out over the next 18-24 months. I would map our 'Global Liquidity' model in *fig 4* below to signal a peaking in the liquidity cycle in a few years. The transmission in liquidity would play out thru the classic channels of financial and banking capital flows.

I would map companies, sectors and countries driven by our analytics with an optimism bias overlay on top of this. From a 12-18 month horizon - Consumer discretionary, Non-capex Industrials and Financials should be a good place to be. EM's and especially Asia are well positioned coupled with deep cyclical industrial economies like Europe, as the real world feels the tailwinds in their sails.

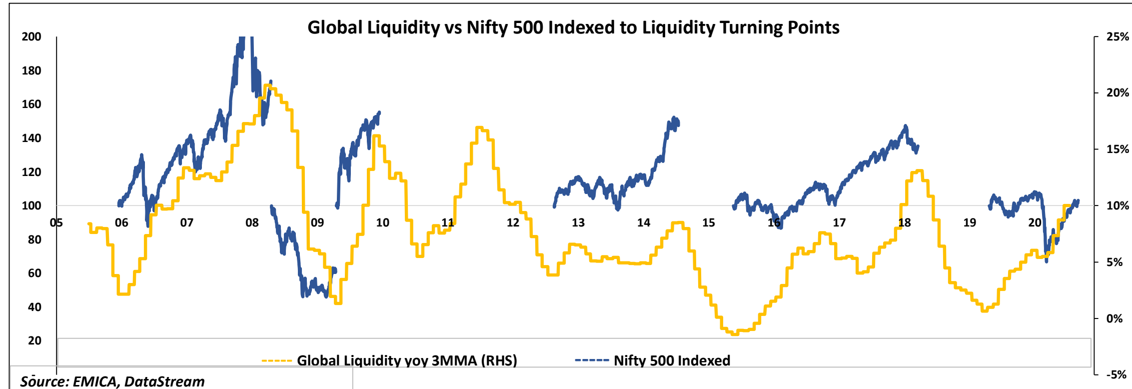
An example here that we are extremely constructive on the 'Class 8' trucks segment in the USA and the entire global supply chains feeding into this should be geared up for higher order schedules by the end of 2021.

Another example, is riding the leveraging cycle that is just about to begin. I would stay invested in some of the ***high quality financial franchises*** where the ability to earn a decent RoE through structural moats, while staying competitive in a disruptive business environment.

I think of the '***Services***' as a big theme that has significantly been '***Geo-neutralized'*** in a lot of pockets in a Post-Covid world, which passes on competitive advantage to countries like *India* and *Philippines* where there is a strong cultural service oriented bias.

I particularly feel good about India – Where services as a core competitive advantage continues to thrive, with manufacturing and agricultural reform turning a few key core sectors upwards. With fresh doses of banking capital through markets, it then creates balance sheet capacity for the country to grow. This coupled with demand from the US/Europe should kick start a new cycle and bring back RoE's for the strong players who will be beneficiaries of the shakeout since the ILFS crisis in 2018. The digital infrastructure put to work should catalyse the opportunity and enable '*Services*' to thrive more seamlessly.

Fig 4



Source: EMICA, DataStream

Risks to this thesis -

1. The Covid related challenges gets much worse than the current situation resulting in larger economic weakness than we factor in.
2. The US elections or other potential events shifting policy from the easy stance on fiscal and monetary stimulus currently at work.
3. A significant geopolitical event like a China-US South China sea escalation that risks the equilibrium we see in the world currently.