Video Transcript: Charting the Global Economy: A Roadmap for Inflation, Growth, and Asset Allocation
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Jack McIntyre [00:00:05] I'm Jack McIntyre, one of the global bond portfolio managers at Brandywine Global. And what I wanted to do is take an opportunity just to kind of elevate things to a 40,000 foot standpoint, to really get a sense of where the global economy might go in terms of the inflationary outlook, but also kind of the growth--the economic activity--outlook, because that's going to provide a roadmap on where we want to be in terms of our asset allocation. So what I'm looking at is just a pretty basic four quadrant framework and defined by on the vertical axis--price. So that's inflation. And then the horizontal axis is economic activity. And as I talk about this, I mean, there's going to be shades of gray. Nothing is going to be ideally in one particular quadrant. It might overlap into others. But, so let's start with the upper right, because that's where we came from in 2020 and 2021, this inflationary boom. And think about it, it was the policy response, both fiscal and monetary, to the pandemic that got us into this quandrant. Great growth recovery, but it generated inflation. So the things that do well in this environment: commodities, crypto, equities for a while, real estate, anything that can be perceived as sort of a store of value in an inflationary environment. Well, we didn't stay in this quadrant very long. We went from sort of this man-made depression because of the pandemic to this sort of big recovery, and that's the inflationary boom. Well, then there really wasn't much of an expansion phase. We transitioned into the quadrant on the upper left, the inflationary bust. And you can think about this is sort of just a fancy term for stagflation. You know, that growth is slow, but yet inflation is still running at high levels. It's not a great environment for financial assets, equities or bonds. Equities don't do well because the growth concern part of the stagflation. But bonds don't do well because of the inflationary aspect as well, that concern. So cash is king in this kind of environment. So this is the backwards looking portion. This is where we are today, how we got here. Where are we going forward? And here, I'm going to make a giant assumption that central banks are going to stay committed to breaking the back of inflation. So given that premise, we're going to go into one of the quadrants at the bottom. The left is the disinflationary bust. You can think of this again, a traditional recession. Basically, it just means that we've got to break the economy to break inflation. So here, the asset that does well is safe-haven government bonds. So from a Brandywine standpoint, we've been increasing our exposure to high quality, sort of safe-haven bonds. Because until we get a little bit more clarity, we're not going overweight. We're just more neutral in that stance. And again, you know, it could be a mild recession, which actually I think it could be to break the back of inflation. But if it is, we might transition into the quadrant on the lower right. That's the disinflationary boom. Boom is probably too strong a word. I'm viewing it through the lens that we might go into a more sustainable expansion. The point being is that we actually get some economic activity with inflation coming down. I mean, you can think about that this is "Goldilocks." This is kind of where we've been, I'd say, over the last decade or so going into the pandemic. We had growth, but it was a non-inflationary kind of growth. And maybe we're going to transition back into that environment. Well, the assets that do well in that kind of environment, you can think of it in terms of risk assets. It's equities do well. In our sort of parlance of bonds, it's anything that has a yield. You know, we've actually been increasing our exposure to some emerging market, local currency bonds in anticipation of transitioning into this quadrant. Again, remember, there's no time axis on this framework, so getting the time right is going to be challenging. But the point being is that we think it's not too early to start adding some risk. And again, sort of we're using emerging markets as our sort of metric of the type of risk that we want to be in. But the point being, we're going to go into lower inflation, disinflation. So you'll want to start owning more bonds. It's just we've been doing that with high quality bonds, and now we're actually starting to increase our emerging market bonds as well. And the key determinant of which one of these sort of disinflationary quadrants we end up in is really going to be about inflation, how much it comes down and how quickly it comes down. So, you know, we'll have to sort of revisit this over the coming months.