The global economic outlook for 2019? Look out for a seismic shift this year.

By **Stirling Larkin**

When asked over the Christmas table what 2019 has in store for global investors, I couldn't help but paraphrase the "father" of value investing Benjamin Graham's prescient insight that the market is a voting machine in the short term but a weighing machine in the long term.

For ultra high net worth global investors, this perspective enunciates 2019 consummately – set to be a robust year of lucrative returns and asset price appreciations, it will also be one anchored in the realities of all late-business-cycle machinations.

It will be complicated further by short- and-longer term geopolitical rifts plus the weighty forces of a seismic shift in the foundations of the underlying economy itself, with a transition from human labour to one of automation and artificial intelligence.

Goldman Sachs says the likelihood of a 2019 recession in the US is fairly low. *Stewart Hawkins*

For the United States, the world's spearhead economy, all the key financial ingredients remain favourable for a lucrative year for investors: a strong and resilient greenback, a benchmark 10-year bond yield returning to the much safer sub-2.75 per cent level and a leading stockmarket, the S&P 500, driven by cyclicals and not defensives.

The greenback's resilience has been supported by the international consensus since the February 2016 G20 meeting where central bankers set the Shanghai Accord, which in principal welcomed the Chinese yuan to the global currency mix without destabilising the paramountcy of the US dollar as the reserve currency for the world.

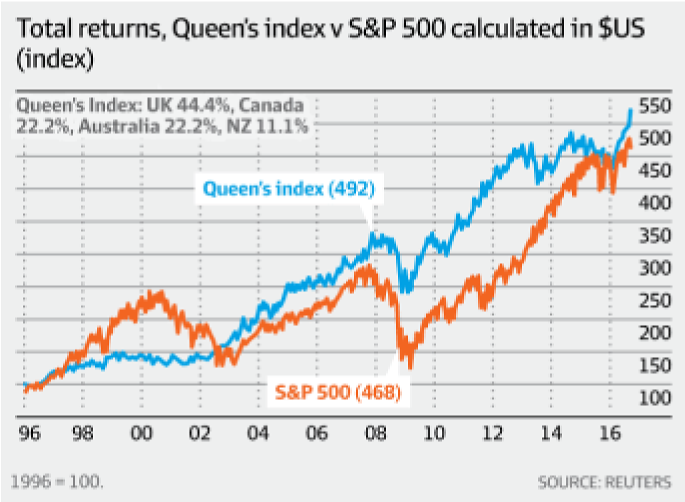
For the all-important US 10-year government bonds, even though yields rose fast in September and the first few days of October (topping out at an alarming 3.24 per cent), the S&P 500 retracement throughout November and December hosed out the fires of overheating, bringing the benchmark yield back 50 basis points, or half a per cent, to about 2.75 per cent today.

Further to go

Albeit volatile, this healthy interconnection between a leading sharemarket and its fixed-income counterpart demonstrates that robustness remains and is evidence that the late bull cycle has further to run.

In support of this, Goldman Sachs last week published a report arguing that the recession risk is lower than the "voting machine" market believes, with the likelihood of a 2019 recession fairly low (in the neighbourhood of 15 per cent over the next year) evidenced by the two key historical recession risk factors, inflationary overheating and financial imbalances, remaining largely absent.

While the baseline case for the American economy and its leading sharemarket remains bullish, UHNW global investors recant Graham's acumen which was that the market in the longer term always ends up being a weighing machine.



As alluring as it is to assign blame on Donald Trump, cyberhackers or global "bad actors" (such as Russia's Vladimir Putin, Turkey's Recep Erdogan or North Korea's Kim Jong-un) for the imbalances of ballast weighing on global financial stability, the true source of underlying change weighing on markets over the longer term has far more atavistic origins.

French economist Charles Gave explained it best – that since the onset of the first industrial revolution, human institutions have typically had a lifespan of about 70 years.

How it works

In the first generation, the elite build the institutional structures needed to meet the economic challenges of their time; the second generation maintains them as best as they can; and the third generation of the elite, which more often than not is corrupt to the bone, merely aims to live as well as it can off the existing system, which by now has become utterly ossified.

At this point the elite gets fired by the population, and the cycle begins again. This helps to explain why the post-war 70-year old political structure is obsolete.

Knowing that the economic infrastructure determines the political superstructure, the new industrial revolution creating the knowledge-based economy is replacing the needs of the (human) worker with those of citizens.

The greatest weight on global financial stability is the transition from the old economy to the new, with 2019 representing a critical turning point.

Whether looking at North America, Europe, Japan or Australia, financing the overgrown and increasingly ossified state pyramid, built to represent the needs of workers, has become much more difficult.

As a result, there is a complete incongruity between the economic infrastructure and the political superstructure and, as usual, it will be the political superstructure that crumbles.

Breakdown

The first sign of this breakdown is the increasing inability of states to finance themselves by taxing the productive system; the process began with the collapse of the Soviet Union.

Now it has become obvious that state pyramids elsewhere are no longer able to protect anyone apart from their own state sector personnel and even that protection will prove transitory, since it is being paid for by issuing debt not by taxation.

In countries across the world, we are witnessing the emergence of parties which do not claim to protect the "workers", but rather the "citizens"; the workers' parties are being replaced by citizens' parties.

Historically, these older transitory roots have frequently been identified with a "strong man", and through this lens, Trump, Putin and others appear as the symptom and not the cause.

For those fearing that these 70-year transitory forces will weigh too much on global markets in 2019, Gave provided some savvy advice – one should concentrate one's investments in those countries which historically have shown they can manage such root and branch political transitions peacefully while maintaining both democracy and the rule of law.

There are very few of these countries, and funnily enough, they all have pictures of the Queen on their banknotes.

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