AROUND THE WORLD IN 8 PAGES...

4th QUARTER 2018

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From another
point of view.
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ABOUT OUR '8 PAGES' SERIES:

The Librarium Associates monthly 'Around The World In 8 Pages..' series is a quarterly publication created by our team focused on geopolitical and macro economic trends and developments around the World during the last 3 months. As long term thinkers we draw on the lessons of history as a guide to understanding the present and charting the probable paths ahead. There are no crystal balls but in the words of A.W. Pinero: "The future is only the past again, entered through another gate." It's our mission to glean valuable insights from history and apply them as a foundation for understanding the journey ahead.

We are constantly engaged in active horizon scanning while adhering to our belief that students of the lessons of history and permanent features such as geographic realities can provide superior insights.

From these broad scenarios we work to identify investable trends and specific opportunities. We find that such a broad approach provides an 'early alarm' system for risk management and an indicator of attractive price/value situations across asset classes.

The intention of our research and the basic premise of this publication is to present rational perspectives based upon a diligent analysis of historical data. Through organizing the data logically, information is created. Through understanding and developing perspectives on the information, knowledge is generated. With knowledge, one can then start to make informed decisions.

The most practical way to imagine the future is to question the expected, this is best done making use of what we call 'critical thinking' – Critical thinking is the careful, deliberate determination of whether one should accept, reject or suspend judgment about a claim and the degree of confidence with which one accepts or rejects it. Critical thinking employs not only logic but a broad intellectual criteria such as the one outlined above. Critical thinking requires extensive experience in identifying the extent of one's own ignorance in a wide variety of subjects which is often captured in the following sentence: I thought I knew, but I merely believed.

As J.F. Kennedy put it: "Belief in myths allows the comfort of opinion without the discomfort of thought." Our aim is always to avoid this trap of the mind, when one attempts to look into the future one is better of exhibiting a more intellectually humble approach and challenge one's beliefs and opinions by asking the question: What if we took the opposite view? This leads to a more balanced set of insights in our view.

The insights and opinions offered in this document are meant as a summary of events and our views – not a conclusive or exhaustive overview or for that matter a specific investment recommendation.

We hope it will offer some food for thought and that it can form the basis of conversations between our clients, interested parties and ourselves.

Sincerely yours,

Mr. S.H. Sorensen
Senior Associate

PRE-DEPARTURE BRIEFING:

Napoleon stated that; **"The power of all nations are inherent in their geography."** Combined with slow moving and relatively 'solid' data such as demographic trends, geography forms the foundation for our approach to understanding the world we inhabit. Then you can apply a lens of historical context and an understanding of human and group psychology. With these tools one can distil broad insights on national and global trends and the probable paths forward.

In our opinion too much is made of traditional data, GDP % growth per quarter etc. are simply the short term effects of these underlying forces and should not be considered as the foundation for understanding but merely as a limited and 'noisy' symptom. We look for long-term patterns and potential breaks from the expected linear paths of most observers. As Niccolò Machiavelli puts it in 'The Prince'; **"One change always leaves the toothing for another."**

On our whirlwind tour Around the World in 8 Pages we will not offer traditional broad bland descriptions of quarter over quarter economic data but we will offer variant perceptions on the World's key regions as well as individual nations. We will delve into specific trends or events that caught our eye as significant during the last quarter.

As always we hope to inspire our readers to explore the World further by themselves, to ask questions and let people find the answers, to awake a sense of curiosity and a quest for further understanding. We welcome your observations and feedback and hope to meet up with you for a cup of coffee or a glass of wine in the future and mull it all over together. It has been our experience that real learning resides at the intersection of differing informed opinions expressed respectfully between learners.

Let's begin the voyage together...

"Not all who wander are lost." – Tolkien

A DAY IN THE OFFICE...

The World is no different from any other object in that we can make more sense of it by viewing it from different angles. In our quest for insights we cover global macro economic trends and geopolitical events seeking variant perceptions in order to discern future paths and probabilities of likely outcomes.

–Mr. Sune Hojgaard Sorensen
Senior Associate
Librarium Associates Ltd.

Our first guest navigator of rough seas is...
Skipper Simon Mikhailovich.

Simon is a contrarian investor, entrepreneur and an expert on systemic risks. He grew up in Leningrad, USSR, and in 1978, at 19, made it to the US as a stateless refugee with $100. Simon graduated from the Johns Hopkins University in 1983 and worked in the Investment Department of USF&G Corp, a nationwide insurance company, until co-founding, in 1998, a successful investment firm focused on distressed opportunities in structured credit securities backed by corporate debt and subprime mortgages. The firm predicted and profited from the financial crises of 2000 and 2008. In 2014 Simon co-founded Tocqueville Bullion Reserve to position for the next financial crisis by focusing on wealth preservation and the opportunities related to physical gold.

"THE KEY IS NOT TO PREDICT THE FUTURE BUT TO PREPARE FOR IT." – PERICLES, 5TH CENTURY BC.

LEARN MORE ABOUT SIMON'S WORK HERE: WWW.BULLIONRESERVE.COM & REACH OUT TO HIM ON TWITTER: @S_Mikhailovich FOR SOME ALWAYS INTERESTING CONVERSATION.

Meet our 2nd guest navigator of rough seas before he hits the waves...

The Millennial Macro Man.

Our secret agent down under is the founder of Millennial Macro Research – an independent multidisciplinary research platform that aims to educate, enlighten and empower all who seek to understand how our complex world works. He is a self–taught macro practitioner with a keen focus on second derivate data analytics.

He started his professional career in transfer pricing before following his passion by moving into private wealth management. His transfer pricing background provides him with unique insights on multinational corporate royalty and taxation structures, which he combines with his understanding of macroeconomics, history, geopolitics and rate of change analysis to guide investment decision making.

"The improvement of understanding is for two ends: first, our own increase of knowledge; second, to enable us to deliver knowledge to others." – John Locke

Get access to the Millennial Macro Man's thinking at www.millennialmacroresearch.com & strike up a conversation with him on Twitter via @MillennialMacro for his views on daily events & global trends.

From his elevated vantage point above the canyons of Manhattan, Simon Mikhailovich spins his 'Macroscope' far and wide in order to distill a poignant brew of hard hitting insights on the world facing the U.S. & investors worldwide as we see out the year 2018.

The morning after Lehman Brothers went bankrupt I spoke to Jim Grant, the brilliant economic historian and a well known bear, who simply said: "We haven't been bearish enough…"

In the years leading to 2008, our small group of likeminded contrarians spent countless hours discussing the timing of the upcoming crisis and its consequences. We parsed the data on the grossly mis-rated subprime bonds, the leverage hidden inside the CDOs, the overly tight credit spreads and the excessive leverage. To be perfectly honest, however, not even the most bearish of us considered systemic risk as a real threat. We had been bearish on credit and equities but, given the ensuing systemic blow up, we hadn't been bearish enough. One of the lessons from the last crisis was that modern economics and finance heavily focus on the data and the models whereas identifying systemic risks is about the broader context and "preexisting conditions" - economic, structural, political, geopolitical, social, etc. The subprime debacle was considered "contained" because it was a relatively small market by size. Structurally, though, its impact was amplified via derivatives and securitization, which made it large enough to topple the financial system whose vulnerability was not captured by the conventional ratios. Collective failure to look beyond the data was the reason why so few recognized the crisis when it began in the summer of 2007 with a failure of two Bear Stearns structured credit funds. Neither did they recognize it when Bear Stearns itself failed, requiring a Fed bailout. By mid-2008 the risks were in the open and yet, almost no one was willing to consider the obvious implications.

The same is true today. Even those who profess being bearish are not worried, at least in public, about systemic risks. Over the past three months, such market legends as Ray Dalio, Paul Tudor Jones, Stanley Druckenmiller, and Jeffrey Gundlach, have all voiced grave concerns about the markets and the economy and some have gone as far as to say that we are in a "global debt bubble" and that the current period is similar to the late 1930s. And yet, none of the experts have mentioned the potentially catastrophic risks to capital their views imply. For if we are truly in a global debt bubble and the current period is really similar to the late 1930s, is it reasonable to have confidence that outcomes would be no more serious than a garden variety bear market and/or a run of the mill economic recession?

The elephant in the room that neither the sell side analysts nor the money managers are willing to confront head on is that since the 1982 peak in rates, Western demand has been heavily subsidized through ever-expanding credit while the asset values have been lifted by the ever-declining rates. This worked while the declining rates were offsetting the impact of the rising debts and keeping the debt service manageable. However, this system broke down in 2008 requiring massive bailouts, near-zero rate levels and US$ trillions in subsidies and QE to stabilize the system. Since then, global debts are up by over 40%, the TBTF banks are bigger than ever and the rates, until recently pinned near or, in some cases, below zero, have left public and private pension plans severely underfunded.

Since excessive leverage, the reason behind the 2008 crisis, has not been addressed, the Fed's attempt to normalize rates is roiling both the equity and credit markets, i.e. the "patient" has been left on life support for ten years and the Fed's attempt to have him walk on his own is not going well. This is a symptom of too much debt Vs. the cash flows available to service it at normalized rates. Because every US$1 of debt is someone's asset, there is no painless fix. The only question is when, how and to whom will the losses be allocated.

Since capital stewardship is first and foremost about avoiding catastrophic losses, the key, as Pericles advised 2,700 years ago, is not to predict the future but to be prepared for it. Clearly, preparing for something requires an idea of what it could be. And so, instead of recounting the market action and making predictions, I would like to simply point out some issues and recent developments that I believe directly bearing on the systemic risks we are likely to confront in the coming year and beyond.

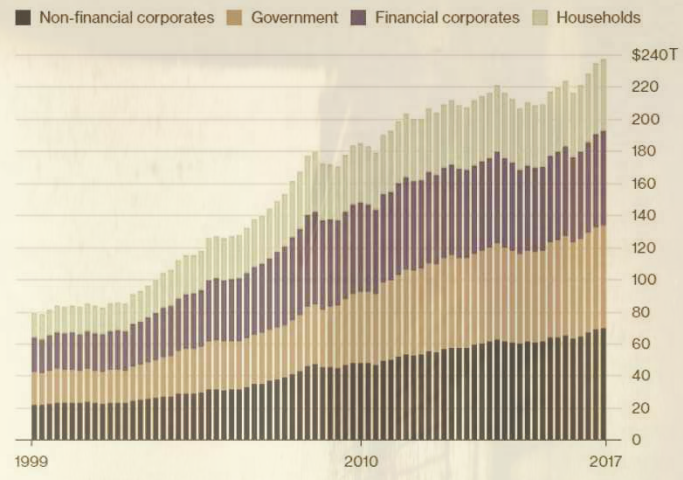
A couple of notes first:

- While material systemic risks can result in catastrophic losses, risks are not certainties. However, as with any insurable risk, if the probability of catastrophic losses is material, failure to address such risks in advance is imprudent, if not reckless. Investors and politicians got a pass for not being ready in 2008 but using the same "black swan" defense next time would ring hollow.

- Systemic risks tend to turn into systemic disruptions during acute market and economic crises. This is known as second- and third-order effects whereby a seemingly "contained" initial debacle sets off a chain reaction of consequences that few would have thought even remotely possible immediately before they occurred. E.g. The pre-2008 thinking was that a failure of a major investment bank would be Armageddon and not worth insuring. It turned out to have been no Armageddon and those few who had worried about it got paid very well for buying insurance well in advance.

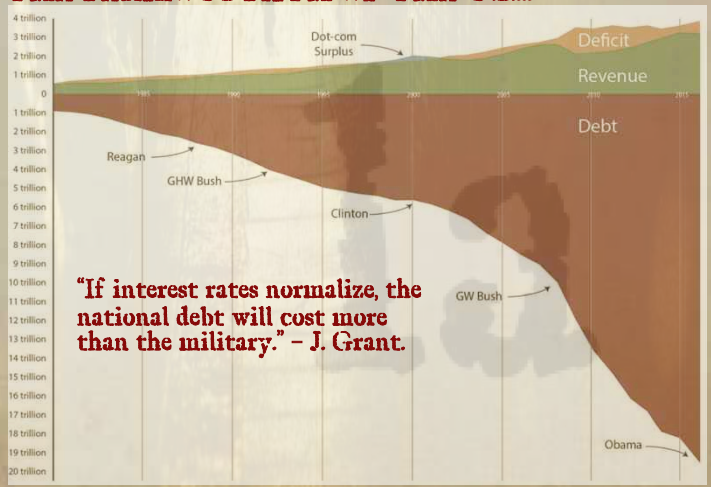
With this in mind, here is a quick run through some of the systemic risks, in no particular order. These represent, in my opinion, the most obvious candidates for becoming the second and third-order effects of a steep market decline, a recession, or a credit bust.

RECORD LEVELS OF DEBT GLOBALLY...



Source: IIF

THE PERILOUS PATH OF THE U.S....



Sources: J. Gabriel – US Treasury – CBO.

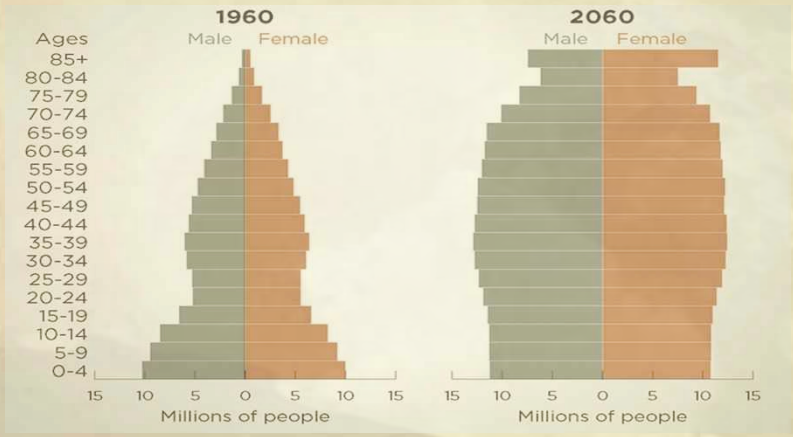
Demographics

The upcoming pension crisis is a big topic but, in brief, there is no plausible path for avoiding it. Promises to the current and future retirees are not backed up by sufficient reserves and, therefore, can only be met on a pay-as-you go basis, which is not feasible, given the already stretched government finances.

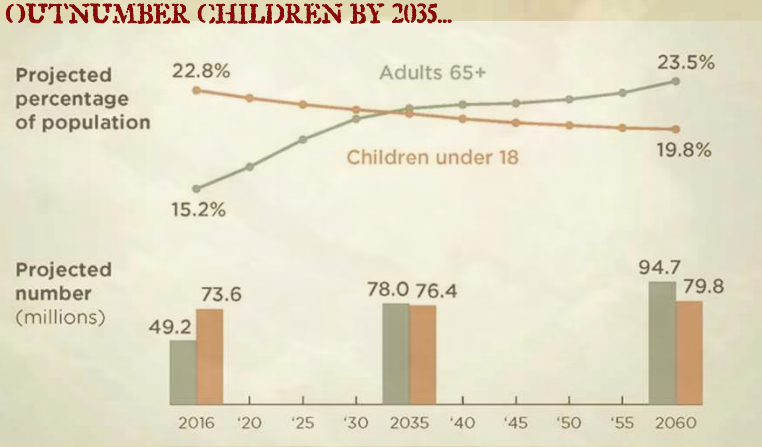
For years, pension underfunding was a future problem but now the future is here - 75 million US baby boomers started turning 65 in 2011 and by 2029, every baby boomer will be over 65 and eligible for the benefits. In the meantime, the Social Security system has turned cash flow negative, which means that instead of buying treasuries with excess cash, it will be steadily selling treasuries to fund the deficits. A conversion of a long-term structural buyer of the treasuries into a structural seller at a time when the government is running large deficits is a problem that would become a major problem in the next recession and/or financial crisis.

The same is true for the state, municipal and many private pensions that are underfunded as well. The only way to fix the pension system is to either increase taxes and mandatory contributions or to reduce the promised payouts. Both options are politically disruptive but tough choices will have to be confronted and soon. This is one risk that will not dissipate; pensions and entitlements are set to become a serious financial mess with the equally serious political consequences.

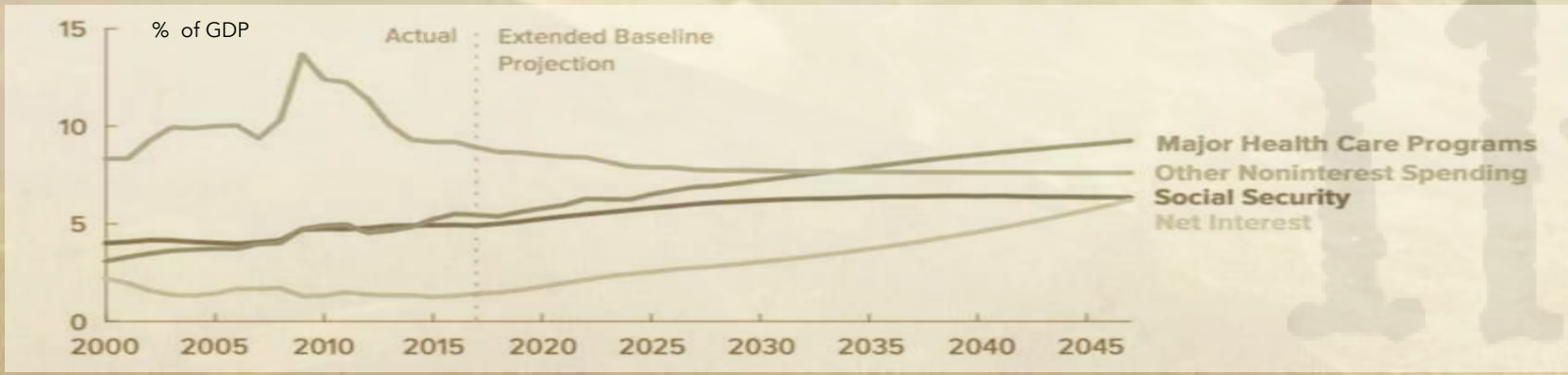
POPULATION OF THE U.S. FROM PYRAMID TO PILLAR – A CENTURY OF CHANGE…



AN AGING NATION – FOR THE 1ST TIME IN U.S. HISTORY OLDER ADULTS ARE PROJECTED TO OUTNUMBER CHILDREN BY 2035…



ENTITLEMENTS DRIVE THE U.S. DEBT & DEFICIT WITH DEMOGRAPHICS SET TO BE THE CATALYST…



Sources: U.S. Census Bureau – The CBO.

Geopolitics

Over the past 25 years, globalization and offshoring have transferred swaths of the Western manufacturing base and intellectual property to the Communist China. The thinking had been that integrating China into the global economy would cause it to transition from a totalitarian Communist state into a Western-style democracy, while, at the same time, super-charging corporate profits via much lower labor costs. It sounded like a win-win at the time but that time is over. Corporate profits did boom but instead of joining the Western economic and geopolitical alliance, the Chinese Communist party has implemented "Made in China 2025," a state-led industrial policy that set course to challenge the U.S., triggering a U.S. response that includes tariffs and is already having significant consequences.

If the start of the US-Soviet Cold War ("CWI") has been pinned to the 1946 Winston Churchill's "Iron Curtain" speech, future historians will likely pin the start of the U.S.-China Cold War ("CWII") to the Vice President Pence's October 2018 remarks at the Hudson Institute. Mr. Pence's message was as clear as Mr. Churchill's:

"...I come before you today because the American people deserve to know… as we speak, Beijing is employing a whole-of-government approach, using political, economic, and military tools, as well as propaganda, to advance its influence and benefit its interests in the United States. China is also applying this power in more proactive ways than ever before, to exert influence and interfere in the domestic policy and politics of our country. <...> Today, America is reaching out our hand to China; we hope that Beijing will soon reach back – with deeds, not words, and with renewed respect for America. But we will not relent until our relationship with China is grounded in fairness, reciprocity, and respect for sovereignty."

Translation: We will not rest until China stops challenging the U.S. and shows "renewed respect for America," i.e. recognizes the U.S. dominant position in deeds, not words. I expect China to make whatever promises serve her immediate goals but as to the deeds... good luck with that.

In early December, reinforcing the hardening U.S. position, The General Accountability Office (GAO) released a report on the long range threats facing the United States that placed China at the top of the long term strategic threats facing the U.S.:

"China is marshalling its diplomatic, economic, and military resources to facilitate its rise as a regional and global power. This may challenge U.S. access to air, space, cyberspace, and maritime domains. China's use of cyberspace and electronic warfare could impact various U.S. systems and operations."

And then there is Russia, which is right below China on the GAO list of threats. Late in 2018 Russia has announced implementation of hypersonic weapons against which the U.S. and NATO have no current defenses. From the same GOA report:

"China and Russia are pursuing hypersonic weapons because their speed, altitude, and maneuverability may defeat most missile defense systems, and they may be used to improve long-range conventional and nuclear strike capabilities. There are no existing countermeasures."

"THE GOOD FIGHTERS OF OLD FIRST PUT THEMSELVES BEYOND THE POSSIBILITY OF DEFEAT, AND THEN WAITED FOR AN OPPORTUNITY OF DEFEATING THE ENEMY." – SUN TZU

In the post-WWII world, investors have done well by ignoring the geopolitics but it certainly looks like the "times they are a changin." Here is my take on the potential near to medium term substantive financial and economic implications:

- Trade war with China is the current "tip of the spear" in the budding U.S.-China conflict and is already being felt across many industries and companies. We may see tactical pull-backs but the strategic direction will not change unless China accepts the U.S. hegemony, which is not likely. Trade wars are bad for confidence and, by extension, for the markets and asset values.

- The Western defense complex can no longer rely on the Chinese-made components, i.e. the high tech intellectual property and supply chains are facing radical de-globalization. This process is in the early stages but will have major implications, both positive and negative, for many companies and markets. Multiple recent developments related to the Chinese telecommunications giant Huawei Technologies is a sign of things to come.

- The advent of the hypersonic weapons poses material military and financial risks:

    - Since the 1940s, the U.S.-USSR nuclear parity maintained peace between the superpowers by ensuring a "mutually-assured destruction" in case of a nuclear war. A period of Russia (and soon China) having an edge in WMDs until the U.S. develops countermeasures is both destabilizing and extremely dangerous, especially in light of the current state of the US-Russia relations and the intensifying US-China trade war.

    - Less stability is an intangible but the financial implications are concrete - the U.S. must now catch up by developing its own hypersonic weapons at a cost that is likely to be high. Getting into an arms race, while running US$1+ trillion structural deficits is problematic, even without a recession or a financial crisis.

These long term military and geopolitical risks would not be of immediate relevance if we did not live in a world where a lot, if not most, of the consumer and high tech goods bear a sign "Made in China" and where China holds $1.14 trillion in US Treasuries - almost 8% of the publicly held U.S. debt. For these reasons alone, a cold war with China will be very different from the one with the Soviet Union. The USSR was never intertwined with the Western economies through numerous supply chains and financial obligations.

Any conflict with China, even if only a Cold War, will have direct financial and economic consequences across all supply chains and markets.

"TO DETERMINE THE INTELLIGENCE OF A RULER, LOOK AT THE MEN HE PUTS AROUND HIMSELF."

– Niccolo Machiavelli

Weaponized Finance

The use by the U.S. of economic and financial sanctions against China, Russia, Iran, Venezuela and others has "weaponized" the USD and the global financial system over which the U.S. has been exercising de-facto control. This is causing China, Russia and others to seek alternatives to the USD (by accumulating physical gold) and poses real threats to the USD reserve currency status and to the U.S.' ability to grow its debts without a loss of confidence.

Commingling finance with geopolitics has placed the global monetary and financial systems squarely into the epicenter of the geopolitical conflicts already underway. For example, in November, the Bank Of England, a storied and previously impartial custodian of gold reserves for many countries, has refused Venezuela's request to repatriate US$500 million of its gold on the grounds that it was not sure how Venezuela would use this gold. Since neither the U.S. nor the UK are in a declared state of war with Venezuela, this de facto sequestration of sovereign assets speaks to the elevated sovereign risks for all financial assets and custodial arrangements within the financial system and its institutions.

Property rights did not use to be privileges conferred only on those whom the governments like but if this is what they are becoming, every investor ought to consider their sovereign risk exposure.

On November 1, 2018, confirming the strengthening financial-national security nexus, John Bolton, the U.S. National Security Advisor made the following statement:

> "It is a fact that when your national debt gets to the level that ours is, that it constitutes an existential threat to the society and that kind of threat ultimately has a national security consequence for it."

Bolton merely voiced the obvious - the U.S.' ability to maintain hegemony relies on its ability to fund defense spending that relies on the continuous borrowing at low rates. This has only been possible due to the USD's global reserve currency status. If the last financial crisis was handled as a financial emergency, investors should consider the implications of the next financial crisis being handled as a national security emergency. Those unfamiliar with IEEPA, the U.S. law that gives the President virtually unlimited powers to deal with the international financial national security threats, can look it up here. It is quite an eye opener.

Politics

This topic is well covered elsewhere and so I would just make a brief comment. Regardless of one's political views, it is a fact that the Western world has not seen this level of political divisiveness and rancor since the 1930s and the same is true for the resurgence of populism and nationalism on both sides of the Atlantic. We all know how the 1930s ended and, while we should all hope for a different outcome, it is hard to ignore political risks as insignificant. Populism and nationalism have always been bad for peace, business and, especially, for private capital and property rights.

Since all politics are local, acute political risks translate into sovereign risks that are specific to each jurisdiction. The only way to manage sovereign risks is through jurisdictional asset diversification. This may not be feasible for most institutional investors but it is eminently feasible for private investors and is one area where individuals have an edge over the institutions.

Market Structure

While the current market structure embeds a number of new risks - reliance on the high frequency trading for liquidity, the rise of passive investing, prevalence of the ETFs, untold trillions in derivatives, etc., all of these risks ultimately boil down to one catastrophic systemic risk - failure of the counterparties, including the banks, exchanges and dealers, to meet their obligations.

Looking back to 2008, we may never know which counterparties could have met their obligations in full without the bailouts. We do know that Lehman Brothers couldn't and didn't. And neither did Refco or MF Global, the only other US broker dealers that did not get bailed out.

In light of the blatant imbalances and risks, complacency about the counterparty risk can only be based on the assumption that the governments will always stand behind the financial system and its institutions. This, however, is not the current plan - both the US and the EU regulations prescribe bail ins, not bailouts, as the way to deal with the future crises. It is ironic that investors who have been willing to take the regulators at their word on most issues, doggedly refuse to believe the bail in policies, which have been developed to prevent future bailouts. These regulations are now on the books; no one can say they have not been warned.

Conclusion

Barring an extended period of above-trend global growth, which is hard to envision, a whole lot of financial claims must be written down before the global financial and economic systems can be put back on a solid footing. The 35-year long debt super cycle that propelled rates to their 5,000 year lows and asset values to their 5,000 year highs is coming to an end. Someone will have to lose a lot of purchasing power while the books are getting balanced; there just isn't any way around it.

It is not an accident that the word credit comes from the latin word "credere," which means trust or belief, i.e. confidence. Systemic risks and instability undermine confidence and, without confidence, the global house of credit cannot stand.

Whether any of systemic risks come to bear in 2019 or later, ignoring them is imprudent as the risks are real and growing. Allocating a portion of one's portfolio to assets that do not rely on the financial system and institutions has never made more sense. Such assets confer independence from the financial system and some, like physical gold, also provide the liquid buying power during times when others do not have it, which is when it is most valuable.

There is no better way to insure one's capital than being in a position to buy when everyone else is selling. As it is, the only time insurance is available is when few see the need for it. Since most investors remain "not bearish enough," insurance remains available but, given the recent market action, this may not last.

"REAL GOLD DOES NOT FEAR THE FURNACE."
– CHINESE PROVERB

THE VIEW FROM SOUTH AMERICA...

In the spotlight: Brazil:

In our Q2 ATWI8P report we took a deep dive into the geographical and topographic constraints of Brazil inspired by the sage observation of Mr. Robert Frost; "What makes a nation in the beginning is a good piece of geography." We went on to highlight how Brazil's 'piece of geography' plays a key role in determining that nations natural constraints and opportunities. In this segment we will, in light of the recent elections, take a look at the political and economic realities and constraints facing the new administration.

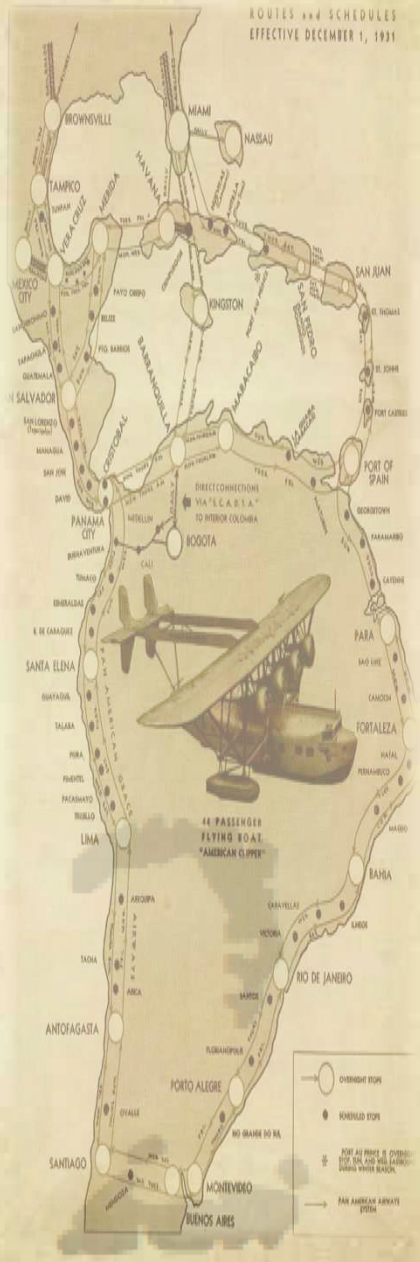
In his insightful 1942 book; 'America's strategy in World Politics' the indomitable Mr. Nicholas J. Spykman stated; "Enormous size and distribution over wide latitudes give Brazil different regional economies and a great variety of products. The potential resources are only partially developed and there is still room for considerable growth, even if the geographic limitations of the interior provinces are taken into consideration. Less than 5% of the total area is at present under cultivation, and improved transportation should open great areas to west-ward expansion. Brazil is practically devoid of good roads outside the immediate vicinity of the large cities, and aside from a few short lines in the northeast the railroads are all concentrated in the states of Sao Paulo & Minas Geraes." As we discussed in our Q2 report much of this still holds true today 75 years after Mr. Spykman wrote his book – both the potential and the natural constraints are still hanging over Brazil and it's politics have in many ways been defined by it.

For the first decade of the new Millennium Brazil underwent a dramatic economic and social transformation, riding high on the China driven commodities boom, from 2000 to 2013, its trade with China grew by over 4,000 percent. During this period, Brazil - under the very popular Lula government – lifted large swaths of its population out of extreme poverty and established a large and growing middle class, who went on to become a significant pillar of an increasingly consumer based economy. Politically this led to an increasingly demanding electorate who wanted to see better government services, less crime and who became a voting block to be reckoned with. Brazil won the rights to host the World Cup and the Olympics, and it felt emboldened enough to campaign for a permanent seat on the UN Security Council. However in 2014 Brazil's economy tumbled into its deepest-ever recession, worsened by slowing growth in China. The economy shrank by more than 7% before beginning a tepid recovery in 2017. Unemployment is currently over 12%, and the government deficit remains over 8% of GDP.

The mood of the nation has decisively changed in the last couple of years and with the economy under dark clouds, political inertia in the face of never ending corruption scandals encompassing most politicians across the political specter, violent crime at epidemic levels and a broad onset of the realization that tomorrow would not be brighter than today, has made for a rude awakening for a population who had dared to believe that the eternal country of the future's time had finally arrived.

Politically the country has been bitterly divided between Lula's supporters and the anti-Lula forces. The deep and lingering recession, the chronic crime and insecurity of everyday life combined with the overwhelming corruption of the political elite has led to a collapse of faith in the traditional political system and the main parties. Brazil has been a democracy with direct presidential elections since 1989, but for the preceding quarter-century it was ruled by a brutal military government. In recent years the longing for strong leadership with simple solutions to complex issues has grown, and as the social conflict and weak incompetent leadership has continued to block any real attempts towards addressing some of Brazil's structural issues and chart a path out of the current malaise the electorate became restless and splintered.

Heading South...



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In the recent presidential and state government elections we have witnessed real fragmentation and renewal, with a sharp rise in number of parties and with the pendulum swinging violently to the extremes on both sides. Another development, which also mirrors the prevailing global political trends, is a pronounced antipathy. The antipathy towards both presidential candidates who made it to the final run-off was deep and consistent and it will make any reconciliation very difficult. The wide gap between the two candidates had narrowed considerably over the course of the campaign. The October Datafola opinion poll gave Bolsonaro 58% of the valid votes to Haddad's 42%. On the eve of the election the difference in Datafola polls was 55% for Bolsonaro and 45% for Haddad. The rejection rate for both candidates remained very high: At 45% for Bolsonaro and at 52% for Haddad. In the end Bolsonaro won decisively. He received 57,797,416 votes, Haddad 47,040,380 votes. Just like in the recent US presidential elections abstentions were high at 31,371,204 votes or 21.30% of the total votes.

The "winner" Bolsonaro has been given the monicker, tropical Donald Trump, and has been compared to Philippine president Rodrigo Duterte. His support comes mainly from 3 critical blocs in the congress, the so-called bullets, bible, and beef brigade; which represents the interests of the powerful Christian evangelicals, the rural interests of big landowners, and the powerful gun lobby. This grouping is dominated by wealthy white males, but to reach over 57 million votes a much broader electorate must have supported him. Many people expressed that they wanted a "law and order" government regardless of the consequences or with the hope that the more extreme tendencies would be negated by the other bodies of government. Some simply wanted a change from the deeply unpopular political elites.

In a chaotic election Bolsonaro appeared as an agent of change, for most of his 27-year career in national politics, he has been a fringe figure on the far right of Brazilian politics, hopping among 9 different political parties and shouting his half-cooked extreme ideas and support for Brazil's bygone military dictatorship into empty congressional chambers. He embraced the role of the spoiler and the outsider but now he will have to lead and chart a path to a better tomorrow. Considering the global climate, Brazil's inherent structural challenges, demographic realities, the fragmented and hostile political environment, the complex economic and social issues and it is clear that he will find it near on impossible to effect any real positive change beyond rhetorical and theatrical maneuvers. Being that these are exactly his two hallmarks and go-to moves, we expect that this will be his modus operandi and that after a brief honeymoon realities will lead to more inertia and hubris in an increasingly menacing atmosphere.

Politically the well has been poisoned and economic realities, the source of much of the discontent, are laden with politically poisoned pills. Take pension spending, it is the biggest driver of the deficit, accounting for more than 8% of Brazil's GDP. With the country's population aging fast, that could more than double in coming decades. Any attempts at reform could be a politically explosive issue, as outgoing President Michel Temer's failed efforts demonstrated. However, without action on this front to stabilize Brazil's finances, investors could reverse their positive reaction to Bolsonaro's win.

Bolsonaro has brought in an outsider economist, Paulo Guedes, with roots in the notorious LatAm chapter of the University of Chicago to oversee his so-called super-ministry, which is set to combine the ministry of economy with the planning ministry and ministry of industry and commerce. It is a move supported by many leading Brazilian businessmen, but in the end will Bolsonaro really stand by as Guedes attempts to cut through the Gordian knot that is Brazil's state bureaucracy which will surely lead to more gridlock and protests? Of course such events could be the trigger for Boslonaro to dust off his 1999 declaration that "..if he ever became president he'd immediately launch a coup and declare himself dictator for life" – which in turn could lead to even further escalations and the complete tearing of the social fabric of Brazil.

Bolsonaro has vowed to align the country more closely with the U.S. and has bashed China on several occasions during the elections. Moves that naturally endeared him to the Trump administration. However economic realities dictated by natural constraints means that Brazil's economic fate lies with China, as the US and Brazil are natural competitors with matching export outputs dominated by agricultural and increasingly petrochemical products. Furthermore while Trump has been high on rhetoric in his embraces of potential partners he has been low on actual follow-through, and with Bolsonaro already fully stocked on bombastic rhetoric but low on hard cash and FDI commitments he may have to walk back his anti China statements and seek the financial help he needs to modernize the Brazilian economy or face being left on the scrapheap of history as yet another empty barrel – loud, yet with nothing to show for it when reality set in.

While large-scale infrastructure assets, which could be made available in a state fire sale, might be very interesting we suggest that investors sit out the initial phase of this supposed new paradigm and keep an eye on actual developments over noisy pronouncements. Also take a pass on any 100 year bonds being floated.

"THE PROMISE GIVEN WAS A NECESSITY OF THE PAST: THE WORD BROKEN IS A NECESSITY OF THE PRESENT." – Niccolo Machiavelli

VISUAL ADDENDUM TO PAGE 2: SOUTH AMERICA: BRAZIL:

BRAZIL SETS A NEW WORLD RECORD IN FRAGMENTATION BEATING IT'S OWN 2014 RECORD WITH 16.5 'EFFECTIVE PARTIES' IN RECENT ELECTIONS...

Effective number of parties in recent parliamentary elections.

Source: Santander

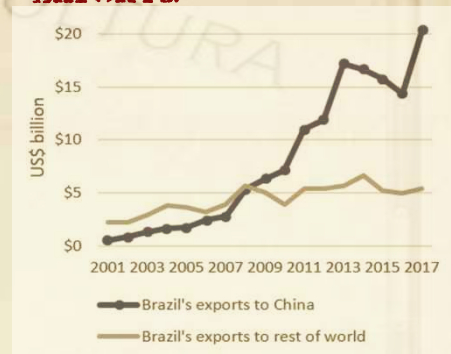
Brazil: Lower House effective number of parties over time.

10,500 MILES:

The distance that separates Beijing from Brasilia – So far yet so close, distance is no obstacle for China & Brazil's increasing proximity. Economic realities dictates pragmatism in the relationship even if the new Brazilian administration bangs the anti-China drum & dreams of US alignment...

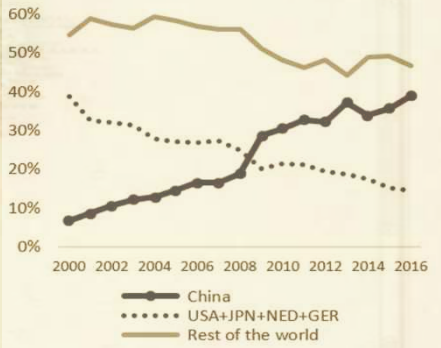
BRAZIL EXPORTS BY COUNTRY (Top 6)

BRAZIL'S SOY BEANS EXPORTS.

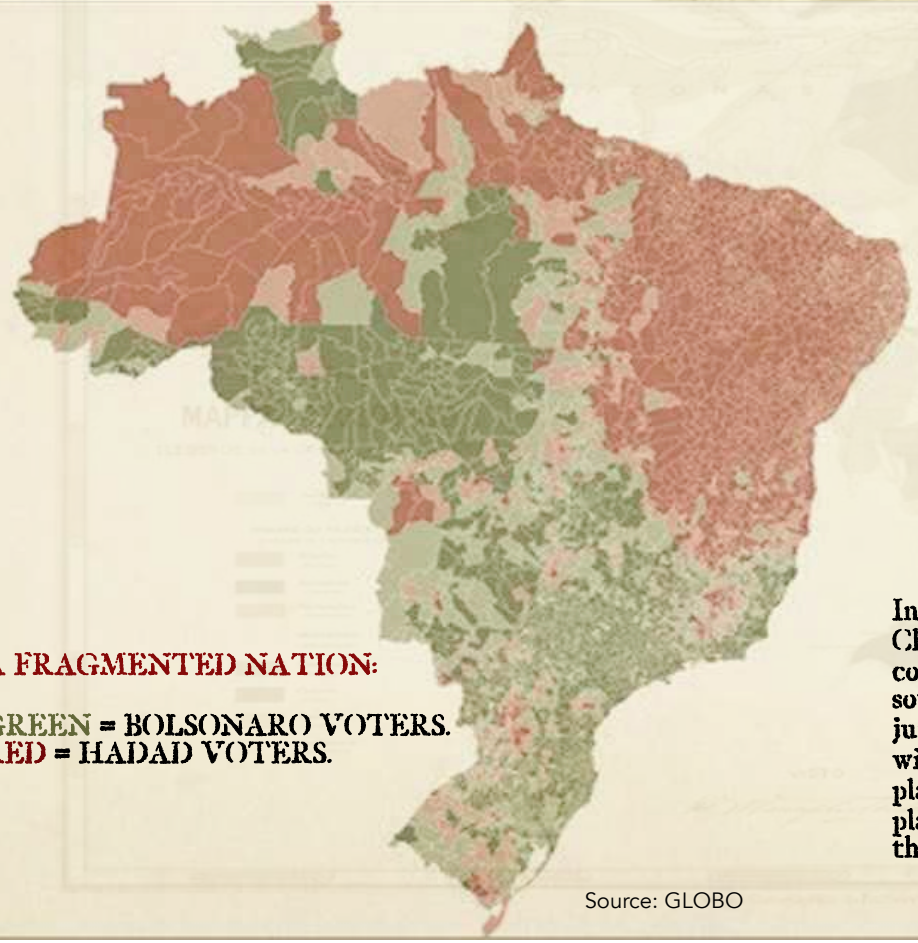


CHINESE INVESTMENT IN BRAZIL (Accumulated)

BRAZIL'S RAW MATERIAL EXPORTS.



Sources: (3 Illus Above) China Global Inv. Tracker, WITS)



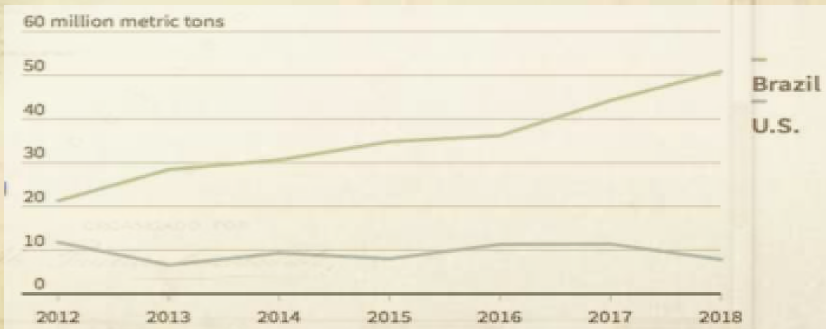
A FRAGMENTED NATION:

GREEN = BOLSONARO VOTERS.
RED = HADAD VOTERS.

Source: GLOBO

In light of US/China trade conflict Brazil soy exports jumped 15% yoy with more planting taking place to harness this windfall...

SOY EXPORT VOLUME TO CHINA (US VS. BRAZIL)



Source: Reuters Graphics

In the spotlight: France:

Much is being made of the current protests, the supposed 'Gilets-Jaunes' movement & the unpopularity of the current incumbent (or is that 'incompétent'?) President Macron. As with all things French, it is more complicated & nuanced than what the international media presents.

Macron is unpopular, weird & kind of annoying, but this unpopularity has multiple dimensions to consider. Macron is operating in a multi-party environment where all national party leaders are extremely unpopular. According to recent surveys voters prefer him in the position of President over every other national party leader, despite the fact that the vast majority of French voters clearly disapprove of what he is doing as a President. The French are a complex people, more artful than logical.

If one can cast ones recollection back say a decade, you will find that the last two to hold the office – the 'Bling Bling President AKA Sarkozy & Mr. Lover Man AKA Hollande – did not exactly deliver the goods nor were they loved, with the 'Sark' finding himself in hot water over alleged corruption amongst other misdeeds and Hollande limping out of his term with little backing and deciding against running for a second after a litany of gaffes, affair rumors & the annual $132,000 hairdresser bill for the balding Romeo at a time of supposed national austerity screamed of Champagne socialist which surely didn't help. France does not like its presidents much in general and by the end of their terms they tend to leave through the backdoor. Taking an even broader arch of history into consideration a great paradox jumps out at you, in the eloquent words of ML Avila; "How has France managed to cram in 4 Revolutions (1789, 1830, 1848, 1871 Paris), 5 Republics & 2 Empires into 230 years despite having had a relatively non-tumultuous economic history by Western European (or really any) standards?"

Protests and strikes is a part of daily life in France, has been for centuries, multi-party democratic politics has been the 'safety valve' that has led to a more ceremonious and less spectacular end to most national leaders stints in office (Think 'tell-all sob story interviews in Paris Match magazine as opposed to an appointment with the Guillotine). In summary; France has inherent issues that have no politically acceptable solutions and as such as to Monsieur Bastiat's 1848 quip - "The public has two hopes, and government makes two promises – many benefits and no taxes. Hopes and promises, which being contradictory, can never be realized." – the Republic is doomed to keep chasing it's own tail in an all too predictable tale of hope, hubris and disillusion.

Have we now reached a tipping point? I doubt it, as visually spectacular as the protests on Champs-Élysées are and as awkward as Macron is in his attempts to play 'man of the people' this is more likely a flashpoint – bright light followed by damp retreat into the background.

France has a great big security net that captures most of it's population, it also has a maddeningly complex bureaucracy that stifles economic growth & the abilities of its brightest & ensures the prevailing of the status quo and its desperate attempts to hold onto the past and ensure liberté, égalité, fraternité in a world of contradictive realities. It is a comfort blanket that never quite covers all parts of the (electoral) body leading to constant pulling, squabbling & discomfort with the only consensus being that all parties want more blanket.

This natural state of almost theatric conflict has no doubt been given real impetus by a decade of relative financial austerity, a loss of traditional values in rural areas as MacDonald's AKA 'McDo' & big box retailers on the outskirts have gutted out the village centers along with a move of young dynamic people to the urban centers, in these urban centers, beyond the more recent waves of terrorist attacks and the resulting militarization of the urban reality, France has a long and mixed colonial past that has meant a large number of immigrants making Frances' cities their home over the last 50-60 years, many from Muslim nations, and many ending up in the 'Banlieues' with little social mobility resulting in the rise of petty crime. Combined with France's search for a future in an increasingly globalized economic reality and within an European Union with a rising Germany and a sharpening North/South divide, which France – geographically and culturally – finds itself right in the middle of. These factors – new and historic – sets the stage for what comes next. If the past is any indication, then the most likely outcome is more of the same, for better and for worse. Another crumbling empire crumbling on – but the crumbs remain tasty and the wine is fine.

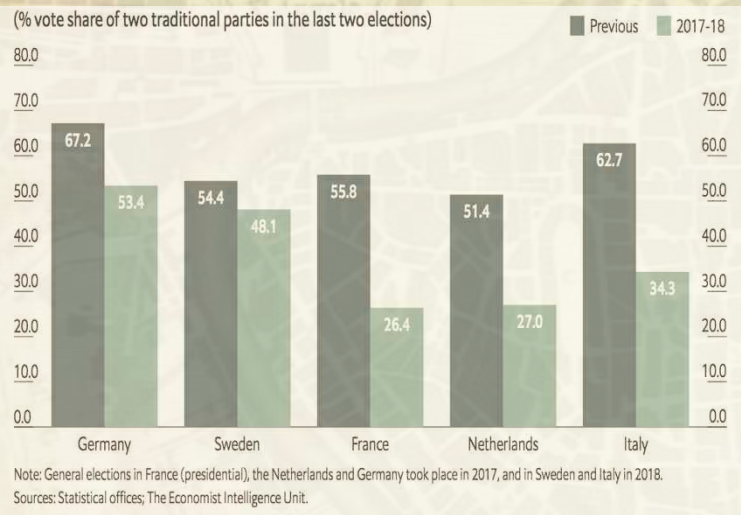
"HOW CAN ANYONE GOVERN A NATION THAT HAS 246 DIFFERENT KIND OF CHEESE?" - CHARLES DE GAULLE

VISUAL ADDENDUM TO PAGE 3: EUROPE:

A ramble through some European visuals that caught our attention during Q4 2018.

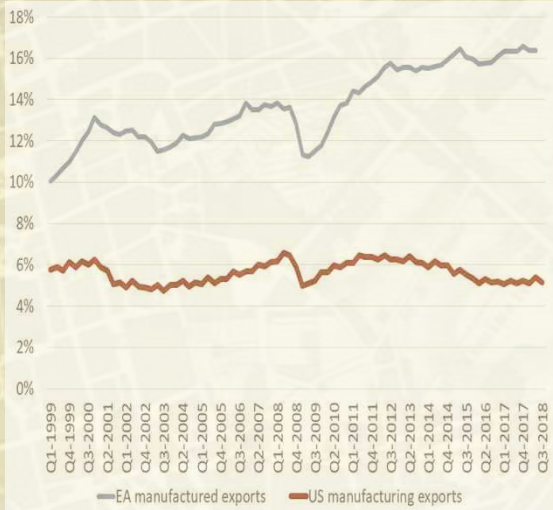
DIVERSITY OF OPINIONS ON THE RISE...

The continuous decline of the two-party system controls the swings to the extremes but ensures a slow decision making process by committee.



US VS. EU EXPORTS OF MANUFACT. GOODS (% Of GDP).

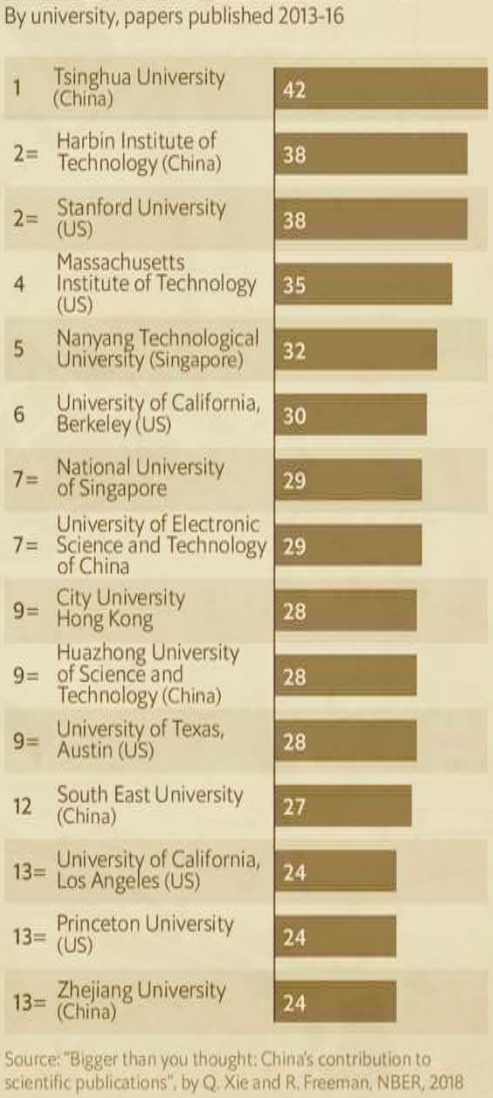
On the current path who has the optimal model?



READY FOR THE FUTURE?

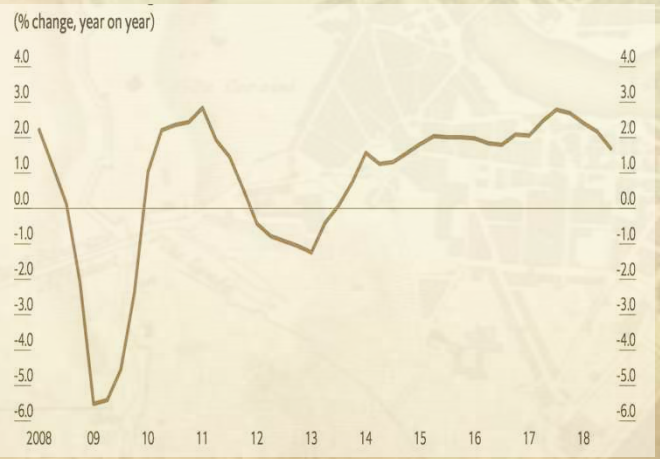
Europe appears to be falling behind in key areas of education vs. the US & China.

Number of papers in the top 1% most highly cited ones in mathematics & computing.



EURO ZONE REAL GDP GROWTH...

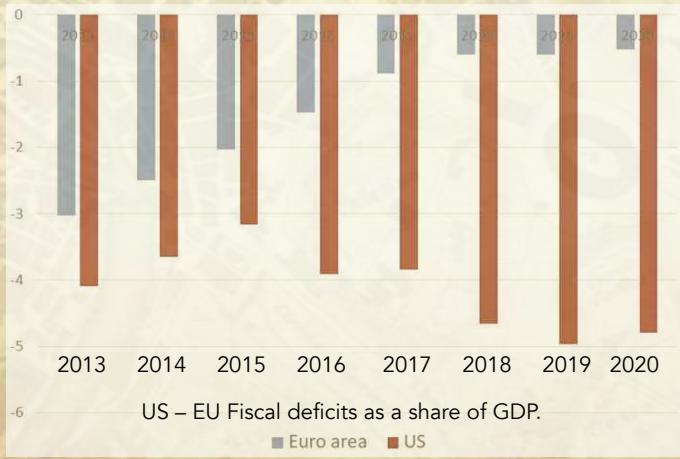
Where to next?



Source: EuroStat.

EU VS. US – FISCAL DEFICITS....

The US making the EU look like a thrifty well-run machine with flexibility for fiscal stimulus...



Sources: (Top & bottom Illus.) Setzer/IMF.

Source: EIU.

In the spotlight: The UK:

As you may have heard, in June 2016, British voters decided in a referendum to leave the European Union (EU), however clear majorities in Northern Ireland and Scotland preferred to remain. As such it is likely that Brexit will affect not one but two unions: the EU and the United Kingdom. The aftermath of any potential Brexit deal between (or lack thereof) the two could prove even more complex and contentious than what we have witnessed between the UK & the EU so far - a study by the House of Lords' Europe Committee in 2017 outlined: "The impact of UK withdrawal from the EU on the U.K.'s devolution settlements is one of the most technically complex and politically contentious elements of the Brexit debate." The study goes on to say that Brexit "presents fundamental constitutional challenges to the UK as a whole" and that it would require "the consent of all the nations of the U.K." for a durable solution. Since that study was done, the realities have only become even more contentious and complex.

The supposed appeal of Brexit to it's supporters at the time it narrowly passed was that it would make Britain feel big and important again, casting the anchor of the sinking European continent away and unleashing Britain to once again pursue its rightful place in the world after too many years stuck in the Brussels quagmire listening to foreigners harp on about rules and regulations. The Brexit saga has been described as a story of a proud former imperial power undergoing a mid-life crisis. With all of us having to listen to its therapy session as it goes on about it's ex-spouse, the EU. And while the reality is obviously more nuanced with many voting at the referendum in search of solutions to the very real problems they faced, be it concerns over employment opportunities, economic concerns over government spending on the EU and it's citizens relocating to the UK and getting access to already strained public services, there are some truth to this description on a more basic instinctive level. As such it would be ironic if the act were to lead to the unraveling of the final vestiges of this once global empire. As Machiavelli stated; "One change leaves the teething for another." – as the cogs spin out of the current inertia the unintended consequences will be far and wide. Scotland and Northern Ireland would have their own concerns about the union they were now locked in and the one that they had been forced to leave against their will.

Whatever the UK's political sovereignty aspirations, it is bound by the weight of geography, historical events & the economic reality that it's most important trading partners are the other 27 members of the EU. Surely a 'nation of shopkeepers' will have to reassess and come to some realizations that lead to a more pragmatic approach. As an ageing mid-sized European nation without the scale nor intestinal fortitude to put it's weight around in the world, the reality is that globally it has little heft alone - as is true for all in the EU family - and even if the dreams of running away with the younger and more agile Instagram model has much appeal, one is best served getting back in the clunky mid-sized grey sedan, picking up some flowers at the petrol station and heading back home to the family even if it's more the Adams Family than the Kardashian Family.

The vote in 2016 was at best undertaken with the population under-informed and at worst misinformed and certainly with no real way of knowing what an actual 'Brexit' would look like nor that they would have to endure 2 years of watching a mind-numbing political slow-motion (clown)car crash. Who really understood the intricacies of the customs union, the realities of the Irish border issues, the fact that much of the UK manufacturing industry is now integrated as a component of a larger EU complex, that Scotland's exports are largely agricultural and as such has been deeply ingrained in EU quotas and subsidies, that Spain may have some issues with Gibraltar, that much of the infrastructure build-out in Wales and other economically challenged regions was done with EU grants or that the hundreds of thousand British retirees and expats living in Europe might be adversely affected – the list goes on and on and worse it has since become abundantly and painfully clear that most of the politicians who championed both sides of the argument had little idea about any of these aspects either. So while doing a U-turn on Brexit would no doubt be damaging and leave lasting scars on the collective reality of British society so will all the other options bantered around currently.

Europe has haplessly arrived at a point where there can be no 'winners' – not the Leavers, the Remainers of the UK nor the EU – but only losers. As the main powers of Europe has fretted away the last couple of years in a pointless vanity project the rest of the world has moved on, with China and Russia aggressively advancing their interests and the US turning to its own priorities. Europe, including the UK, needs to wake up and have a pragmatic conversation about current realities and together chart a more productive path forward or consign themselves to irrelevance and cascading decline.

As a rational individual, when faced with multiple paths ahead, all of which carry some degree of physical damage to you and your family, you are likely to take a considered approach and take the one that leaves you with the least amount of lasting pain. However as a herd who have been energized and then challenged by opposing views, people tend to rally around their cause with little rational consideration, but as to Mr. C. Mackay's observation from his enduring book; 'Extraordinary Popular Delusions and the Madness of Crowds' – "Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly, one by one. It remains to be seen if the nations of Europe will come to their sense in time or if they will once again choose the path of conflict & zero-sum thinking.

"WE GIVE THE IMPRESSION OF BEING IN OFFICE BUT NOT IN POWER."

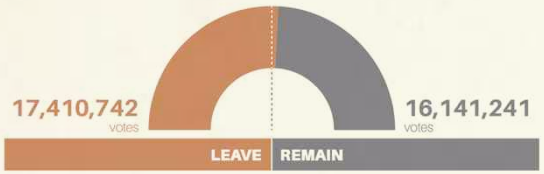
– Norman Lamont's 1993 resignation speech.

VISUAL ADDENDUM TO PAGE 4: EUROPE: THE UK:

2016 BREXIT VOTE:

Regional Overview of a Divided Union...

What would the result be if the referendum was held again today with the benefit of hindsight?



Area	Type of devolution	Population (millions)
England	Limited "devolution deals"[18]	54.3
London	Directly elected mayor and Greater London Assembly	8.6
Scotland	Government and directly elected parliament	5.3
Wales	Government and directly elected assembly	3.1
Northern Ireland	Power-sharing executive and directly elected assembly	1.8

	Leave (%)	Remain (%)	Turnout (%)
U.K.	51.9	48.1	72.2
England	53.4	46.6	73.0
London	40.1	59.9	69.6
Scotland	38.0	62.0	67.2
Wales	52.5	47.5	71.7
Northern Ireland	44.2	55.8	62.7

TOP 10 UK EXPORT DESTINATIONS:

How Global Britain's toast is buttered...

Rank	Importer	2017 UK Exports	2016-7
1.	United States	$59.2 billion	-3.9%
2.	Germany	$46.7 billion	+6.6%
3.	France	$30.4 billion	+14.9%
4.	Netherlands	$27.6 billion	+8.2%
5.	Ireland	$25.1 billion	+9.6%
6.	China	$21.4 billion	+17.8%
7.	Switzerland	$20.3 billion	+2.6%
8.	Belgium	$17.8 billion	+13%
9.	Spain	$13.5 billion	+3.4%
10.	Italy	$13.2 billion	+0.6%

CURRENT STATE OF THE UNION ON THE BREXIT QUESTION...

	VOTED LEAVE	VOTED REMAIN
Stay in the EU	● 12%	○ 83%
Leave on the Brexit terms negotiated by the government	● 55%	○ 7%
Would not vote	● 15%	○ 2%
Don't know	● 16%	○ 7%

Poll question: If there were a public vote, and the choices were to stay in the EU or leave on the Brexit terms negotiated by the government, how would you vote?
Source: YouGov People's Vote survey of 25,537 adults conducted Dec. 21-Jan. 4

A COMPLEX UNION:

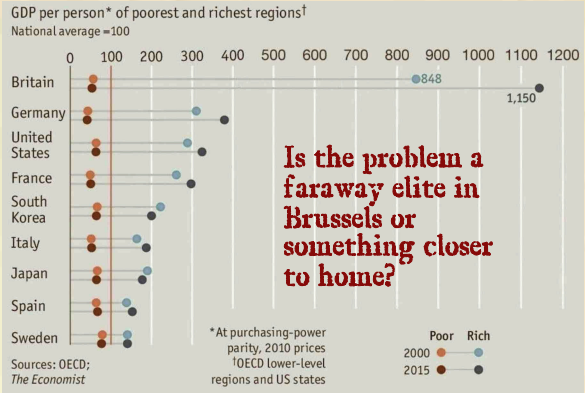
Overview of the devolution agreements between the different parts of the UK...

DIVERGING INTERESTS:

Brexit vote totals across the different components of the UK...

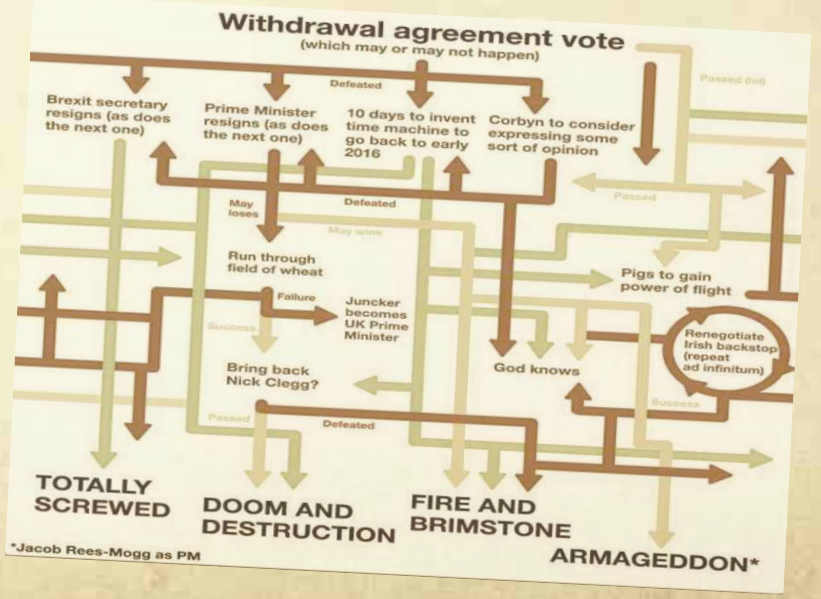
EXTREME REGIONAL DISPARITY:

An outlier that perhaps should receive more attention and is more relevant to the underlying socio-economic reasoning behind the impulses that led to the Brexit vote...



Is the problem a faraway elite in Brussels or something closer to home?

Finally some much needed clarity from some funny individual on Twitter...



Sources: The Economist, RAND, IMF, Brookings Institute, YouGov, Random person on Twitter.

8.7832° S, 34.5085° E
29.2985° N, 42.5510° E

In the spotlight: Africa's Cities:

The century from 1950 to 2050 is 'the global century of urbanization' during which, broadly speaking, the global population will transform from a 70% rural to a 70% urban population majority. The United Nations (2013) has predicted that 64.1% of developing and 85.9% of advanced economies will have urban population majorities by 2050. This process is accelerating in the two global regions that are relative late entrants in this transformation: Asia and Africa.

Nowadays, cities account for roughly 70% of global GDP according to the World Bank, which affirms the profound role that urbanization plays in unleashing the economic potential of cities. In Africa, primary cities like Johannesburg already account for a considerable share of national GDP. The African Union's Agenda 2060 points out that cities already plays an outsized role in their contribution to African GDP, generate employment, reduce poverty and can be considered a major driving force in the continent's transformation.

Various studies such as UN-Habitat's 'State of African Cities' reports, show that African urbanization rates far exceed initial expectations. It is projected that several African cities could become some of the largest in the world. The high rates of urbanization are today not merely attributable to large-scale rural-urban migration but, as urban populations grow, natural growth plays an increasingly important role in Africa's urbanization.

However this trend of rapid urbanization in Africa is a double-edged sword as it often results in the urbanization of poverty that manifests itself in mushrooming urban slums. The World Bank's 2017 Africa's Cities report identified three features of African cities that restrict urban development.

1: African cities are crowded but not economically dense, meaning that physical, industrial and commercial structures have not developed in parallel with the fast-growing populations. In short, African urban population growth is significantly outpacing urban economic growth.

2: African cities are generally internally fragmented and composed of small and disconnected neighborhoods. Such cities typically lack efficient transport networks, which limits access to job opportunities and reduces the productivity of firms, as they are unable to fully reap the benefits of economies of scale and urban agglomerations.

3: African cities are expensive to investors, particularly regional and international investment, due to high transaction costs associated with inefficient urban planning, e.g. urban sprawl and underdeveloped transport networks. Plus bureaucracy and corruption adds to the overall cost of doing business.

Considering the evidence from East Asia, it's clear that there is a close association between episodes of rapid urbanization and economic development. Unfortunately, these links appear weak in Sub-Saharan Africa. Cities in Africa are not delivering the required agglomeration of economies or reaping the urban productivity benefits; instead, they suffer from high costs for food, housing, and transport. These high costs are the result of coordination failures, poorly designed policies, weak property rights, and other factors that lower economic density. This in turn lock firms into producing non-tradable goods and services which can not be the foundation for an economic reality that provides the fast growing populations with the required opportunities for an improved life and for them to become the rising consumers that could in turn reinforce a positive upward economic spiral.

472 MILLION:

People live in urban areas in Africa. That number is set to double over the next 25 years.

Urbanizing from a position of low GDP per Capita, means that cities lack the means to invest in physical capital, such as infrastructure. They have fewer resources for public services, such as education, and lack human capital, which hinders efficient administration and improvement of existing institutions. Successful cities are economically dense and connected. Africa's cities are crowded but not dense, and they are disconnected. Investments in infrastructure, industrial and commercial structures, and affordable formal housing have not kept pace with the concentration of people. Congestion and its costs overwhelm the benefits of urban concentration. Cities have developed as collections of small and fragmented neighborhoods. The lack of connectivity, particularly the absence of reliable transportation, limits job opportunities for workers and prevents firms from reaping scale and agglomeration benefits. To grow economically as they are growing in size, Africa's cities must open their doors to the world and attract global investment in tradable goods production, cities must develop economies of scale, which are associated with successful urban economic development in other regions. Difficult yes, impossible no.

As discussed under conditions of rapid urbanization, African cities bring both problems and solutions to this vast continent. In the absence of commensurate economic growth, in both urban and rural economies alike - and with its challenging geographic realities combined with unpredictable factors such as climate change and the lasting vestiges of colonialism still leaving large swaths of the continent immersed in conflict – development of Africa's cities form a crucial tipping point for whether the continent and individual nations will be viable prosperous societies, set to rise, or whether it will increasingly be a conflict prone region locked in a downward spiral.

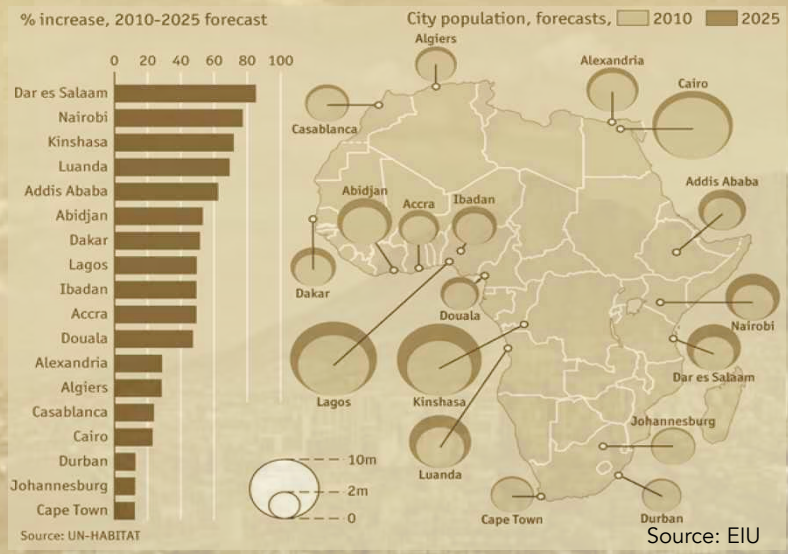
The key objectives should be to facilitate urban employment and poverty reduction, to decrease the proliferation of slums and to secure critical urban food, water and energy supplies. Furthermore, in the context of food security, Africa's urban revolution will arguably have to run parallel to an agricultural revolution. Africa holds 65% of the world's arable land, could generously meet its own food requirements and, under the right policy interventions, could possibly feed the entire planet by 2050 according to the World Bank. Half of Africans are under the age of 19, the continent is going to add another billion or so Africans over the next 20 to 30 years. In Nigeria alone, there are more babies born every year than in the whole of Western Europe. Africa will have the largest working population, larger than Chinas. Where Africa is, contrary to where China was 25 years ago, is a position where it is actually leapfrogging it in many places with technology (A lot of it brought in by China) and that opens up a lot more opportunities that people may not have seen at this stage. For example approximately 645 million Africans have no access to electricity because the continent's enormous renewable energy potential remains essentially unexploited, this is a great opportunity to leapfrog old redundant energy infrastructures and introduce more flexible micro grid solutions. Mobile banking is another well documented area of success.

For investors it is clear that Africa is an under capitalized place, despite a growing FDI influx, Africa's share of total world FDI volume remains small, at roughly 5%. This compares poorly to the continent's 15% share of global population. Investing in Africa is a long-term play. In many places it's the same as China was 30 years ago or India was 15 years ago. While the risks are clear, Africa is positioned to be the next pillar of growth because of it's demographics, because of the natural resources & because of urbanization. Its cities will be the catalysts and could represent global investors with a starting point for accessing this long-term growth opportunity. As an investor and/or business owner you should be asking yourself which nations are getting their urbanization process right and how can I be a part of it. We recommend that you keep an eye on Africa's urbanization as it has far-reaching consequences that will influence developments globally – for the better or for the worse.

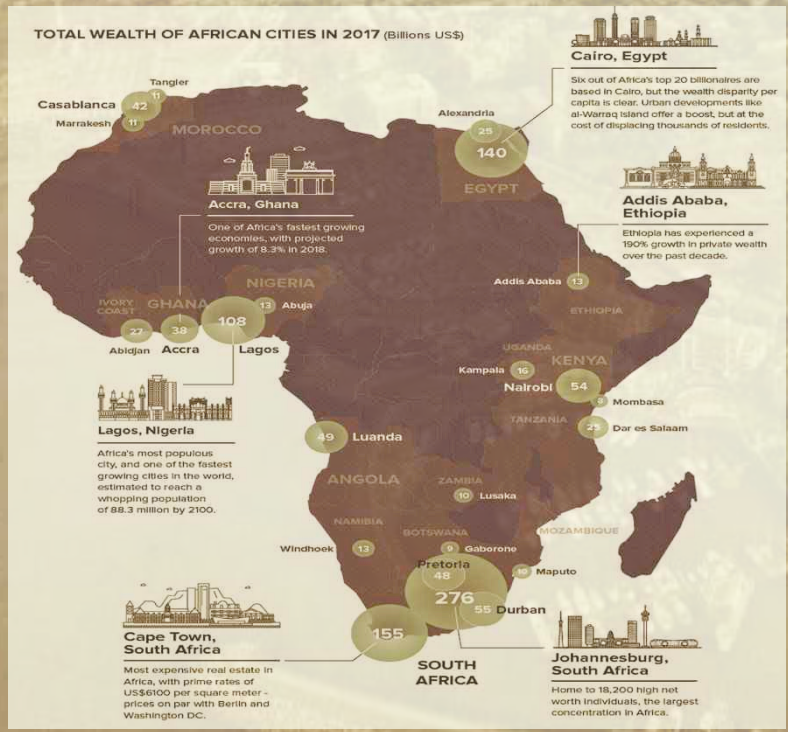
"RISK HIDES IN THE FAMILIAR AND SCREAMS LOUDLY IN THE UNKNOWN." – M. Housel

VISUAL ADDENDUM TO PAGE 5: MENA & SUB-SAHARAN AFRICA: AFRICA'S CITIES:

Rapid growth of African cities...



THE CITIES THAT HOLD AFRICA'S WEALTH:

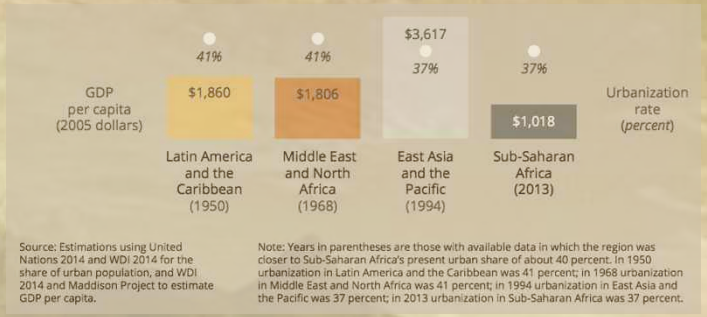


Sources: VisualCapitalist, New World Wealth.

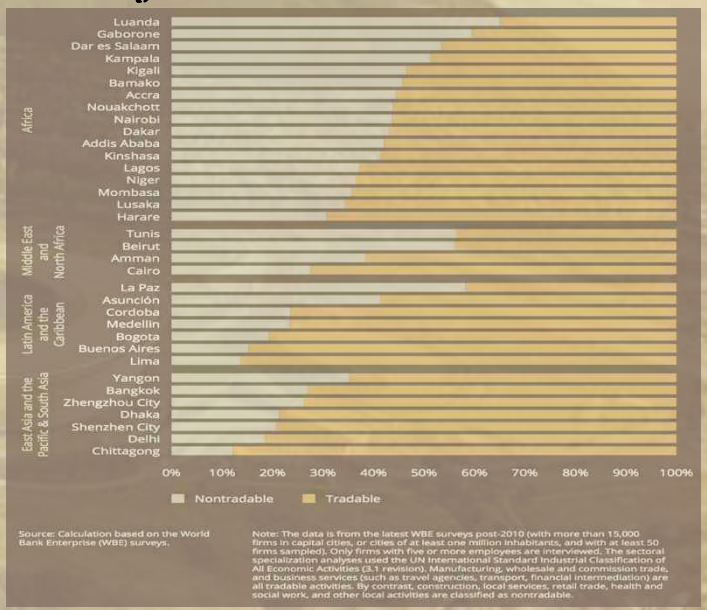
19.5: The average age in Africa compared to 46 in Germany.

Urbanization can be the key to success or a powerful fan to the flames of conflict...

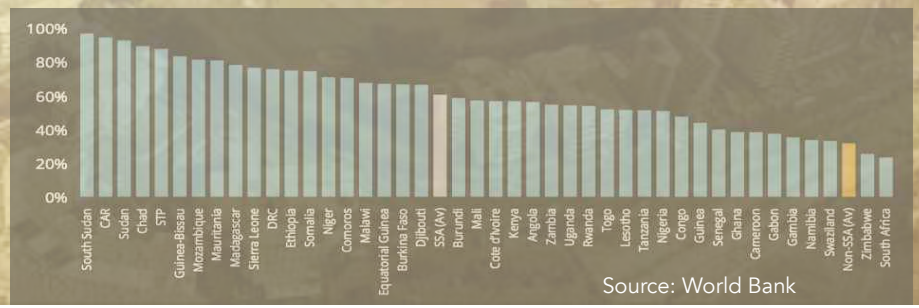
Sub-Saharan Africa is urbanizing, but at lower levels of per capita GDP than other regions...



Share of firms in internationally traded & non-tradable goods...(Select Cities)



Very high proportions of urban dwellers live in slums in Africa...



THE VIEW FROM ASIA...

36.2048° N, 138.2529° E

In the spotlight: Japan:

In our 2018 Q3 ATWI8Ps we played 'Devil's advocate' with the prevailing sentiment that the US was entering 2019 as a pristine hand-tailored shirt, weaved from only the finest two-ply cotton, in a hamper full of soiled ill-fitting polyester monstrosities. Here we will apply the principals of 'Devil's advocacy' analysis from the CIA's manual on 'Tradecraft & structured analytical techniques' towards the prevailing perspective that as 'demographics are destiny' – Japan the nation that consumes more adult than baby diapers, is certain to be in terminal structural decline. When faced with a broadly supported consensus opinion it is always good to dig a little deeper and seek another set of perspectives as Miyamoto Musashi states in his seminal book; 'A book of five rings'; "It is difficult to understand the universe if you only study one planet."

The prevailing view seems to be that Asia's future is already mapped out, between the inevitable decline of Japan on the one hand the irresistible rise of China and India on the other. Japan is often referred to as just a US satellite, completely at the mercy of the whims of the person sitting behind the 'Resolute Desk' in the Oval office and which would immediately become Dragon food the moment the US decided to set sail.

These opinions are obviously based on some truths from the past, some half-truths from the present and some blind linear thinking on the future. Long-range forecasting is a perilous enterprise, when it comes to the affairs of man and most often the reality is far more nuanced and change shows itself to be the only constant. When models meet reality it's like a neatly organized spreadsheet meeting a Pollock painting. So in the spirit of JW Forrester's observation - "Rather than stressing the single-model concept, it appears that we should stress the process of modeling as a continuing companion to, and tool, for, the improvement of judgment." - let's commit to the 'continuous process' of exploration and take a look at alternative paths forward for Japan.

In our 2018 Q2 ATWI8Ps we had a spotlight section titled; 'Japan – Finding strength in your weakness – A recipe for the future.' We outlined the obvious demographic challenges including some scary looking data points such as the facts that Japan's population peaked in 2011 and the number of births in 2017 fell to its lowest since records began in 1899. We shared forecasts from the World Bank highlighting that by 2050 the Japanese population is set to shrink by 20% and on this trajectory it will be 31% below its peak by 2065. Furthermore the math dictates that a larger and larger portion of the population will be older with a declining portion being in the traditional 'productive' age group. However we went onto raise the question; "…in a world of increased automation perhaps having a smaller, older and more educated population will actually turn out to be a position of strength?

We then sourced some insights from an earlier study in our '8 Pages About… Series' focusing on 'Investing in Innovation' from which we stated; "Automation could provide the productivity boost for economic growth projections that would otherwise be hard to reach. A study by Bain Macro Trends Group estimates that as much as $8 trillion could be invested in automation technologies by 2030. Falling capital costs in robotics and rising labor costs in places like China reduce the payback period for automation and in turn prompt higher investment in automation. China has seen a 10 fold increase in purchases of industrial robots between 2009 and 2015. Japan – who faced the demographic challenges before everyone else – is the leader in this space. With the oldest population in the world Japan has made progress with dealing with a shrinking and ageing workforce. These challenges stimulated research, investment and development in areas such as robotics and domestic automation, while it is only home to 2% of the world's population it accounts for 20% of its R&D. Furthermore through its culture of not just focusing on developing new products but on optimizing the industrial process or 'Monozukuri' – literally the "art of making things" and 'Kaizen', the Japanese word for "improvement as a reference to the business practice of "continuous improvement – it has established a basis for doing more with less, that could put it and its companies ahead of the global demographic curve."

"DEVIL'S ADVOCACY: DEFINITION: CHALLENGING A SINGLE STRONGLY HELD VIEW OR CONSENSUS BY BUILDING THE BEST POSSIBLE CASE FOR AN ALTERNATIVE EXPLANATION."

– The CIA Tradecraft & Structured Analysis Manual.

CONSENSUS ON JAPAN: DEMOGRAPHICS ARE DESTINY. JAPAN IS IN TERMINAL STRUCTURAL DECLINE.

We also highlighted the already reoccurring harvest from these prudent ongoing investments, according to the most recent (2017) government and OECD data on national earnings from Intellectual Property (IP) shows that Japan is generating soaring revenues from this field with a jump of 74% over the past 5 years to a record level in 2017. Japan ranked 2nd behind the US in IP exports (IP data includes intangible assets such as brands, copyrights, patents & industrial design) in 2014, the last year for which complete data is available. This trend is only set to continue with advances in robotics and so-called 'smart-automation' by companies such as the industry leader, Fanuc Corp, set to continue delivering outsized returns for Japan.

A recent study by the ITIF showed that; "The more robots a country has, the higher its gross domestic product and, on average, the richer its citizens. On the other hand, a country that resists automation loses out not just on wealth creation but on new jobs as well."

Automation can take many forms, but industrial robots are a good example to monitor in relation to Japan and other ageing nations, because they directly displace low-skilled workers in manufacturing and other blue-collar professions where the workers tend to rely on physical strength. In a recent WSJ article they share the findings of a study on the adoption of robots in 17 countries that found that increased use of robots accounted for 0.36% of the annual growth in hourly worker productivity. A seemingly small increase, it amounts to a substantial 15% of overall productivity growth. Not surprisingly, adopting robots also lowered prices of the goods they helped produce.

As stated earlier Japan was long ago consigned to stagnation with its aging population and rock-bottom birthrate. But with structural changes and increased focus on automation it has in recent years defied destiny. Since 2012, its working-age population has shrunk by 4.7 million, yet the number of people working has surged by 4.4. million, this being the critical ingredient in what is now Japan's second-longest economic expansion since World War II. The proportion of the population in the labor force has risen sharply since 2012, by more than in any other major advanced economy.

Japan is refreshing its labor force from three often-neglected pools: the elderly, women and foreigners. This offers important lessons for the many other countries that now, or very soon will, face similar demographic pressures. A population's size can still impose limits on long-term growth, but they may be further away than long assumed by economists and policy makers as Japan is proving. With unemployment near a 25-year low of 2.5% it has forced employers to be more imaginative and flexible about whom they hire and even how they think about the work itself and the operational structures. Policies enacted by Prime Minister Shinzo Abe, meanwhile, are reshaping cultural norms about when to retire, whether women with children should work and whether Japan should admit overseas workers with positive effects. An example is female labor participation, which has long been one of Japan's handicaps. No longer. In 2012, female participation was 63%, marginally above the OECD average of 62%. By 2017, it had shot up to 69%, five points above the OECD average.

Besides women and the extension of work life more broadly, the third source of labor has been a renewed effort to increase immigration, which has long been Japan's third rail and it is still difficult for a foreigner to acquire Japanese citizenship. However the Abe government has considerably loosened the rules for working in Japan. In 2015 it began admitting foreign construction workers to alleviate shortages as the country rebuilt from its 2011 earthquake and prepared for the Tokyo Olympics in 2020, and for housekeepers in special zones. In 2017 it did the same for nursing-care workers. It now allows foreign "technical interns" to stay for three to five years, and issues "green cards"—permanent residence—to highly skilled professionals after a one-year stay. Discreetly the number of foreign-born workers has nearly doubled between 2012 and 2017 to 1.3 million according to government data. The combined effect of the elderly, women and foreigners on the labor force has been to sustain Japan's underlying growth rate in the past few years as well as hold off the wage and inflationary pressures that would ordinarily emerge when unemployment is so low.

It will take a continued push into automation and a permanent targeted set of immigration policies to offset natural decline in these sources but with vast numbers of young people seeking economic and educational opportunities in surrounding nations and the continuous automation trend it would appear that having a mature, well educated and smaller population may just be the recipe for success in the world around the corner.

In the past having a so-called 'youth-dividend' with a mass of working age eager people striving for betterment in life has been seen as the key to having a dynamic economy, but in a world with less need for human brawn and more need for human ingenuity the traditional thinking may just be turned on its head, and a large group of young people without economic opportunity becomes an angry hostile mob with little to loose from challenging the existing order. In a world of rapid automation, high and rising life expectancy and a declining population appear to be better 'problems' to face than rapid population growth, that currently threatens to overwhelm job creation capabilities in many emerging markets economies. Amongst the giants in Asia Japan is a graying nation but so is China and at a stage of much lower development and wealth and as for India with it's outsized youth bulge, it may find itself too late to the party and the source of immigrantion to other nations, like Japan, of it's most dynamic people while being left behind with the less educated and not enough economic growth to create 'escape velocity' for its billions of young people.

As for the assumption that Japan will always be the junior partner of the US in maintaining the Pax Americana in Asia and the Pacific, while inherently true in the present, it is worth noting that there are many moving parts in that particular calculation including the US's internal politics and China's approach to a more gradual rise towards regional strategic power status and its embrace of a less confrontational approach towards its neighbor.

In Q4 during Abe's 3 day visit to China we saw, the flags of both countries lined up along Changan Avenue in Beijing not far from Tiananmen Square, a significant symbolic step. The visit was a further step to establish a new format for potential further cooperation between Asia's two biggest economies. There should be no doubt that this is a practical arrangement and one where both parties goes into it with their eyes wide open. However necessity is a powerful motivator. In 2018 China stepped up its outreach to Japan and others as it locked horns over trade with the US. While Japan is worried about China's growing naval power, it is keen to explore closer economic ties with its biggest trading partner. As with Australia and South Korea, it must manage its relationship with China without upsetting its key security ally, the US, with which it has trade problems of its own.

In regards to it's security consideration, Abe has made some headway with expanding the Japanese Self Defense Force's mandate and Japan's defense budget has been on a steep rise. It's the first steps on an admittedly long journey towards self-sufficiency in the security space.

In regards to global trade, Japan was a leader in reviving the Trans-Pacific Partnership sans the US. Separately, Asian trade ministers met in Tokyo during Q4 in an effort to develop the framework what could be the world's biggest trading block, including China but, again, without the US. Abe and his team also secured a free trade deal with the world's largest trading block, the EU, in another move to develop a more diversified approach to its international relations. Considering the current trade climate and the negative economic trends it is also worth noting that counter to the popular narrative, Japan is comparatively insulated from a drop in global trade as only 10.7% of it's GDP is generated directly from exports whereas the so-called Asian Tigers and China has far more to loose from a prolonged downturn.

Some of the most important upheavals of the next 20 years can even now be seen in outline, the future of Asia and broader geopolitical realignments yet to come will depend to a considerable extent on the outcome of the struggle between the world's 2nd and 3rd-largest economies for pre-eminence in Asia, not only in economic but also in political and strategic terms. As a nation sitting on the Pacific "Ring of Fire" which covers the intersection of 4 different tectonic plates and has 110 active volcanoes which makes it prone to severe earthquakes, tsunamis and volcanic eruptions - the concept of crisis and renewal is seared into the national psyche.

The Devil's Advocate says: This is a nation of proven resilience and with a history of collectively pulling in the same direction, even through great personal sacrifices, in order to deliver the collective and the nation to it's next phase. Upwards and onwards.

JAPAN & THE US:

THEY ARE TWO PARTNERS STILL SHARING THE SAME BED BUT THERE MIGHT COME A TIME WERE THEY NO LONGER DREAM THE SAME DREAMS...

A rich history of crisis and renewal…

Since the times in 1868 of the great reforms under the "Fukoku kyōhei" (Enrich the nation, strengthen the armed forces) banner, which transformed Japan from an essentially agricultural country into a great industrial and military power. A new Japan was molded, open to the world and rapidly able to equal the Western powers. Manufacturing output increased by a factor of 30 between 1878 and 1939 making it the first non-Western industrialized nation.

As this amazing achievement was literally burned to the ground in WWII, it soon found a path to rise from the ashes and unleash the so-called 'Japanese Miracle' onto the world (With a little help from it's vanquisher and now protector – the US – and lot's of 'tough medicine,' discipline and determination). In the long arch of history it was another transformation taking the nation from crisis to renewal. During this period Japanese GDP grew fivefold between 1955 and 1973 and then doubled again between 1974 and 1990. Between 1980 and 1989 Japan achieved the status of global economic superpower based on technological supremacy and financial dominance – not bad for a country with no real raw materials besides its people's ingenuity and commitment to improvement. This was followed by the 'lost decade' as the financial bubble burst damaging its financial dominance and other powers rapidly encroached on its technological supremacy.

However after some drift and a few ill judged adventures, there are plenty of signs that a new phase of renewal after crisis has been unfolding. As outlined in this segment it could be one that once again put Japan at the very forefront of the demographic realities of the future and provides it with a strong economic, security and political position in Asia, the Pacific and the World.

"JUST 19 YEARS AFTER ITS SURRENDER & SEEMING TOTAL DEVASTATION, JAPAN HAD BUILT THE FASTEST TRAIN IN THE WORLD."

– David Pilling (From the book: 'Bending Adversity – Japan the art of survival'

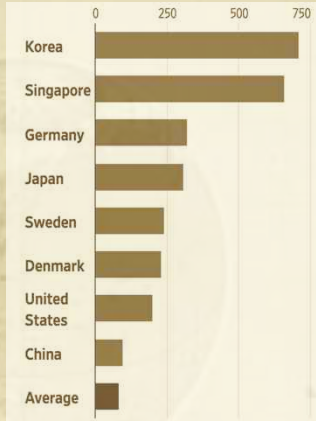
"IN THE MIDST OF WINTER, I FOUND THERE WAS, WITHIN ME, AN INVINCIBLE SUMMER."

– Albert Camus

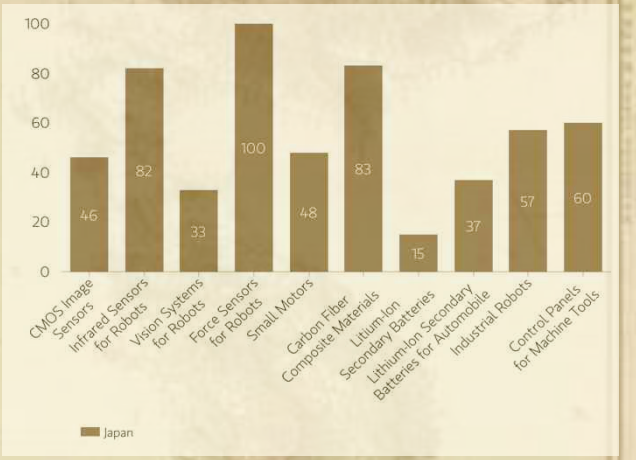
VISUAL ADDENDUM TO PAGE 6: ASIA: JAPAN:

DIVERSIFYING THE LABOR POOL: Women, foreigners & the elderly have contributed the bulk of Japan's employment growth.

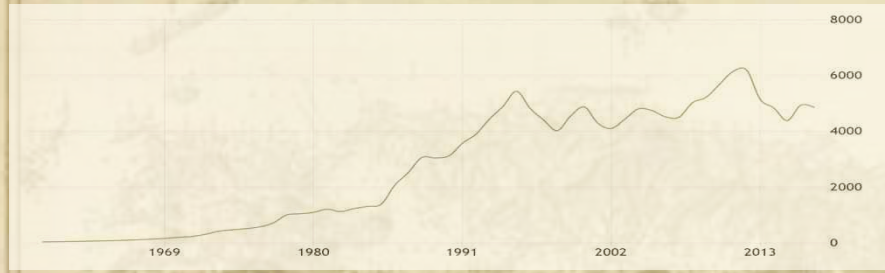
RISING ROBOTS: Robots per 10,000 manufacturing workers 2017.



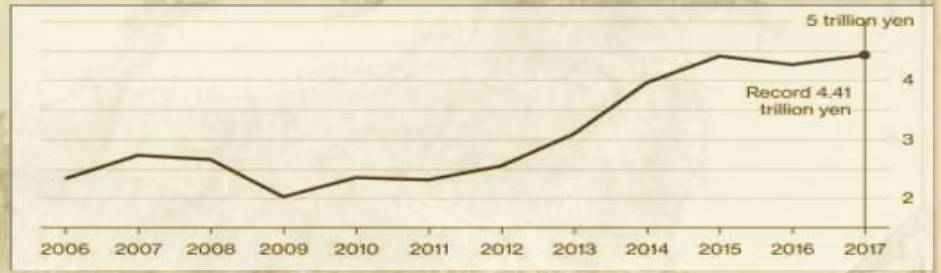
JAPAN CONTROLS THE ROBOTS: Est. market share of Japanese firms in robot-related products. (METI Estimates %)



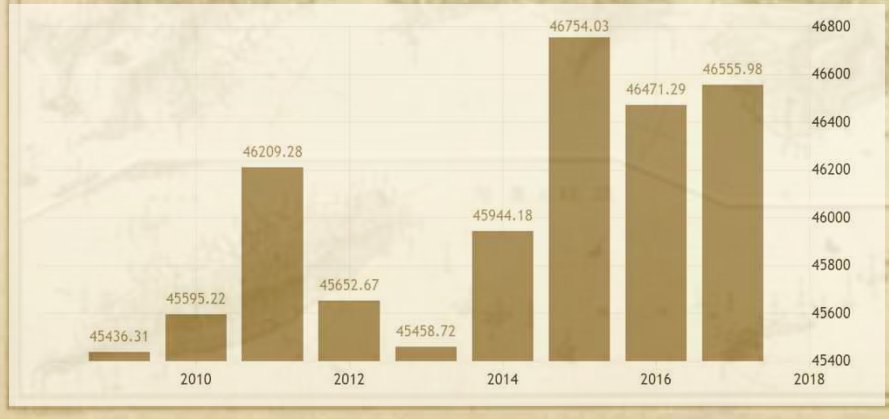
JAPAN'S GDP: A steep rise up Mount Fuji before reaching a permanently high plateau... (USD Billions)



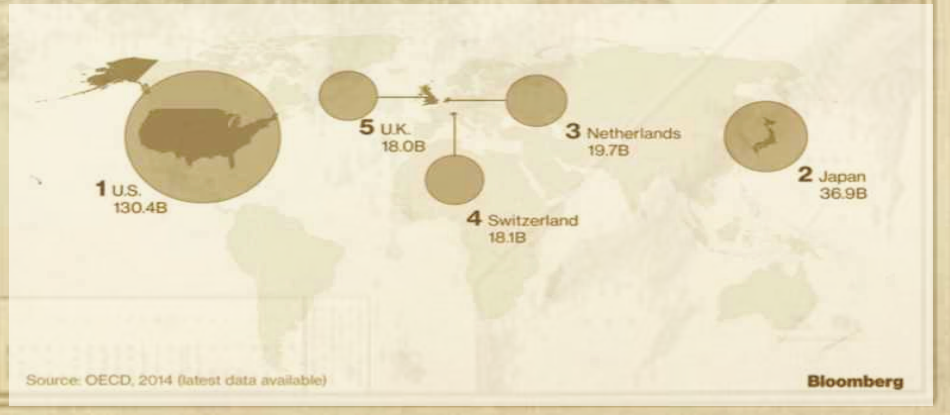
RECORD-BREAKING RISE: 2017 was a record year for Japanese IP related exports...



WHO YOU CALLING PACIFIST? Japan's increasingly muscular defense budget (Military expenditure – Million USD)



INTANGIBLE ASSETS: Japan ranks 2nd globally in exports of intellectual property (IP)...



Sources: (From top down) WSJ/Trading Economics.

Sources: (From top down) WSJ/Morgan Stanley/Bloomberg/BOJ

THE VIEW FROM THE ASIA-PACIFIC REGION...

In the spotlight: Australia:

The following insights are provided by our guest MacroScope navigator, the creator of Millennial Macro Research AKA The Millennial Macro Man.

Australia: The Lucky Country

The so called "Lucky Country" Australia is a former colony of the British Empire and home of the Aboriginal Australians who settled the country over 40,000 years ago. Located in the southern hemisphere, directly south of Indonesia, Australia sits on its own continental lithosphere and tectonic plate, therefore making it a continent rather than an island. The Commonwealth of Australia was established in 1901 and is now home to almost 25 million people, with over 75% of its population situated on the coast due to almost 40% of the landmass being classified as desert. Australia prides itself on being a multicultural, tolerant, and free society but those values are now being questioned as populist/nationalist sentiments grow while the economy continues to slow.

Culturally and militarily Australia aligns with the West but economically its fortunes are tied to the East. This balancing act has been tested in recent years with many saying that Australia should move closer to China while others say it will jeopardize Australia's national security. Australia is somewhat stuck between a rock and a hard place in 2019. Its economy is slowing, its property market is falling and relations with its biggest economic partner, China, is facing issues. This analysis will investigate these issues.

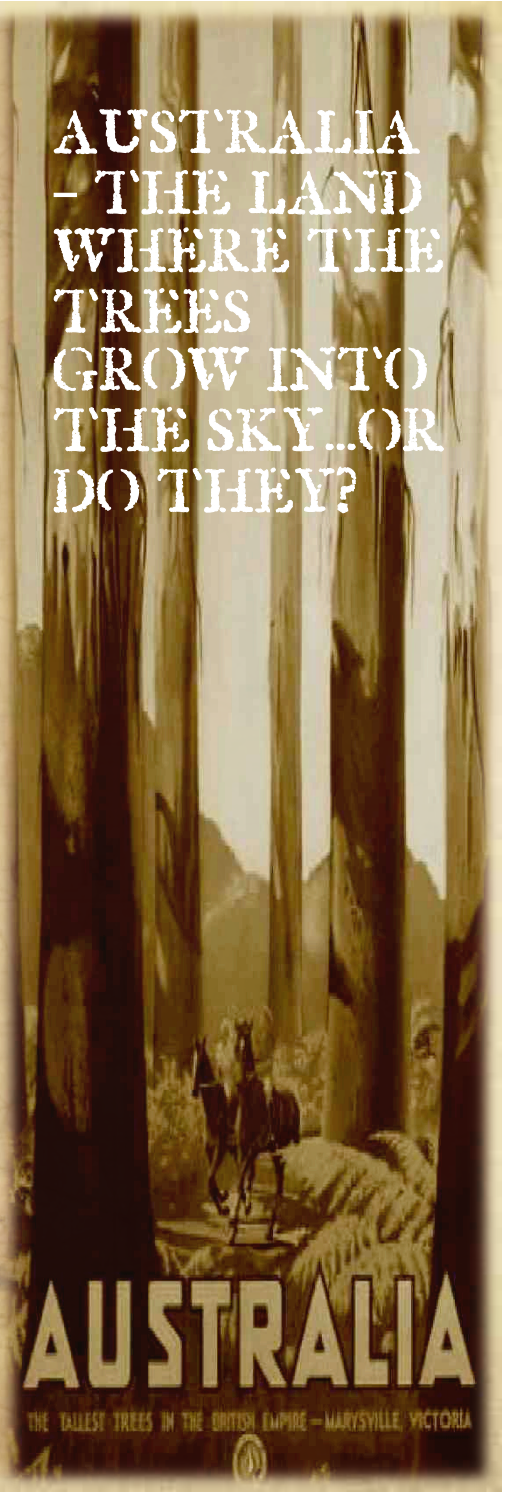
The Economy

Australia is the world's 14th largest economy with a GDP of over $1.3 trillion USD. When it comes to commodities Australia is a powerhouse, shipping vast quantities to its Asian neighbors. The country is the world's largest exporter of iron ore, coal, liquefied natural gas and wool. It is the fourth largest exporter of copper and wheat, the sixth largest of aluminum, and the seventh largest of gold. However, despite world leading success in commodity production and exports Australia's economy is largely driven by its domestic consumption, which accounts for 60% of GDP. Australian's have an average before tax salary of $70,361 USD much of which is captured by small to medium businesses in Australia, who account for 57% of GDP and employ over 7 million Australians. It is well known that Australians love a good coffee so you cannot go wrong opening a café unless you are Starbucks.

Australia has not experienced a technical recession since 1991 and its adults are the second wealthiest in the world on average, behind Switzerland and ahead of the United States. On a median basis Australian adults are the wealthiest in the world according to Credit Suisse and this is largely due to the local property market and retirement system. Property accounts for 60% of gross household assets and Australia's superannuation system holds over $2.02 trillion USD of retirement assets. Australia also has one of the world's most equitable distributions of wealth compared to other developed nations such as the UK or the USA. Less than 6% of Australians have a net worth of under $10,000 USD compared to 18% in the UK and 28% in the USA.

Australia benefits from a highly educated work force with nine universities in the top 200 globally and the second best national healthcare system in the developed world. Beyond the excessive levels of credit growth Australia's long-term economic success has been driven by good economic management and public policy focused on harnessing Australia's competitive advantage in commodities, agriculture, higher education, and healthcare, targeted immigration to fill skills shortages in key industries, and old-fashioned hard work. The Common Law system also provides to a stable legal framework that supports foreign direct investment.

However, Australia's record of recession free growth is under threat. Property prices fell over 6% in 2018 with further declines expected.



In its most recent interest rate decision the Reserve Bank of Australia (RBA) left its official cash rate at 1.50%. The cash rate remains at what the RBA calls "emergency levels" in response to the commodity price collapse and global slowdown of 2015/2016 with many forecasting that the RBA will remain on hold for the foreseeable future. Real wage growth in Australia is flat and the outlook for household consumption continues to deteriorate on the back of a negative wealth effect from falling property prices.

The Infrastructure Boom

Since 2000 Australia has underinvested in key infrastructure, leading to major traffic congestion and reduced productivity while the population has risen from 19.5 million to 25 million. Australia remains one of the few developed countries in the world with a triple A credit rating and balance sheet capacity. As such, the Commonwealth Government has increased its debt load from 16.7% debt to GDP in 2009 to 41.9% in 2017 through a combination of targeted tax cuts and increased infrastructure spending. However, public infrastructure spending is a fraction of total infrastructure spending when considering the magnitude of investment that has been poured into residential apartment construction. Australia has over 700 active cranes around the country according to the National Crane Index. Aware of this slowdown the governments of the Commonwealth and the States have approved over $500 billion USD of public infrastructure projects. However, the economic impact of infrastructure projects is lagging, and it is likely that further counter cyclical stimulus will be needed to prevent Australia's envious economic record of no recession in over 27 years being broken.

The Property Market – Reaching its limits

Australia's love affair with property is more complicated than what the headlines would have you believe. While house prices have soared since the turn of the century historically house price inflation broadly followed general price inflation in the economy. In the mid-1980s Australia undertook a massive privatization of its economy which provided cheaper and easier access to finance which led to a secular increase in the household debt to income ratio, which is now close to 200%. As a result, Australia's house prices have grown at over 7.25% per year for the past 30 years. The biggest beneficiary of this has been Australia's big four banks, Australia and New Zealand Bank, Commonwealth Bank of Australia, National Australia Bank and Westpac Banking Corporation. Together they control 80% of Australia's mortgage market and have become some of the world's largest banking institutions with envious return metrics.

In December of 2017 a Royal Commission into the Misconduct in the Banking, Superannuation and Financial Services Industry was established by the Governor General of Australia after the Commonwealth Government caved to populist political pressures. While findings of the Royal Commission will not be released until February 2019 it has already expose the inadequacy of the industry's regulators and has impacted the availability of credit as banks have been forced to increase their minimum verification of customer expenses. Previously Australian banks had been using their own internal verification methods, however the Royal Commission has exposed these methods as non-existent in some instances, resulting in fraudulent lending to customers that are now considered distressed. According to the Australian Securities and Investment Commission (ASIC) it takes over 1,700 days for banks to identify significant legal breaches and report them, with another 150 days taken on average to notify ASIC that they have started an investigation into a breach. The Australian Corporations Act requires banks to report breaches within 10 business days.

Stricter lending conditions have reduced the availability of credit for potential borrowers and as such lending growth for housing is declining. Along with likely civil and criminal proceedings the Royal Commission is likely to further crackdown on poor lending standards. These stricter lending conditions have come at the same time as a rise in offshore funding rates. Term funding for Australian banks are largely sourced offshore. Foreign currency denominations amounted to approximately 62% of total issuance in the most recent Australian financial year ended 30th June 2018. This has pressured net interest margins forcing banks to raise their mortgage rates at a time when consumers are facing anemic real wage growth.

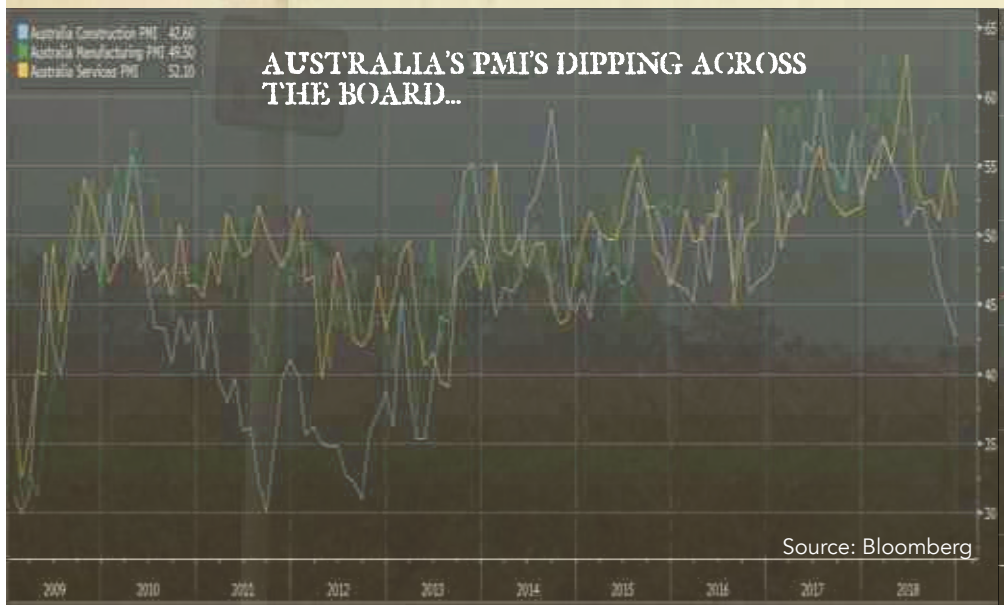
The Latest data points to consider:

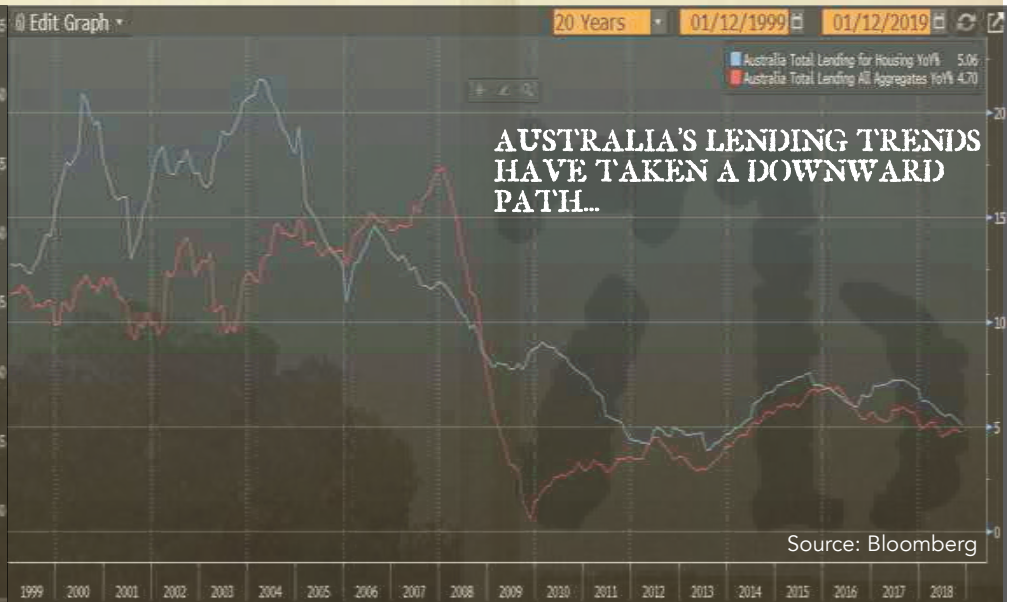
- Construction PMI at 42.6, slowed from its high of 57.20 in March 2018.
- Manufacturing PMI at 49.5, slowed from its high of 63.10 in March 2018.
- Services PMI at 52.1, slowed from its high of 63.00 in June 2018.
- NAB Business Confidence Index at 3.20 down from highs of 11.4 at the end of 2017.
- Retail sales growth of 2.80% YoY, slowed from 3.70% in September 2018.
- M1 money supply growth of -0.89% YoY, slowed from its high of 7.41% in June 2017.
- M3 money supply growth of 1.91% YoY, slowed from its high of 7.81% in June 2017.
- Government bond yield spread 10 year minus 2 year at 0.42%.
- 2018 calendar year property price growth of over -6.00%.

Other factors also contributing to the slowdown:

- A significant amount of interest only borrowers will switch to interest and principal repayments over the next three years.
- Banks are withdrawing from lending to Self-Managed Super Funds (retirement funds).
- Foreign demand for Australian property has collapsed. Chinese investment into Australian real estate has fallen roughly 70% from 2015.
- Surge of supply as apartment construction is completed. Australia has over 500 cranes dedicated to residential construction.
- Collapse in auction clearance rates to 40% from highs of 80% due to a lack of buyers and shift to a wait and see attitude.
- Fears that a new Labor Commonwealth Government will remove negative gearing and tax concessions related to property investment.

Peak to trough property prices are expected to fall 15%-20% by 2020. This would take prices back to 2015 levels, a small correction by international standards. This would be manageable for the economy, but markets rarely play out as the consensus predicts.





Australia and China - a balancing act

Australia's relationship with China is of mutual economic benefit. After the Sino-Soviet spilt of the 1960s Australia increased its trade with China as it no longer saw the country as a national security threat. China is Australia's largest trading partner and it is also Australia's 2nd largest foreign investor after the USA. More than half of Australia's exports are commodities and almost 40% of Australia's total exports go to China, with whom Australia runs a trade surplus with. During the most recent peak in property prices, China was the largest foreign investor in Australian residential property and according to the most recent Foreign Investment Review Board report, foreign ownership of Australian land is over 14%, China being the second largest owner behind the UK.

The relationship is not without its ups and downs. China is now the world's second largest economy behind the USA at over $12 trillion USD in annual GDP according to the World Bank. Accordingly, China is flexing its economic muscle on the world stage through its One Belt One Road (OBOR) initiative, aiming to connect over 65 countries in a modern-day Marshall Plan amounting to over $1 trillion USD. This creates a delicate balancing act for Australia.

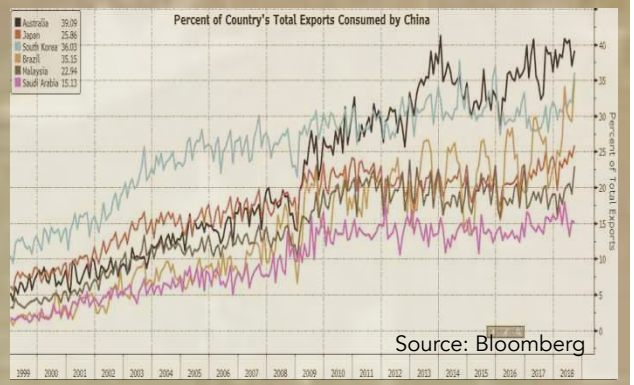
to reap the economic benefits, Australia must balance its national security objectives. Being an island nation Australia's key national security objective is to provide for the defense of its immense coastline and its international trade routes, something it cannot do on its own. Australia relies the USA to protect seaborne shipping and discourage any thought of military action against the country. Australia, along with New Zealand formed the ANZUS Treaty with the United States 1951 under which any attack on either country's territory would be deemed an attack on their own. As such, Australia has fought in every USA led military engagement since World War Two. The close ties between the two nations was reinforced by a free trade agreement in 2004 and an exemption from the 25% tariff imposed on steel products by President Trump. However, from China's point of view Australia's national security and foreign policy actions are an extension of the USA's. They are not wrong.

Australia has been an outspoken critic on China's actions in the South China Sea, regarding Taiwan and the One China policy, and in relation to the re-education centers in Xinjiang targeting ethnic minorities. Until November 2018 an Australian foreign minister had not set foot on Chinese soil for over two years due to these diplomatic disputes. The relationship was further strained when the Commonwealth Government passed new laws banning foreign political donations and new foreign interference laws that strengthened foreign espionage offences, and forced people working for foreign companies and governments to declare their activities. The government also announced new laws that would block two Chinese telecommunications companies from participating in the rollout of the 5G infrastructure network in Australia. Australia's national security concerns were summarized by Malcolm Davis, a Defense analyst at the Australian Strategic Policy Institute. He argued that China's ultimate "goal (was) to have Australia become more pro-China, less pro-US, align with Beijing and distance itself from the United States and ultimately end the alliance."

Interesting fact

In October 2018 Victoria became the first Australian state to officially join China's One Belt One Road project. The State Government of Victoria signed a Memorandum of Understanding with China with the hopes of generating more foreign direct investment in the state. In the past four years Victoria has tripled its share of Chinese investment in Australia and has nearly doubled its exports to China. This goes against Australia's official stance, held by the Commonwealth Government, to not be part of the project under national security grounds. Heads of the Department of Immigration and Defense have warned of serious strategic consequences of Australia formally signing up to the agreement. "The economic case for Australia formally joining simply wasn't made," a senior government figure has been reported saying. "We saw very little additional economic benefit for signing up, but a lot of negative strategic consequences if we accepted Beijing's offer."

AUSTRALIA'S EXPORTS ARE RELIANT ON A HEALTHY CHINESE ECONOMY...



Source: Bloomberg

Australia's security considerations combined with its cultural affinities clash hard with its economic realities...

"Our concerns about what we saw in Australia: Was an economy clearly tied to China, it has hitched its wagon to the tail of the tiger. In terms of the general complacency, what we heard over and over from investors and clients and potential clients was, 'yes, yes, there are some excesses, but the government will figure out a way'."

– Jim Chanos

The Outlook

Australia faces a challenging 2019. Its recent economic results were far below analyst consensus expectations despite strong net exports and government spending. The drop off in in construction and capital expenditure combined with weak real wage growth and falling property prices point to a continued softening of the economy in 2019. Australia's household savings rate has been falling to 2.4%, the lowest level since 2007, and real net disposable income per capita is contracting. The only bright spots are that retail sales growth remains steady and the unemployment rate is holding close to 5%, while population growth continues at around 1.6% per annum.

In the property space the drop off from the apartment building boom is likely to be severe. Building approvals for the end of November fell 32% compared to the same period last year and the construction and manufacturing PMIs are in contraction. Increased infrastructure spending by the Commonwealth and State governments should help to dampen the impact somewhat but it is unlikely to help the residential property market. Auction clearance rates in capital cities around Australia are sub 45% with Sydney hitting 38.8% the weekend of the 15th and 16th of December 2018. Tighter financial conditions look like they are here to stay with the Royal Commission to release its findings next month. The good news is that bad debts remain low and the banks remain relatively well capitalized compared to their global peers.

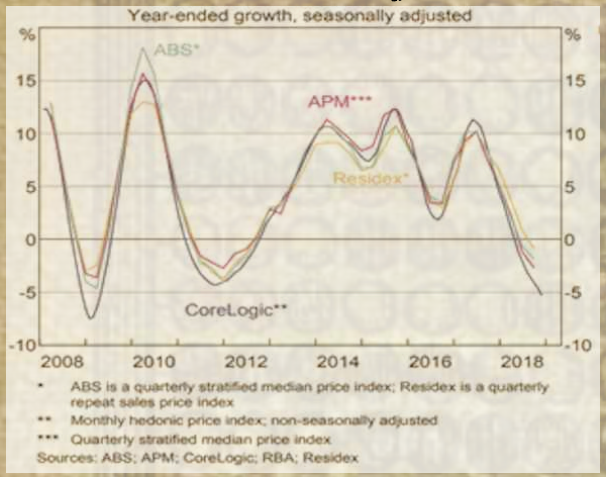
US China relations will also be important. Australia's alliance with the USA means that Australia's relations with China are directly linked to the health of the USA-China relationship, which is currently a work in progress as the two nations attempt to resolve their trade disputes. China will continue to view Australia's foreign policy strategy as an extension of the US agenda. The current Commonwealth government is maintaining a neutral stance and has been exceedingly careful not to openly criticize Beijing after being a vocal critic over the past two years. How China's economy performs in 2019 will also be of key interest to Australia as net exports have been supporting Australia's economic growth in the latter half of 2018. Recent announcements that China's GDP target range would be lowered were not a good sign and the trend in economic data releases has steadily gotten worse as 2018 progressed.

Australia also has a Commonwealth government election in May. Early polling suggests that the Labor Party is likely to replace the incumbent Liberal National coalition. This adds further downside risks as the Labor Party leader and possible new Prime Minister Bill Shorten has proposed numerous changes to Australian taxation laws that will negatively impact assets, especially in the property market.

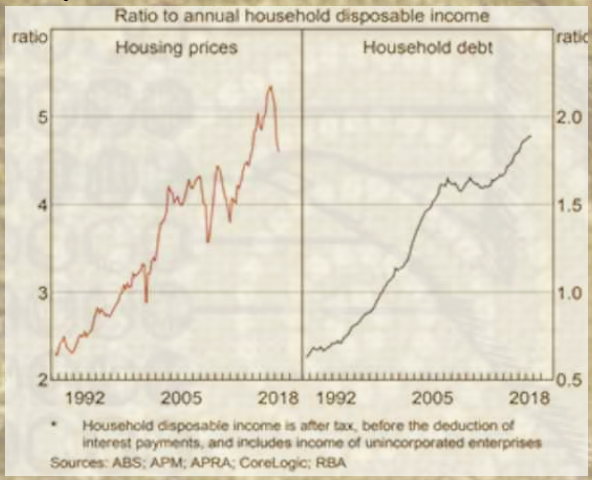
As a macro addict and markets addict, I look forward to seeing how 2019 will play out for Australia.

VISUAL ADDENDUM TO PAGE 7: THE ASIA-PACIFIC REGION: AUSTRALIA:

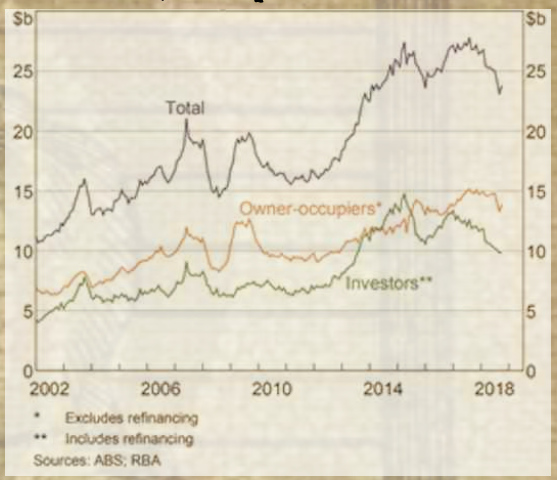
HOUSING PRICES: Heading Down Under



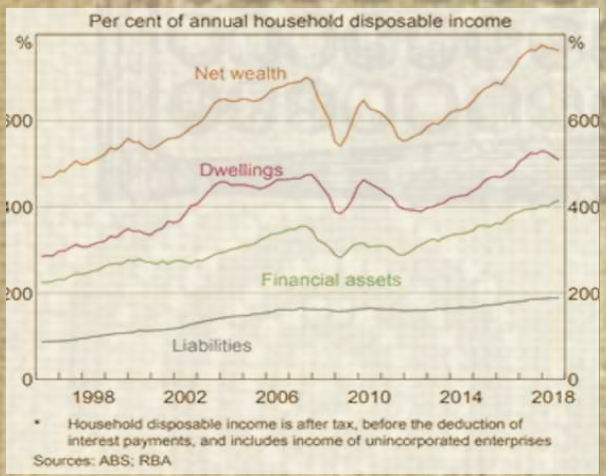
HOUSING PRICES & HOUSEHOLD DEBT*: Prices coming down, debt load stays elevated...



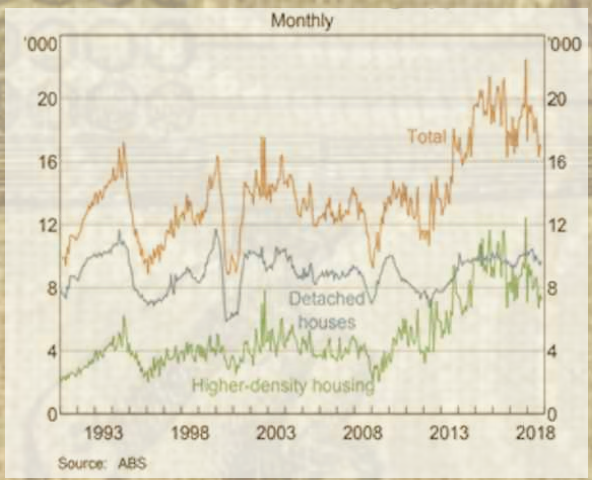
HOUSING LOAN APPROVALS: Did the music just stop?



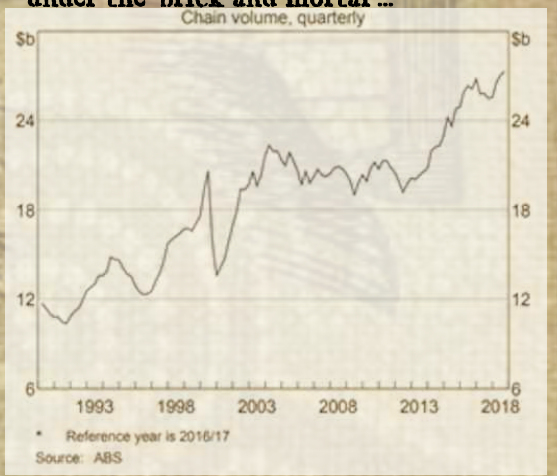
HOUSEHOLD WEALTH & LIABILITIES*: Still wealthy...



PRIVATE RESIDENTIAL BUILDING APPROVALS: Unfriendly trends...



PRIVATE DWELLING INVESTMENT*: A lot is tucked in under the 'brick and mortar'...



AFTER A MULTI-DECADE HOUSE PARTY IN AUSTRALIA, THE QUESTION IS: HAS THE MUSIC STOPPED OR HAS THE VOLUME JUST BEEN TURNED DOWN?

REFLECTIONS ON THE JOURNEY AS WE HEAD INTO THE STATION...

As we head into 2019, beyond the much covered financial & economic risk factors, we see 3 major areas of risk, and as is often the case they are somewhat interconnected.

One is what Renee DiResta calls the 'Information World War' in her excellent essay 'The Digital Maginot Line' (Go read it if you have not already). We scratched the surface on this phenomenon in our 'The Russia Question' edition of our 'GeoStrategic Perspective Series' back at the start of 2018 and will come back to explore it further in 2019. This should be seen in conjunction with a general attack by multiple actors on our global digital reality with pervasive and escalating series of cyber-attacks and massive incidents of data theft.

Another is extreme weather driven by climate change. In 2018 natural disasters – wildfires, tsunamis, hurricanes etc. – killed over 10,000 people and fueled above-average economic losses of $160 billion according to insurer Munich Re AG. These are the data points for the direct effects of this devastating trend, the secondary effects are even more pervasive, and as we discussed in our Q3 ATWI8P report's spotlight segment on Iraq and it's perilous fresh water situation, with broad long-term repercussions on areas such as food security, employment, rapid urbanization, conflict and migration. – matters which are reshaping global realities now and in the future.

Lastly we can look at social conflict within nation states and more broadly. After decades of economic and cultural globalization the pendulum is swinging the other way as large swaths of the populations around the world has begun to question and rebel against a system that has led to much good, but also has brought record levels of inequality within developed nations – with the highly educated and connected leaping out in front and the rich getting much richer while the middle class slowly disappears. We have discussed some of these aspects in this and past ATWI8P reports but beyond the current rhetoric, which seems geared towards blaming the 'foreigner'- immigrant or competing nation states - for all our ills, a larger more pertinent battle is shaping up in the shadows.

Global corporate interests and their strong preference for a continuation of the status quo – a system they are deeply invested in and the major beneficiary of – and the pockets of the populations who have been left behind by this arrangement. As this conflict of interest has come to a head, with electoral trends bending towards the extremes and its 'leaders' with simple solutions to complex issues and so-called populist messages, corporate interests have quietly been positioning itself and while they may be willing to make some minor adjustments (better to give up a little now than to lose a whole lot more in the future) they will not be handing over the keys to some loud upstarts hiding behind the banner of populism without a fight. On current trajectory the tension between corporations (& their shareholders) and nation states (& their populations) will become more and more pronounced as there is an increasing schism between their agendas, which in 'tough times' has led to an awakening of sorts amongst the average citizens and for now the battle has been mostly fought via elections (the release valve of democracies) and some sporadic street protests.

Time will tell if the 'status quo agenda' can be maintained via superior resources, experience and the patience afforded only to those who have the high ground. It's a century old ongoing battle - in Anthony Sampson's 1973 book; 'The Sovereign State - The secret history of ITT' he writes; "From their camp they looked out onto a world benighted with prejudice & unreason; where governments were merely obstructing the long march of production and profit; where nations were like backward native tribes, to be placated, converted and overcome." on the nature of global corporations he goes on to state; "How can governments ever control such an organism which is, like a jellyfish, both everywhere and nowhere?"

So beyond the nation state competition between the so-called 'revisionist powers' & the established US power structure there is a whole other tension pulsating between these powerful interests & the average person, which with increased automation and digitalization will only become more pronounced. With democratic government, a pretty blunt and easily co-opted instrument by a small determined and well organized group, the current tool to effect change, one has to consider that more radical paths will be explored by those seeking change. With all this flux it's likely that the social fabric will continue to be torn, the questions are will it be torn beyond repair? and/or can a distraction such as conflict against a perceived common enemy coalesce the populations? Or can a more lasting and constructive reformatting of the social contract be found? As is most often the case in the affairs of man, the reality lies somewhere in the middle, one thing is certain we are in a complex period of real uncertainty and heightened risk.

SOME GUIDANCE FROM THE THINKERS OF THE PAST:

"Old truths are made new again when the youth discover that dusty old books hold secrets their parents and teachers never told them."

– The Stoic Emperor

"We don't inherit the earth from our ancestors, we borrow it from our children."

– Native American Proverb

"...The same is true of capitalism: it may change all the time but it carries on inheriting the succession. What Henry Hope, a leading Amsterdam businessman once said of trade in 1784 after the 4th Anglo-Dutch War, could also be said of capitalism: 'It is often ill but it never dies."

– F. Braudel

SOURCES & INSPIRATION...

In the words of Sir Isaac Newton; "If I have seen further it is by standing on the shoulders of Giants." On this page we humbly give thanks to those great individuals, source materials, books that provided us with the insights shared in this report.

SOME WRITTEN FOOD FOR THOUGHT FROM OUR Q4 READING LIST:

A new political phase for Europe Report. – The EIU.

Divided Kingdom: How Brexit is remaking the UK's constitutional order. – Amanda Sloat.

Africa's Cities: Opening doors to the world. – The World Bank.

The state of African Cities 2018: The geography of African investment. – UN Habitat.

Africa's business revolution: How to win in Africa. – McKinsey & Co.

Japan's economic revival. – Morgan Stanley.

China or Japan: Which will lead Asia? – Claude Meyer.

Bending adversity: Japan the art of survival. – David Pilling.

Insurgency, Terrorism & organized crime in a warming climate. – Adelphi/German Foreign Office.

How a world order ends & what comes in its wake. – R. Haas.

Global strategic trends: The future starts today. – UK Ministry of Defense.

The digital Maginot line. – Renee DiResta.

The perfect weapon. – David E. Sanger.

Future crimes: Inside the digital underground & the battle for our connected world. – Marc Goodman.

America's strategy in world politics. – N. Spykman.

15 charts that disturb us about American 'Capitalism'. – Jonathan Tepper (Myth of capitalism blog)

SOMETHING TO LISTEN TO THAT WILL MAKE YOU THINK:

The Sam Harris podcast with Renee DiResta on information warfare: https://samharris.org/podcasts/145-information-war/

The Grant Williams conversation with Anthony Deden on a different way to think about investing: https://www.youtube.com/watch?time_continue=88&v=a4_U6bS-cU4

And for some respite from the daily grind, take a different path with Alice Coltrane & Pharoah Sanders: https://www.youtube.com/watch?v=RzuyR6GeXRg

A last thought...

"I thought of the resistless passion which drives men to undertake terrific scrambles. No example can deter them...a peak can exercise the same irresistible power of attraction as an abyss." – Theophile Gautier 1868.

ABOUT LIBRARIUM:

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We offer global accredited investors such as asset managers, family offices and institutional investors with quarterly and annual publications providing an independent overview of global macro economic and geopolitical events and their implications on the world of investing.

We also provide intra-monthly event driven insights as a part of our constant horizon scanning services.

Our services can also be employed on a retained basis, providing the client direct & always confidential access to our team on an on-going basis allowing us to act as an independent sounding board for our clients ventures.

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We prefer to work with a relatively small and select group of active clients allowing us to provide them and their projects with our full attention and as such we operate a limited amount of such partnerships.

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