Economic Firepower Waiting to be Unleashed
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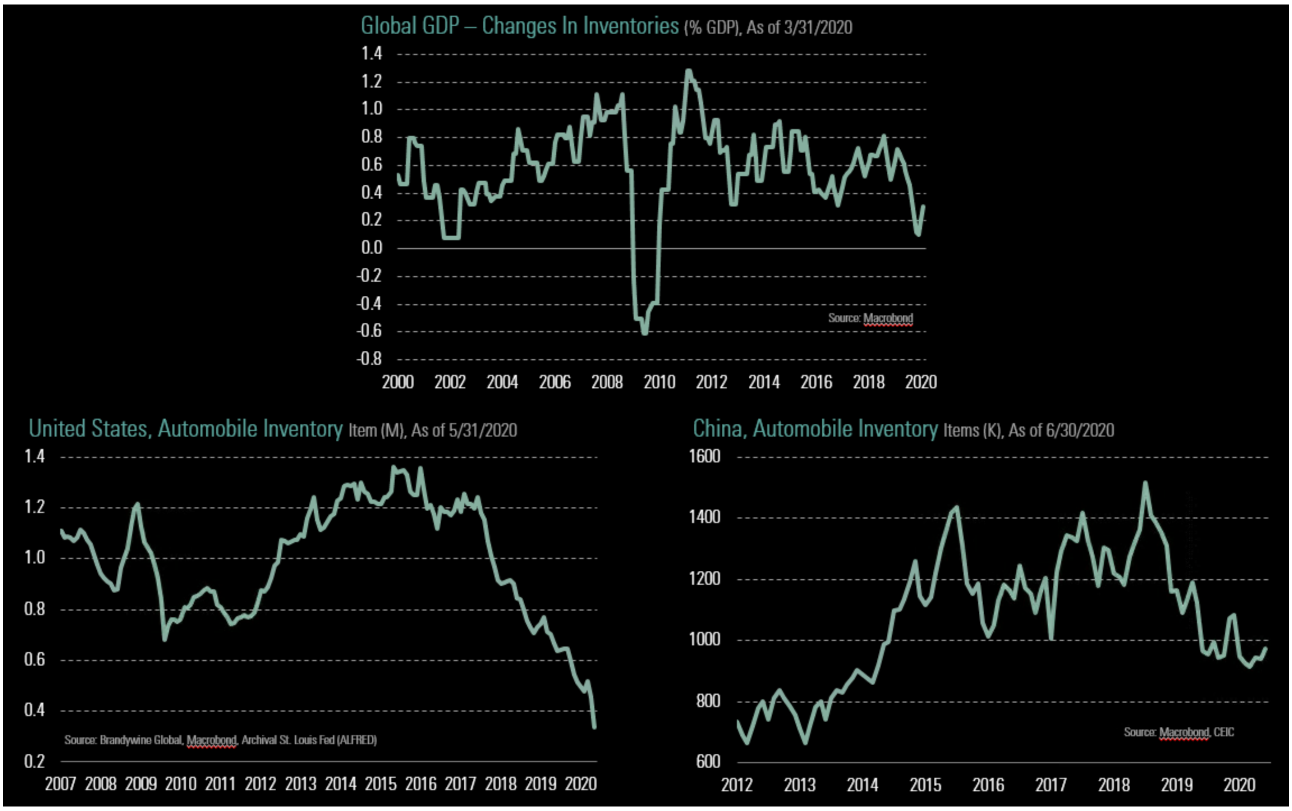
[00:00:03] Hi, I'm Jack McIntyre, one of the portfolio managers on the Global Fixed Income team at Brandywine Global. And, what I'd like to discuss today is some things that might not be getting as much attention as the two critical variables that everybody is focused on right now. Those two critical variables are certainly the pandemic and any mitigation policies being put in place to control it versus the huge policy response—monetary policy, fiscal policy. I'm also going to mention the medical policy front. So you kind of think of those things. I've got this immovable object, the virus, and I've got this unstoppable sort of force along those lines—the monetary authorities, the fiscal authorities—everybody is saying, “hey, we're going to do whatever it takes.” So that to me is sort of this this war that's going on between those two critical factors. Well, I'm going to take a step back and think about some other external factors that actually might have an impact on underlying economies.

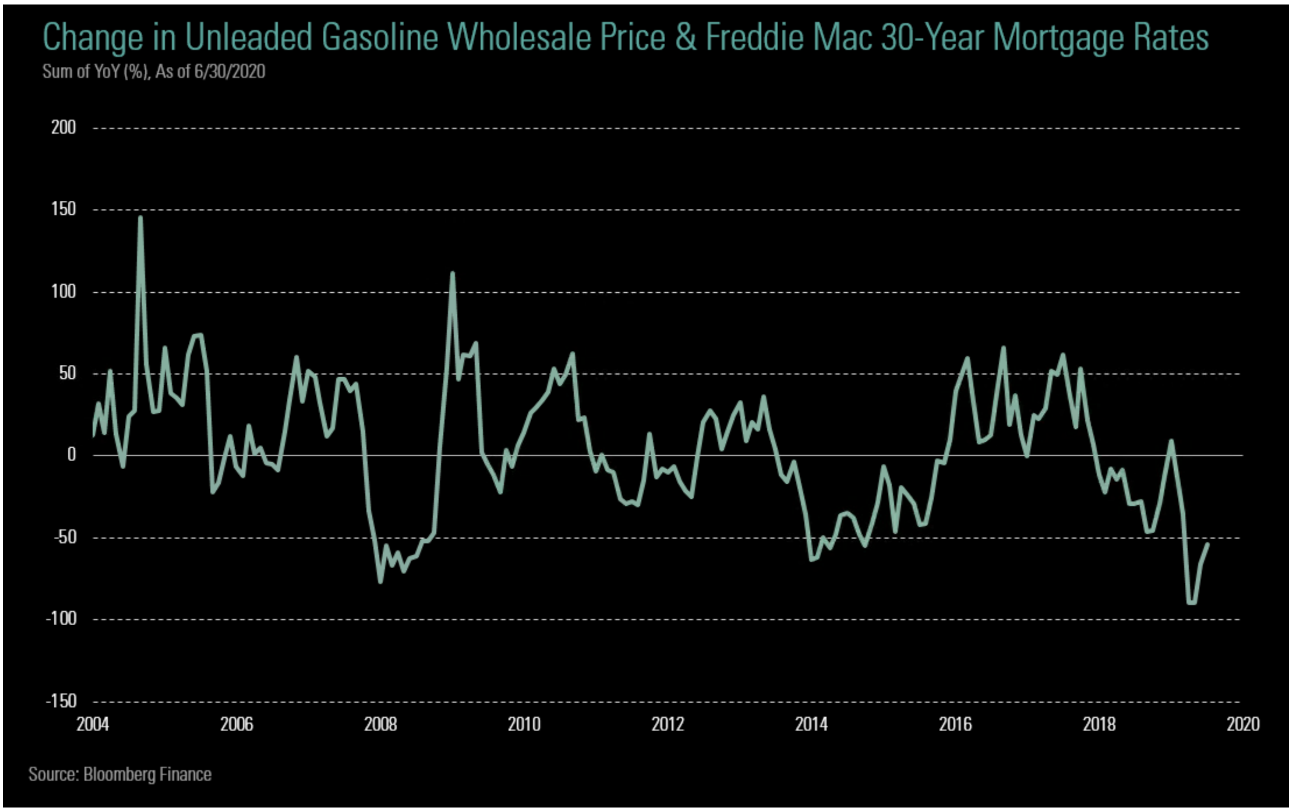


[00:01:18] OK. So there's really three external potential influences. I want to mention the first one. And you've seen the charts, it’s inventories. So, again, this isn't going to be the primary catalyst that's going to get the global economy off to the races. But it's something to keep an eye on, actually. The top chart just shows the year-over-year change in inventories. So, not surprisingly, we've seen the last couple of years an overall decline in the growth rate of inventories. Well, last year it was about the uncertainty over U.S.-China trade. This year it's obviously about the uncertainty over the pandemic and how it's going to play out. And nobody wants to build out a huge amount of capital and inventory right now given the level of uncertainty. And, you know, you can see this in the bottom left is also U.S. auto inventories. And this is global. So, I'm actually including auto inventories in China as well. The point here is that, again, when we get some less uncertainty—and I'm saying uncertainty as opposed to certainty because we're in that kind of environment—but when that diminishes and, you know, the global economy starts to get a little better footing, this could be a source of additional growth as we see investment in inventory. So, again, I think this actually could help the global economy. And this is including the developing world as well as the developed world. We're seeing low inventories across the board.

[00:02:50] The second potentially external positive influence—and this is probably a little bit more specific to the

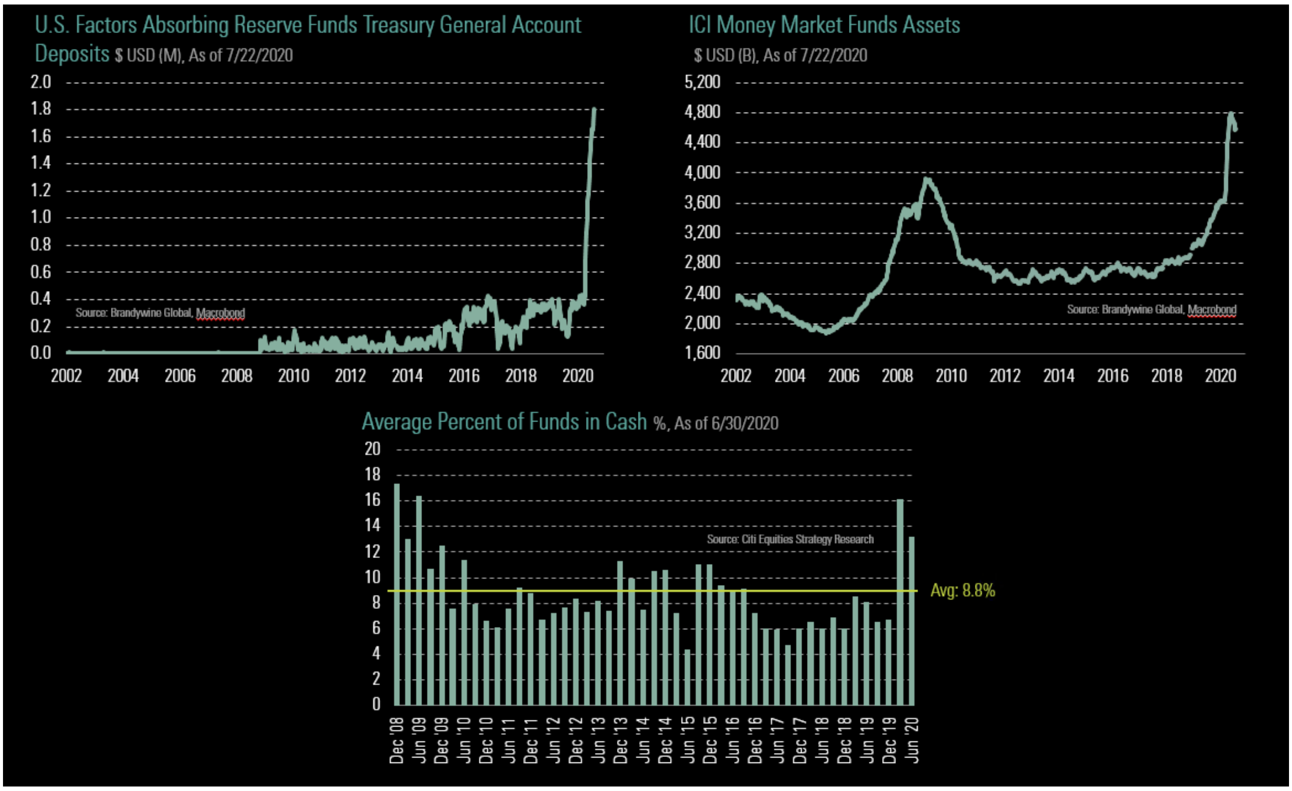
U.S.

[00:02:57] But actually, there are other countries that are saying this, but housing is such a key driver of the U.S. economy that I'm going to kind of focus a little bit more just on some U.S. inputs right now. But what we're looking at and again, I like to keep things pretty basic.



[00:03:11] It's just the year-over-year change in gasoline prices, unleaded gasoline prices, and sum that with the year-over-year change in mortgage rates.

[00:03:21] Because it's interesting, it's the change in these two key variables that can influence economic behavior in the U.S. In the case of gasoline, it influences consumption. And in the case of mortgage rates, it influences housing. Right now, we've seen significant declines in gasoline prices and significant decline in mortgage rates. So you can think of it as the flow versus stock argument. And I think the flow is actually more important. It's how things change that really motivates consumers. And so in the case here, we've seen a much more instantaneous reaction with mortgage rates. They have come down significantly. Well, housing is really starting to see signs of recovery. I'd say it's kind of back to punching above its weight. Right now, we're seeing an uptick in activity. So on the gasoline side of things, well, this is taking a little longer for this to unfold. So the initial reaction, we saw a big decline in oil prices, and it was a significant pullback in CapEx in the U.S. around the energy industry. That's gotten to be such a huge part of our economy, that's meaningful. Now, in the second stage, and this is getting drawn out. But, you know, with the decline in gasoline prices, we are actually seeing—and now that the consumer is driving more—we're actually seeing a net positive. So when I add these two together, given where we are today, it should actually be a net positive for consumption in the U.S. around gasoline prices, and housing should continue to see improvement based on still very low mortgage rates.



[00:05:07] So, the third external influence is about cash. We're in an environment where cash is king right now. You know, cash balances across all aspects of the economy and again, globally as well as in the U.S., reflect high levels of uncertainty. What we expect, though, is as we see uncertainty diminish some of this cash should be put to work. And that's going to be a net positive for the underlying economy. It's going to be a net positive, I think, for markets. So what we're looking at in the upper left—and this is getting a little bit of press right now—it's the Treasury's balance at the Fed. Their general account deposits, it's off the charts. It spiked out. Well, two things are really influencing this. The Treasury has issued a lot of T-bills. So some of this cash is just prefunding. Some is actually dedicated to the PPP. But my point here is that some of this cash is going to work its way into the real economy. And that should be positive for economic growth. The chart to the right is just looking at money market levels, both in terms of retail and institutional accounts. And again, this is off the charts as well. There's a huge amount of increase in a cash. Well, we know in the corporate sector they've been issuing a lot of bonds. So right now, it's parked in cash. But again, this is going to be something—it's not just always going to be there. Because in this environment, central banks and the Fed, in particular, are punishing savers. So time kind of works against you when you're sitting on a lot of cash. And from an investor's standpoint, the bottom chart just shows fund managers and again, not surprisingly, they're sitting with a lot of cash as well. So you can think about early on in this cycle, everybody raised cash because nobody on this planet has been around and been managing money in an environment of a pandemic to the degree that we're seeing now. So there's still uncertainty. Part of that uncertainty is being diminished because of the fiscal and monetary response. And I think that that's sort of winning the war right now. And I think that actually will be the catalyst to get some of this cash to be put to work.

[00:07:20] So in summary again, I just wanted to focus on three external positive influences that might not be on people's radar screens. Certainly, everybody's focused on the pandemic and the policy response. But, as we see uncertainty diminish around that, I think there is that additional firepower that we're going to see. We're going to see more money invested in inventories. We already are seeing positive impacts from lower mortgage rates. And I think as the U.S. economy continues to open up even more, we'll see consumers monetize lower gasoline prices. And then we know again, all aspects of the economy are sitting on a lot of cash. And that cash is going to put to work in the real economy, and it's going to be put to work in the financial markets.