



## **Global Outlook**

**July 2018**

One Glendinning Place  
Westport, CT 06880  
(203) 226-3030  
[www.bridgewater.com](http://www.bridgewater.com)

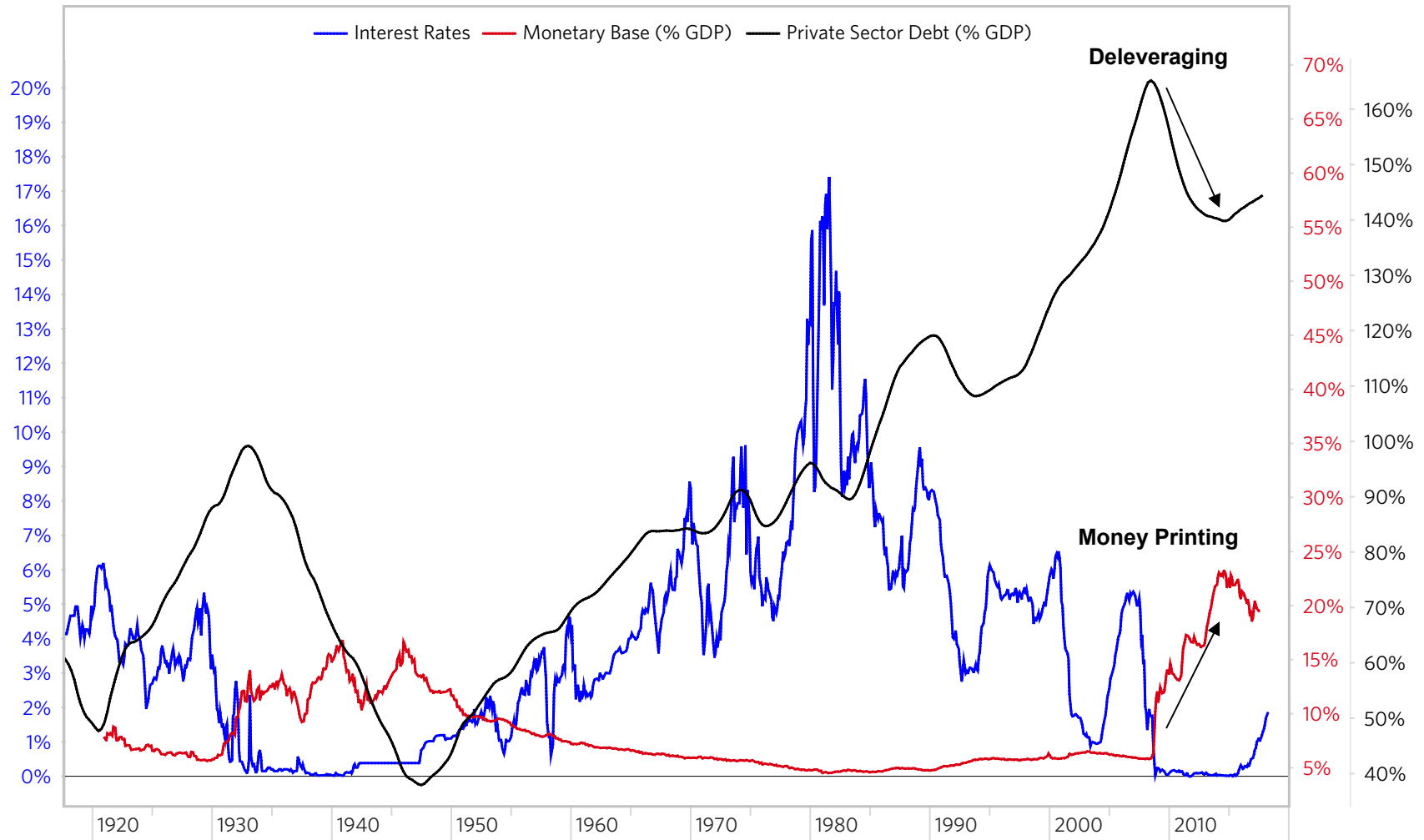
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## OUTLOOK

- ◆ We are in a transition period with a more acute trade-off between economic growth and monetary tightening/interest rate increases.
- ◆ Low financial system leverage is supporting private sector credit growth while central banks are tightening money.
- ◆ The retraction of money and expansion of credit favors real economic activity relative to financial assets.
- ◆ Markets are pricing in the secularly low volatility of the past few years at a time when conditions are changing quickly.
- ◆ The next downturn will be a real mess.

# THE SECULAR BACKDROP

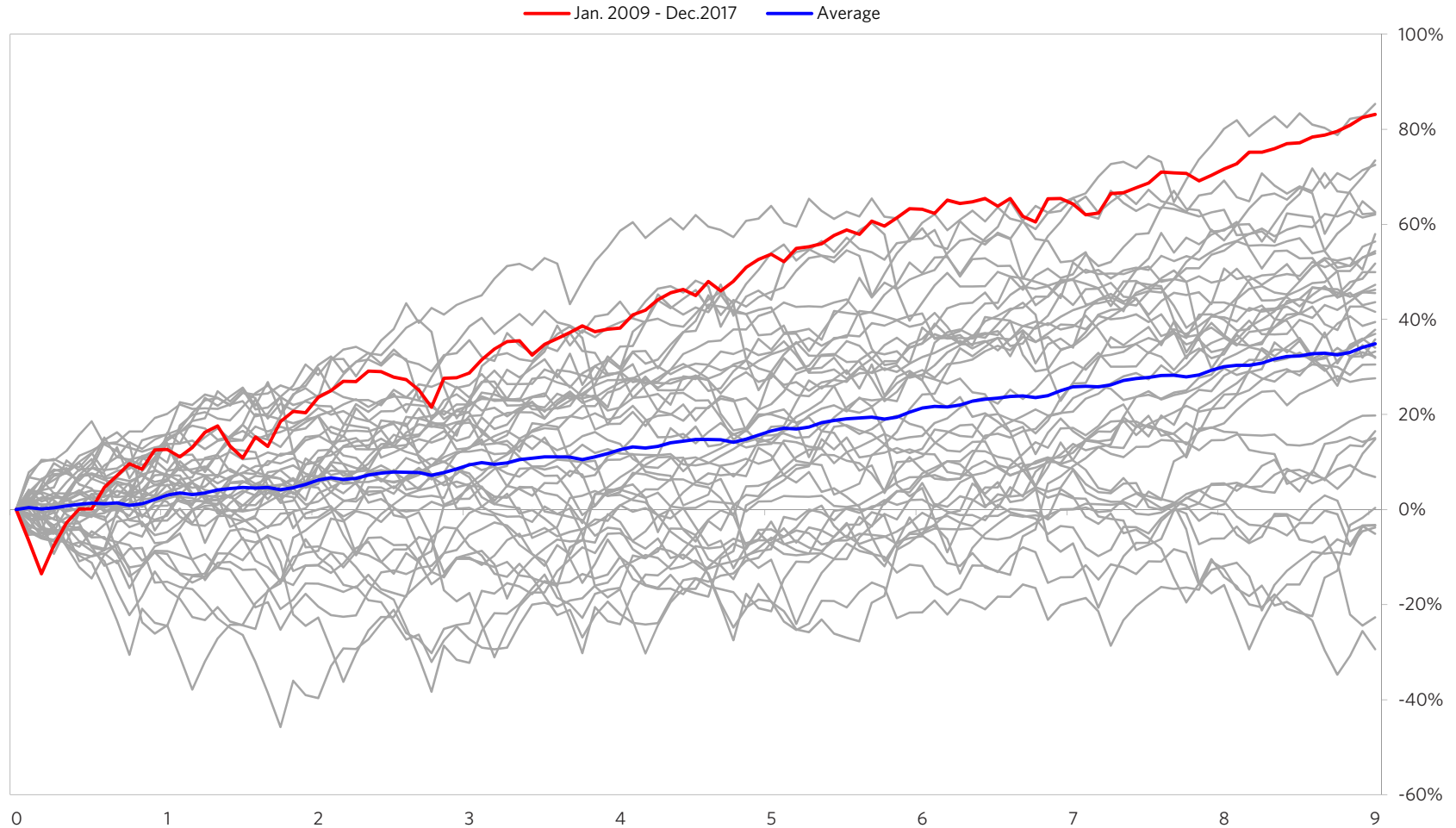
## US Interest Rates, Money, and Debt



Please review the "Important Disclosures and Other Information" located at the end of this presentation.

# ABUNDANT LIQUIDITY HAS PUSHED UP ASSET PRICES...

U.S. 60/40 Portfolio Cumulative Returns Over All 9-Year Periods Since 1970 (ln)



The U.S. 60/40 Portfolio represents 60% capital weight in U.S. large cap equities and 40% capital weight in U.S. government bonds. Each gray line represents a distinct 9 year period beginning in January of each year.

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**...BUT LOOKING FORWARD, FROM TODAY'S LEVEL OF YIELDS, RETURNS ARE LIKELY TO BE THE LOWEST IN MODERN HISTORY**

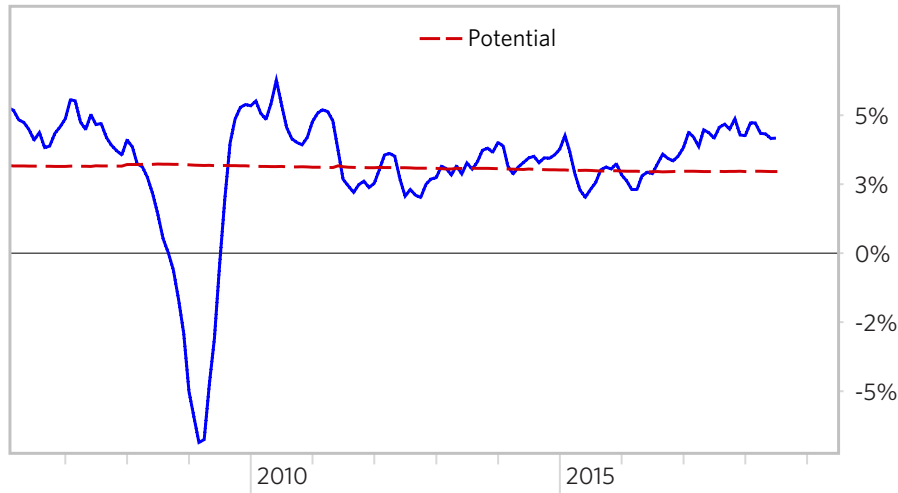
**10Y Value Estimates\***

<b>Region</b>	<b>Bond</b>	<b>Equity</b>	<b>60/40</b>
USA	3.1%	3.5%	3.4%
EUR	0.9%	3.6%	2.5%
JPN	0.5%	3.2%	2.2%
GBR	2.2%	5.0%	3.9%
Global	1.9%	4.4%	3.4%

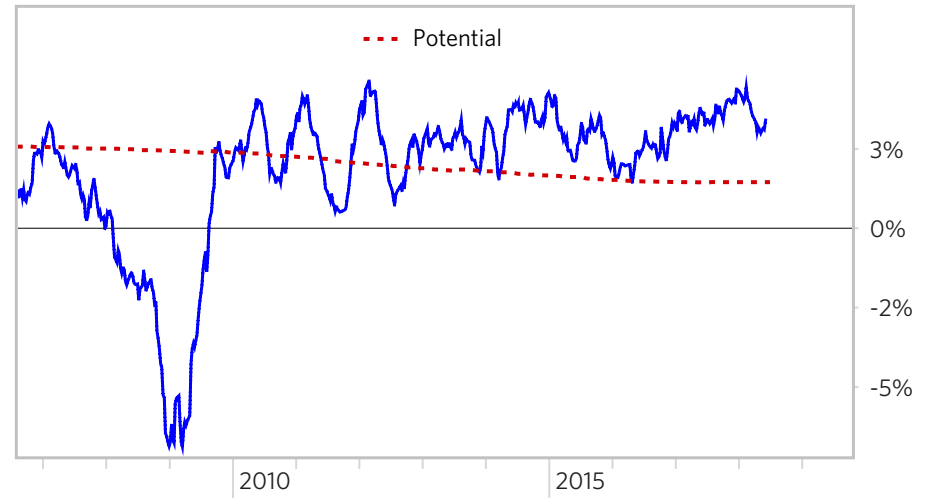
\*Total Returns in local currency terms. Return estimates are based on our projections of what each asset's total return will be over the next 10 years assuming a gradual normalization of economic conditions, earnings and asset pricing. We use long-term volatility measures that evolve slowly, so that our estimates account for a full range of economic environments one could potentially experience. "60/40" represents 60% capital weight in large cap equities and 40% capital weight in government bonds. Please review the "Important Disclosures and Other Information" located at the end of this presentation.

# EXTENDED CYCLICAL RECOVERY

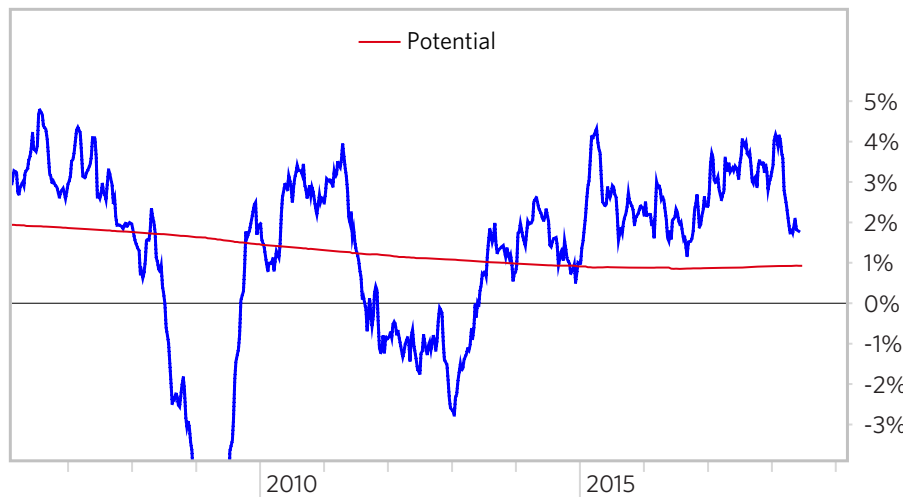
### Global Growth



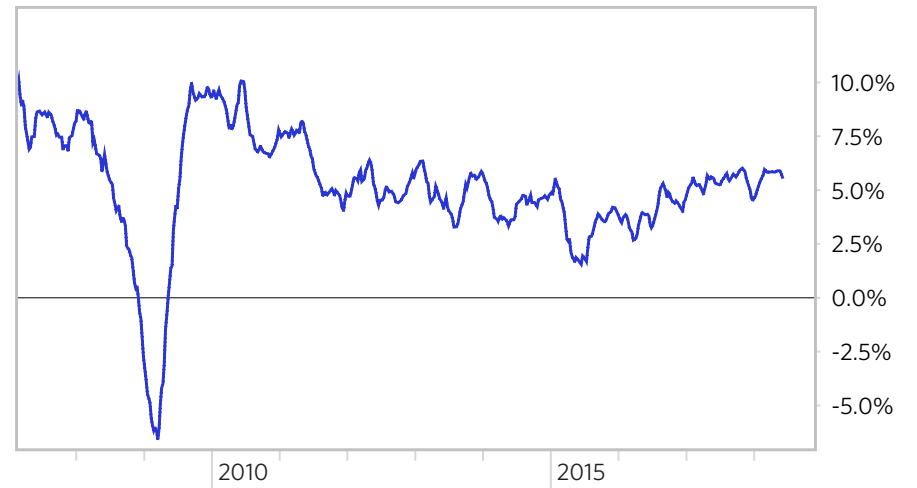
### US Growth



### Eurozone Growth



### Emerging Market Growth

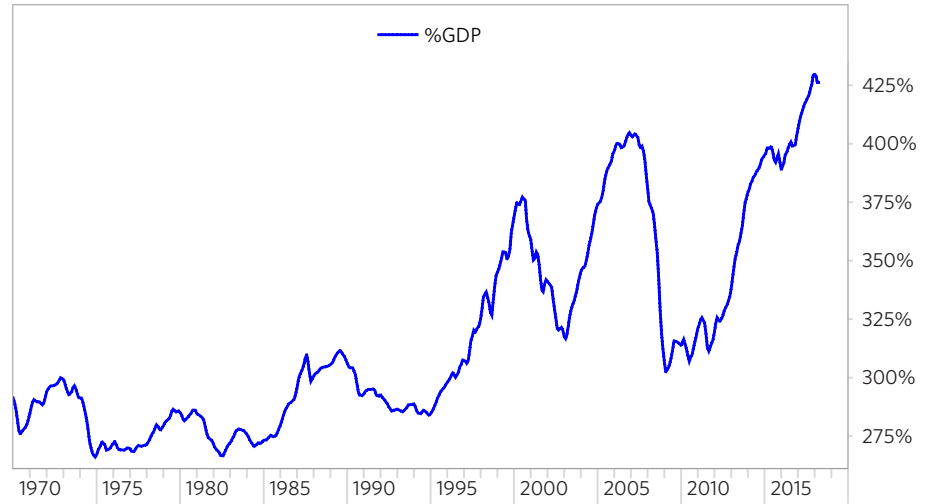


# ECONOMY TRANSITIONING TO THE LATE CYCLE THOUGH INFLATION STILL LOW

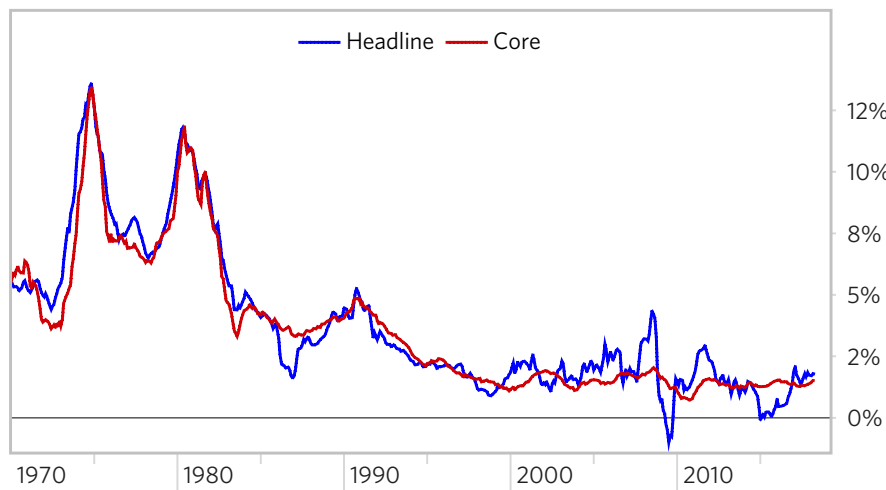
**Developed World Unemployment**



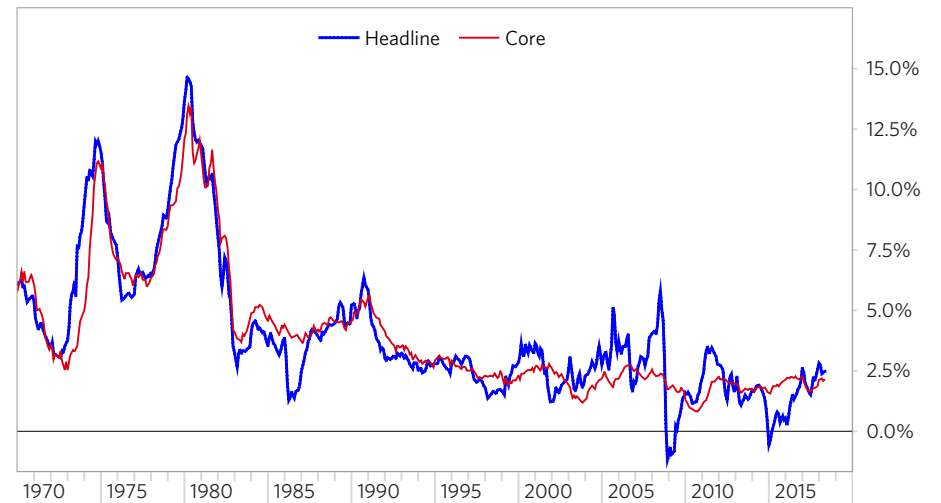
**United States Household Wealth**



**Developed World Inflation**



**United States Inflation**



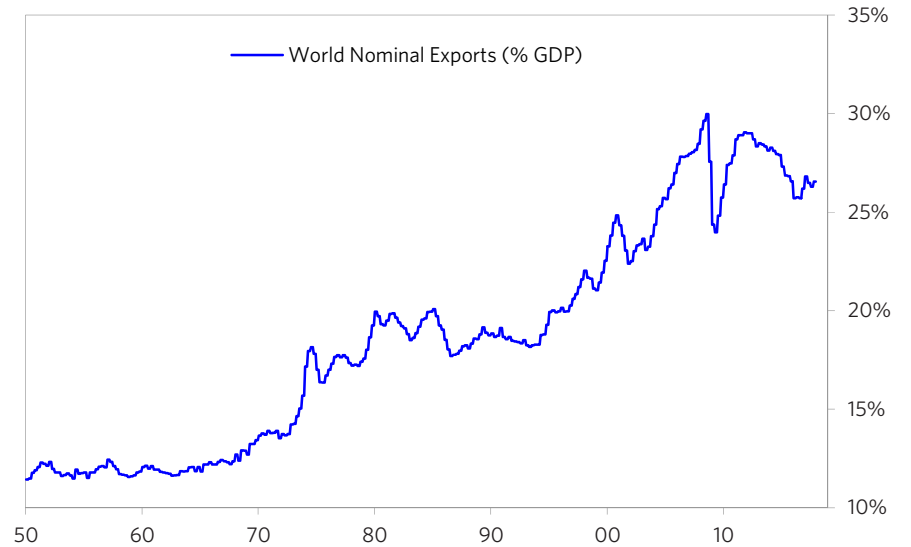
Please review the "Important Disclosures and Other Information" located at the end of this presentation.

# FOUR MAJOR SECULAR DEFLATIONARY FORCES

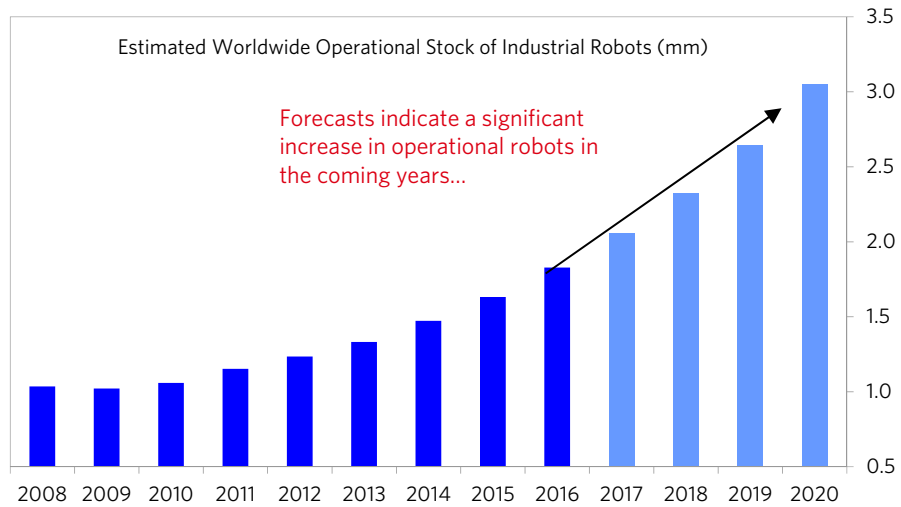
## Debt



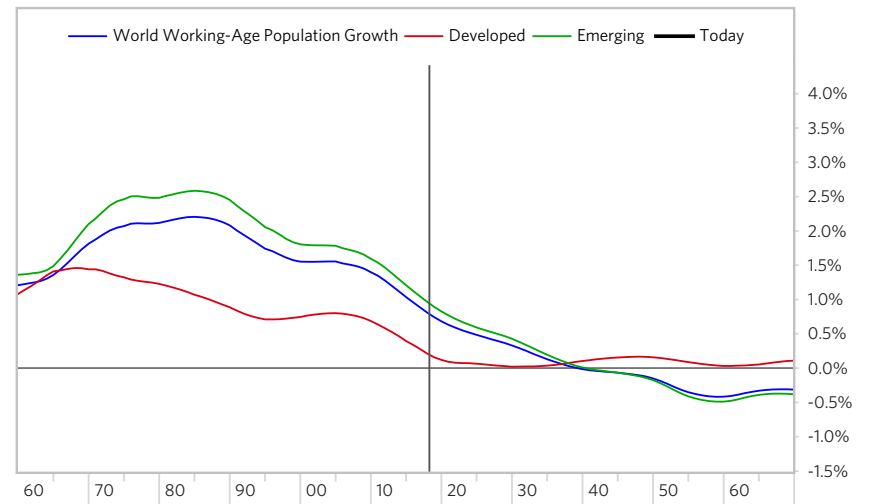
## Globalization



## Automation



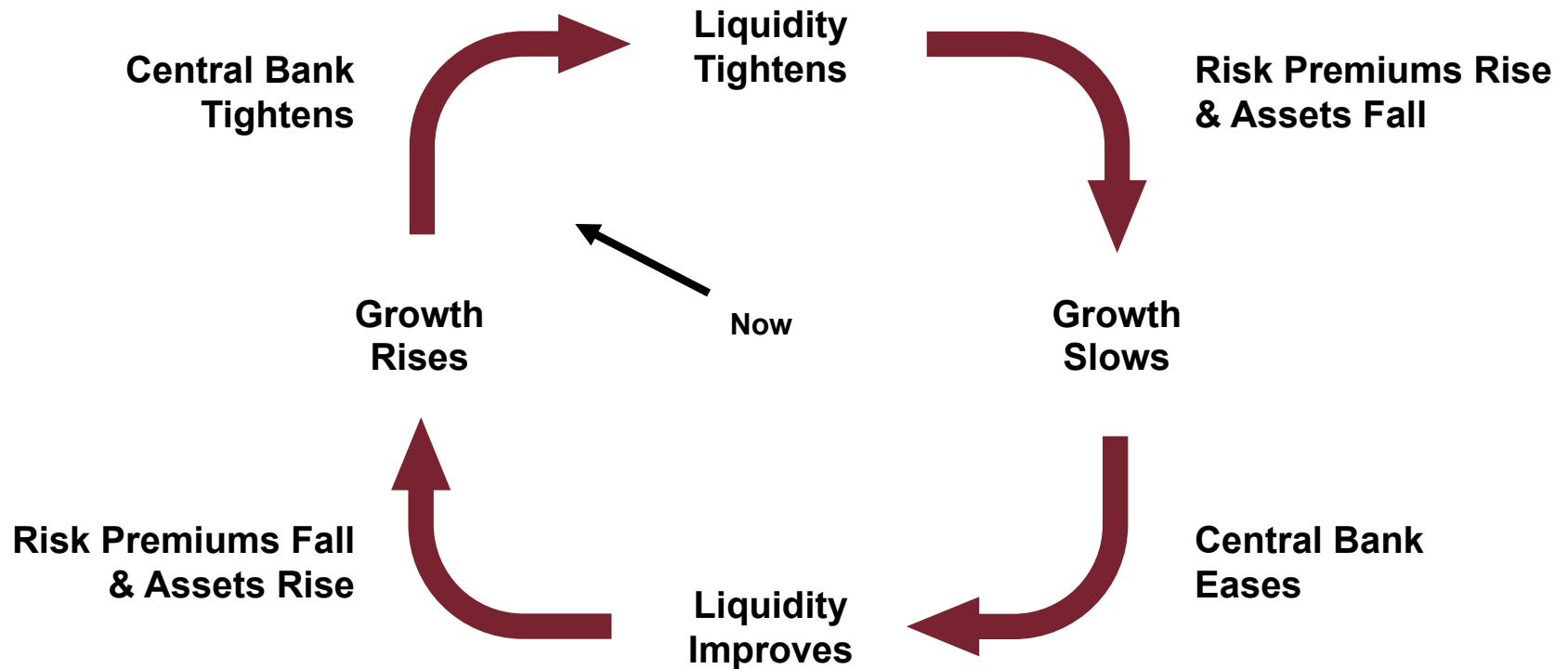
## Demographics





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## TRANSITIONING TO THE LATE CYCLE



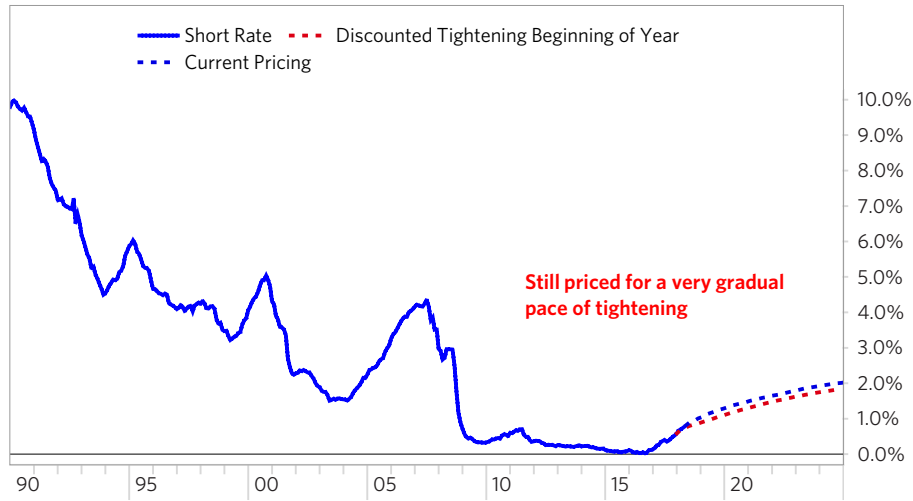
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## **CORRELATED GLOBAL TIGHTENING**

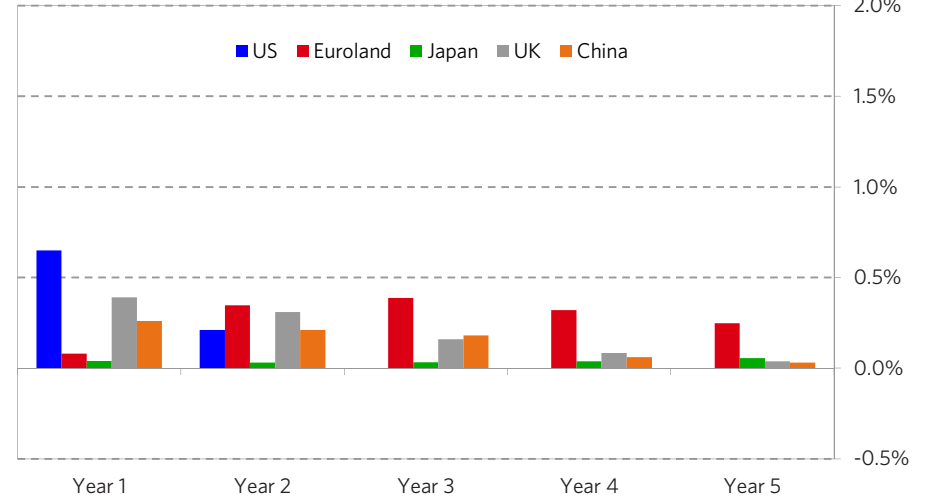
- ◆ The Fed is rolling down its balance sheet, approaching a rate of \$400 billion per year. They are also raising short-term interest rates.
- ◆ The ramp-up in US fiscal stimulation is underway, a draw on liquidity of \$250 billion or more per year.
- ◆ The ECB has cut their purchases of bonds by half (€360bln / yr) and is now beginning to contemplate the timing of interest rate increases.
- ◆ China is pursuing a managed deleveraging.
- ◆ The BoJ has gradually reduced asset purchases.

# MARKETS ARE NOT PRICING IN MUCH TIGHTENING OR RISK

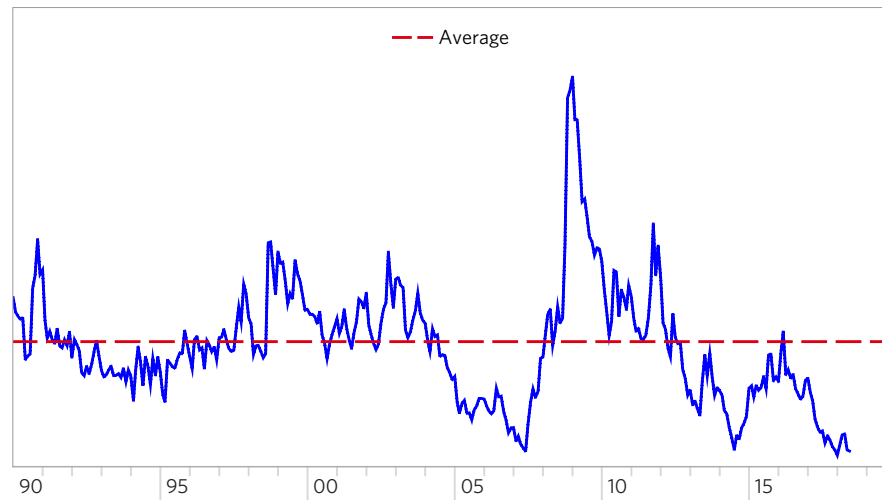
Developed World Short Rate



Discounted Annual Tightening



Global Implied Volatility



Please review the "Important Disclosures and Other Information" located at the end of this presentation.

# ABUNDANT LIQUIDITY HAS COMPRESSED “SPREAD”

## Where is There Spread?

Asset	Current	LT Avg	Percentile	Asset	Current	LT Avg	Percentile
<b>Yield Curve (Local FX)</b>				<b>Sovereign Credit</b>			
United States	1.0%	1.4%	37%	Europe (Periphery) Spread to Bunds	0.9%	0.7%	75%
Europe	0.8%	1.1%	39%	Emerging Markets (Hard Currency)	1.0%	1.4%	22%
Japan	0.2%	0.9%	19%				
<b>Investment Grade Corporate Credit</b>				<b>Illiquid Assets</b>			
United States	1.4%	1.6%	49%	Private Equity (Valuation vs. Public)	93%	76%	33%
Europe	1.4%	1.4%	63%	Private Infrastructure	7.8%	8.8%	29%
Japan	0.6%	0.6%	64%	Real Estate (Cap Rate vs Real Yield)	5.4%	6.0%	25%
<b>High Yield Corporate Credit</b>				<b>Asset &amp; Mortgage-Backed Credit</b>			
United States	3.5%	3.5%	40%	US ABS	0.9%	1.8%	21%
				US MBS	0.5%	0.8%	20%
				US IG CMBS	0.8%	1.8%	20%

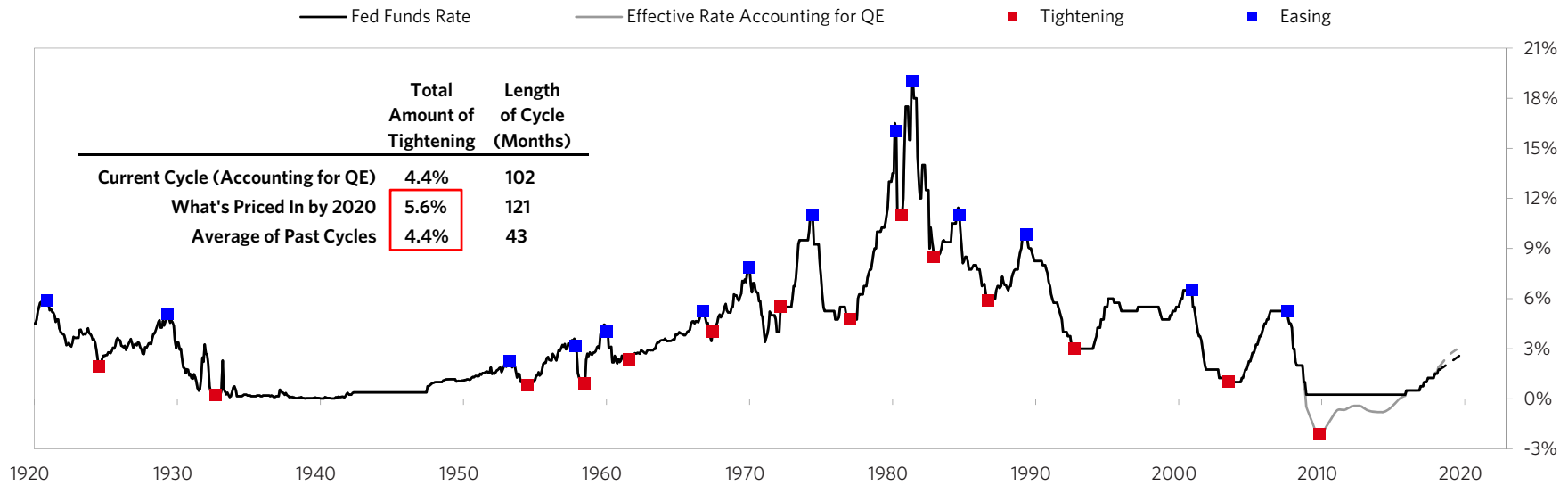
## LATE CYCLE CONDITIONS INCREASE RISKS

<b>Average Ratio</b>	Early Cycle	Mid Cycle	Late Cycle
Equities	0.6	0.5	-0.2
Nominal Bonds	0.9	1.0	-0.4
IL Bonds	0.6	0.5	0.4
Credit	0.9	0.7	-0.4
Commodities	0.1	-0.2	0.4
World 60/40	0.8	0.7	-0.3

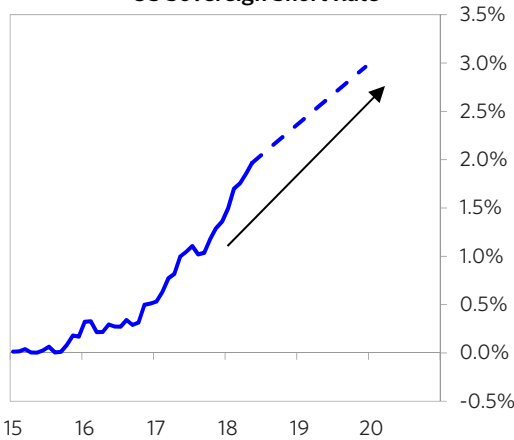
Results shown 1970 through April 2018. Past performance is not indicative of future results. Please review the "Important Disclosures and Other Information" located at the end of this presentation.

# 2019 IS SETTING UP TO BE DANGEROUS FOR THE ECONOMY; FOR INVESTORS THE DANGER IS ALREADY HERE

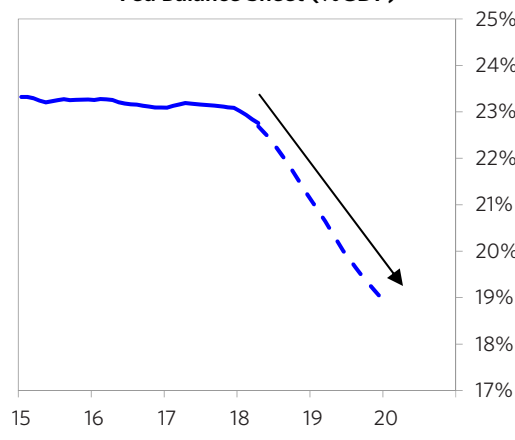
## Current Tightening Cycle Is On Track to be the Largest Since 1982



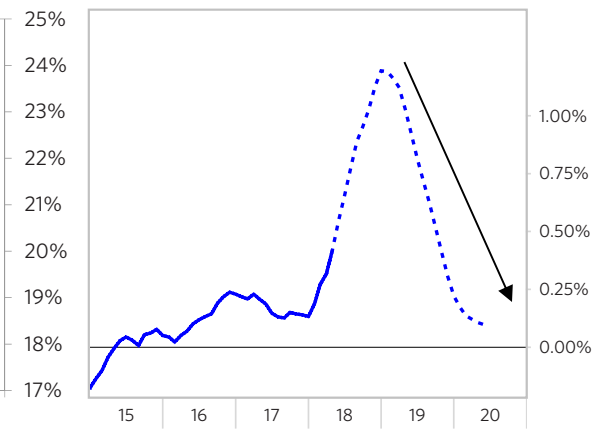
US Sovereign Short Rate



Fed Balance Sheet (%GDP)



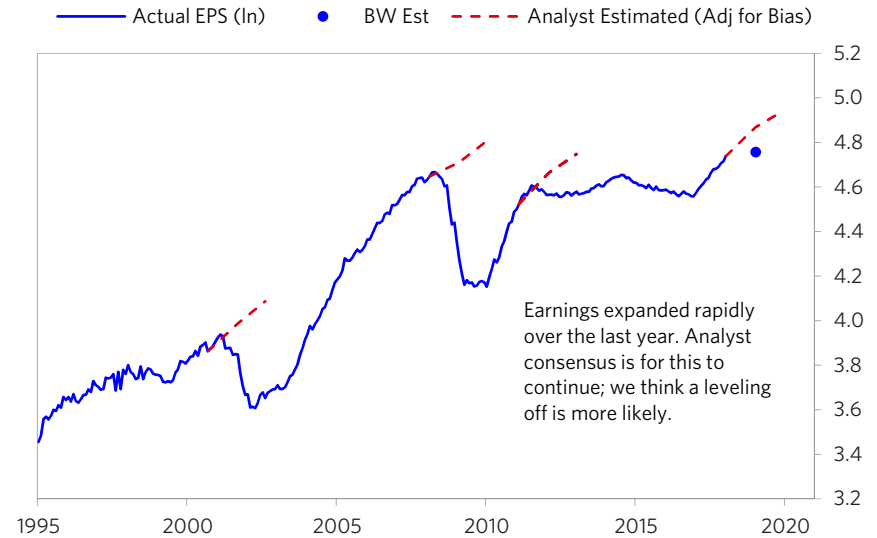
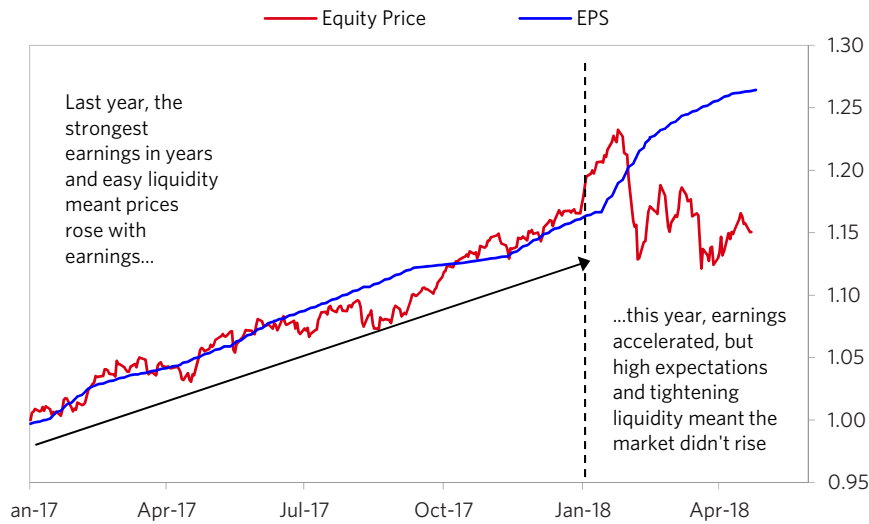
U.S. Government Growth Impact (%GDP)



Please review the "Important Disclosures and Other Information" located at the end of this presentation.

# EARNINGS GROWTH STRONG, BUT ALREADY PRICED IN

Global Equity Prices & Earnings per Share  
(Indexed to Start of 2017)



## What Happens Following Periods of Strong Global Growth?

If Growth Subsequently:

Then the Average Subsequent  
Equity Return is:

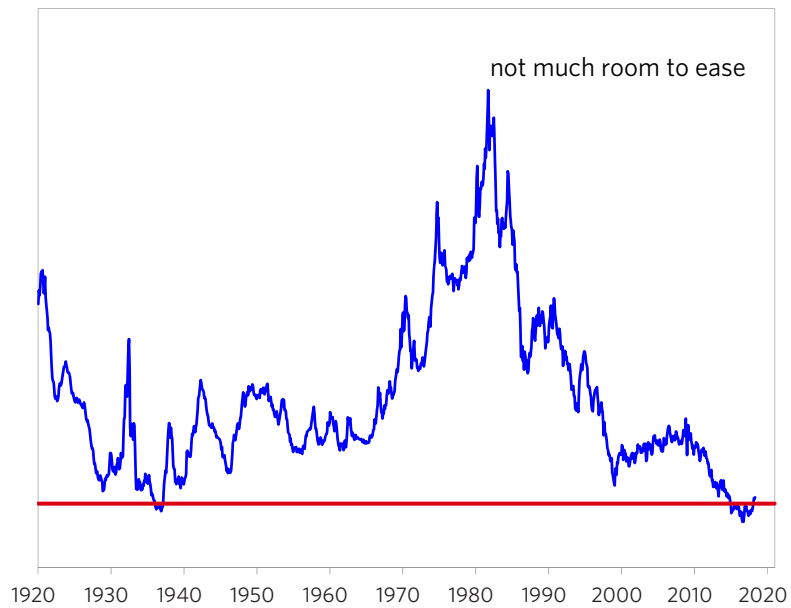
Strengthens Further	11%
Is Flat or Moderates	-1%
Falls Significantly	-20%

*Equity returns shown in excess of cash*

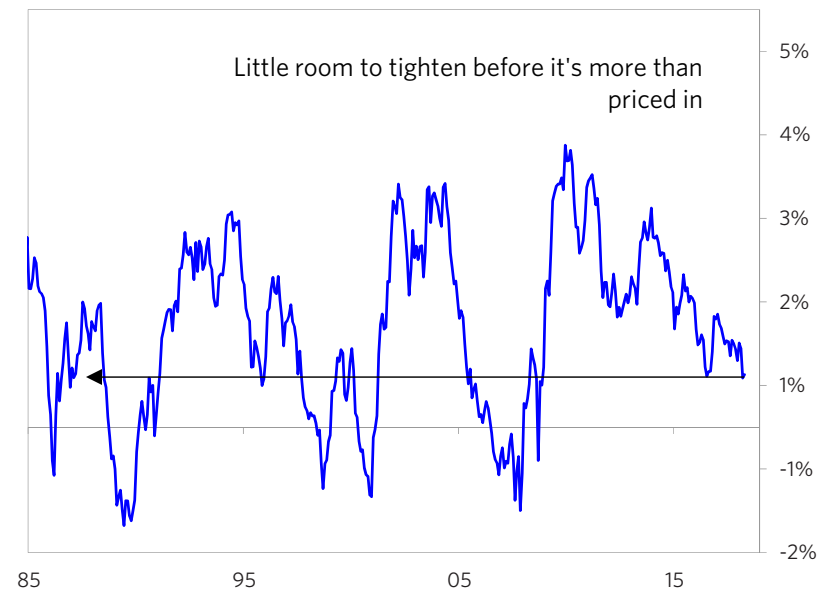
Even small moderation after strong periods leads to poor equity performance on average

# CENTRAL BANKS HAVE LITTLE MANEUVERABILITY

Developed World Central Bank "Fuel in the Tank"  
(Ability to Ease)



Developed World Yield Curve

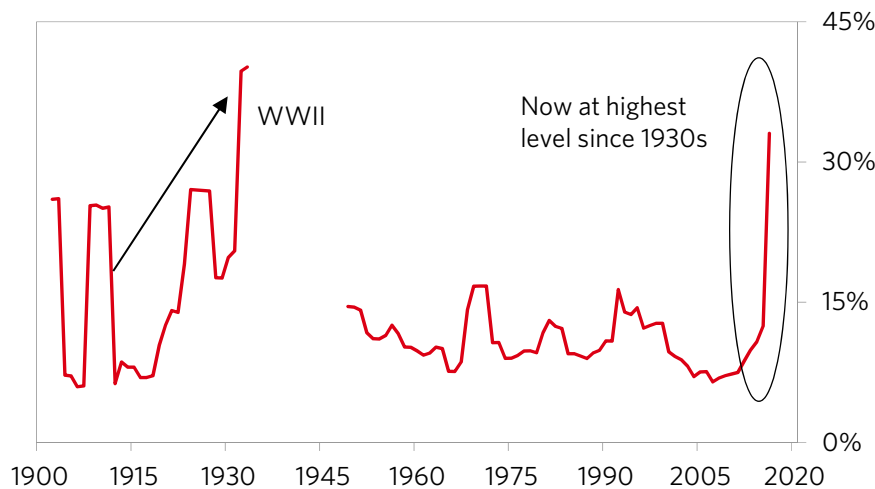




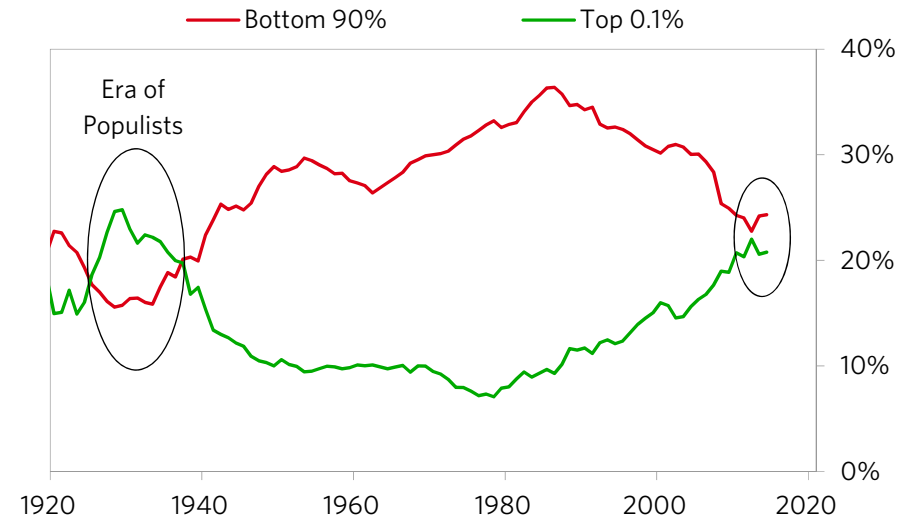
# THE RISKS ARE EXACERBATED BY UNDERLYING ECONOMIC, POLITICAL, AND SOCIAL ISSUES

	IOUs %GDP		Demographics		
	Total	Entitlements	Workers per Retiree		
			1980	2015	2045
<b>Japan</b>	1090%	660%	7.5	2.3	1.5
<b>France</b>	1070%	750%	4.5	3.3	2.1
<b>United Kingdom</b>	1040%	610%	4.2	3.7	2.4
<b>Italy</b>	1040%	730%	4.8	2.9	1.5
<b>Spain</b>	930%	600%	5.6	3.6	1.5
<b>Germany</b>	900%	660%	4.1	3.1	1.8
<b>United States</b>	810%	490%	5.7	4.5	2.7
<b>China</b>	650%	400%	12.9	7.9	2.3

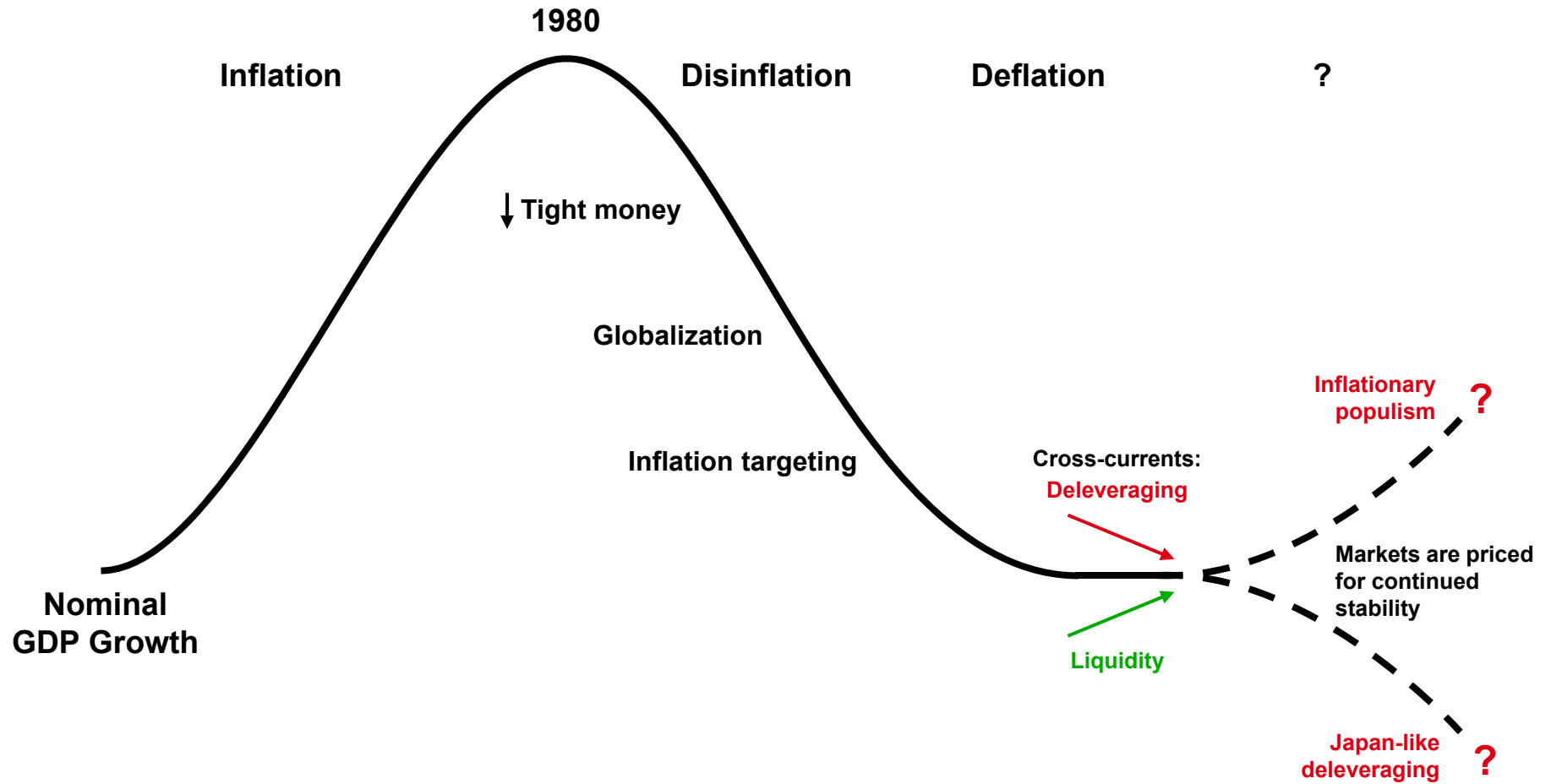
**Developed World Populism Index**



**US Net Wealth Shares**



# A WIDE RANGE OF POTENTIAL OUTCOMES



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## UNIQUE RISKS OF THE NEXT DOWNTURN

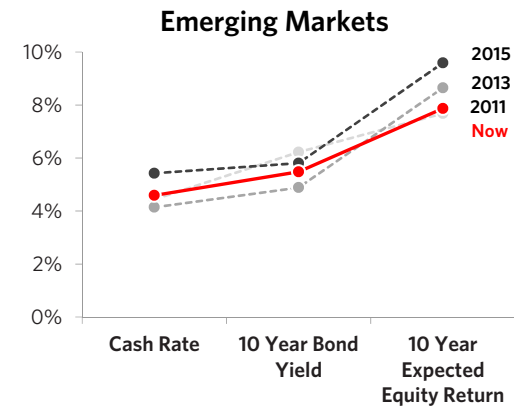
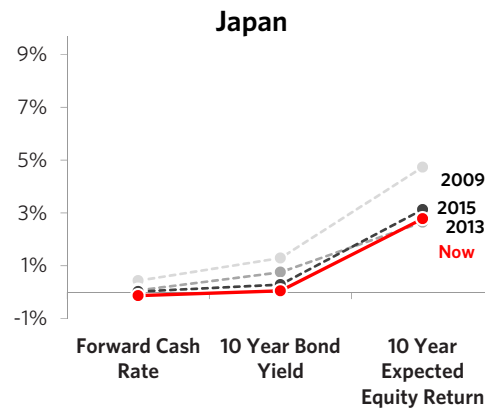
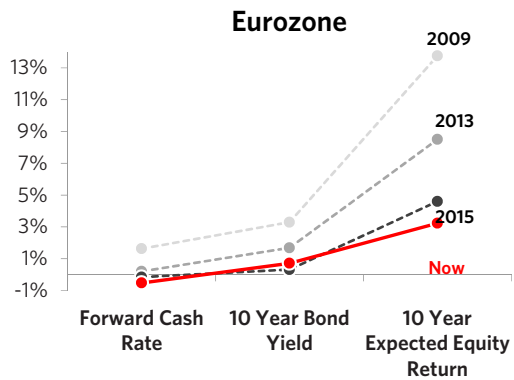
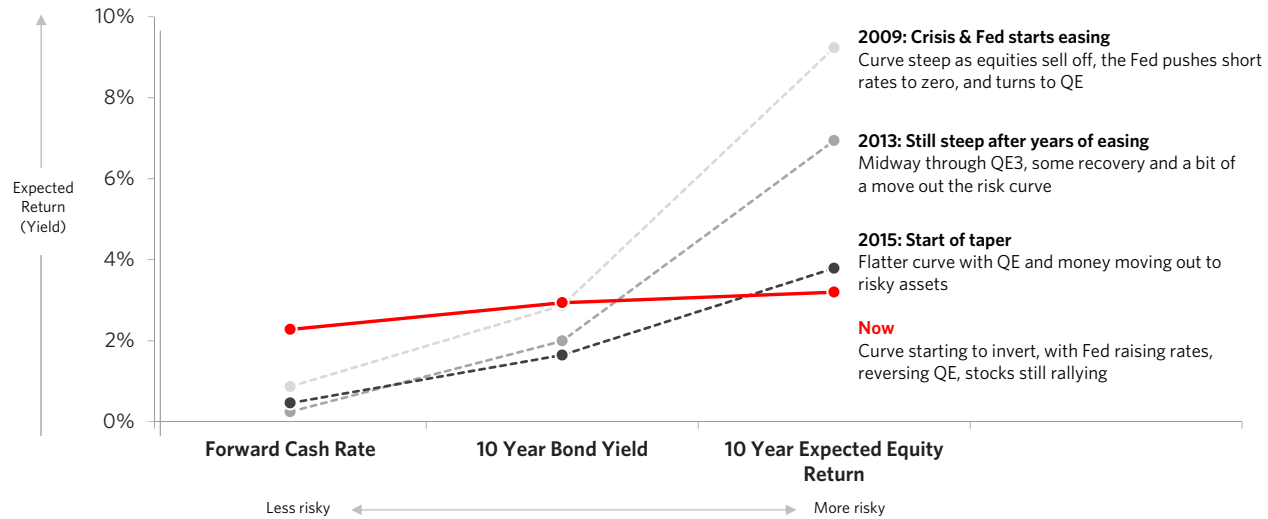
- ◆ Central banks' ability to reverse the next downturn will be limited.
- ◆ Political divisions will impact effective policy action.
- ◆ Deflation with interest rates near zero can trigger a self-reinforcing rise in real interest rates and rising risk premiums.
- ◆ Too many financial promises to be kept.

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## **Global Outlook Appendix**

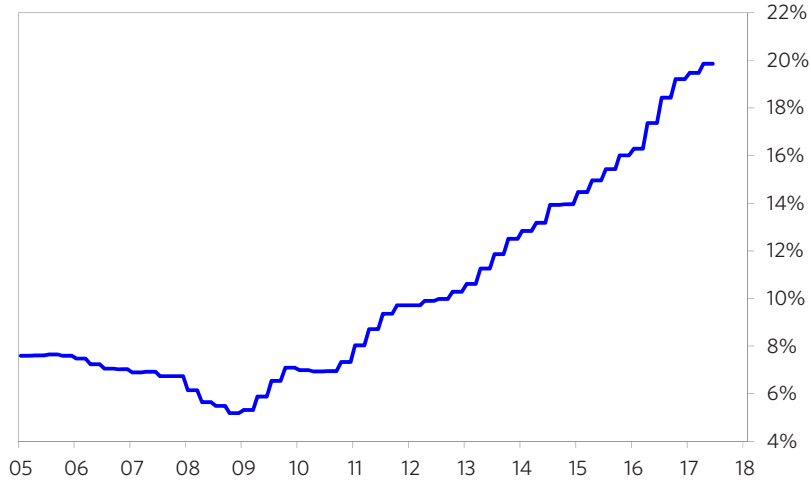
# RISK CURVES HAVE SHIFTED

The US Risk Curve has Gone from Steep in the Crisis to Inverted Today

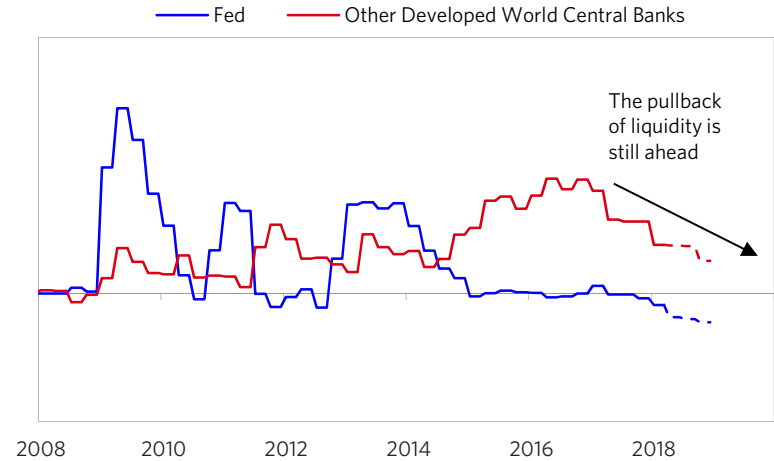


# TOO MANY BONDS RELATIVE TO PRIVATE SECTOR DEMAND

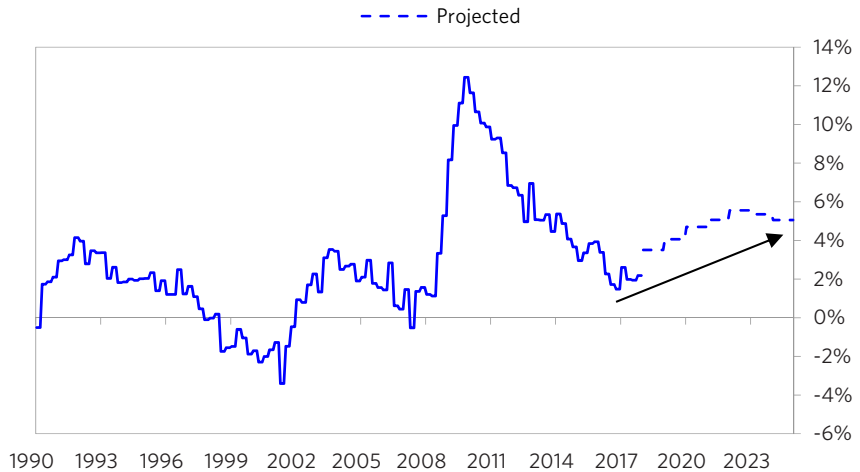
Central Banks' Sovereign Bond Holdings from QE (% Market Cap)



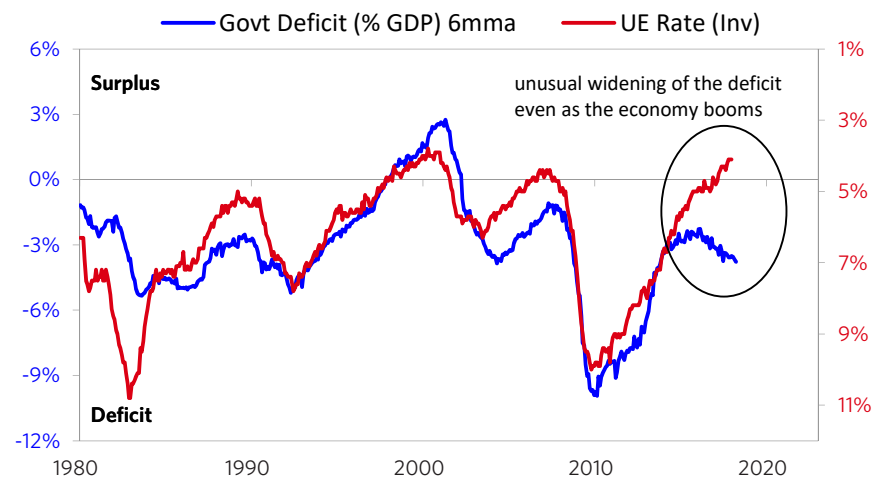
Central Bank Bond Purchases



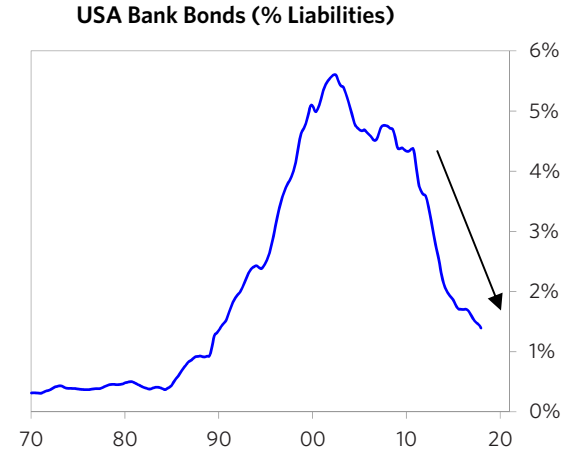
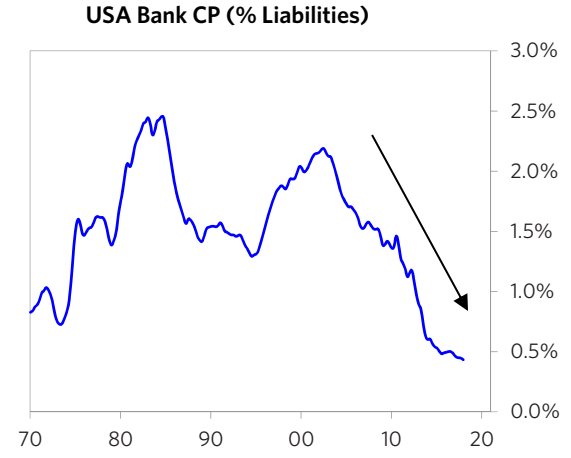
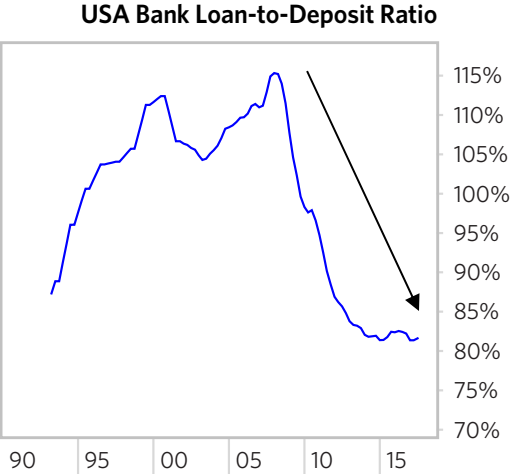
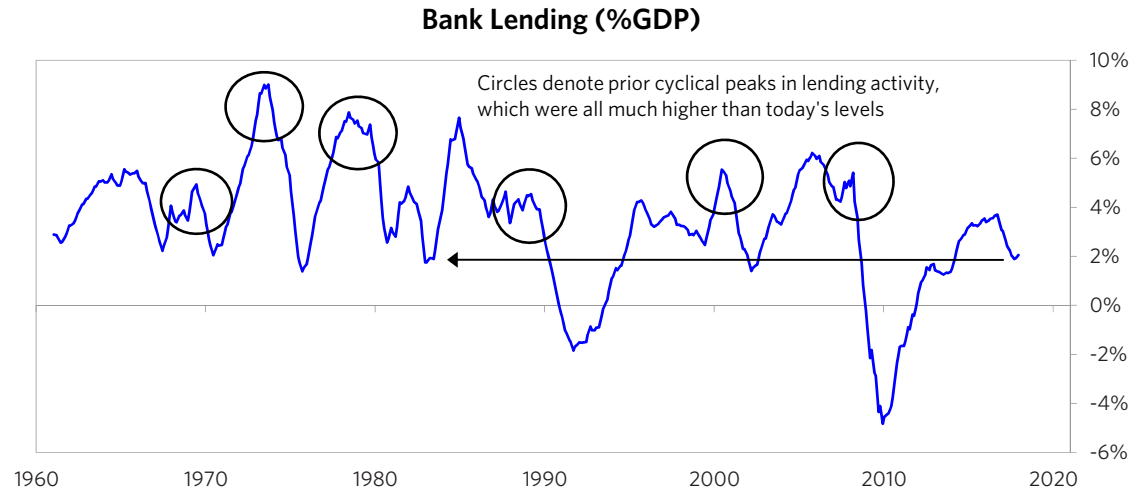
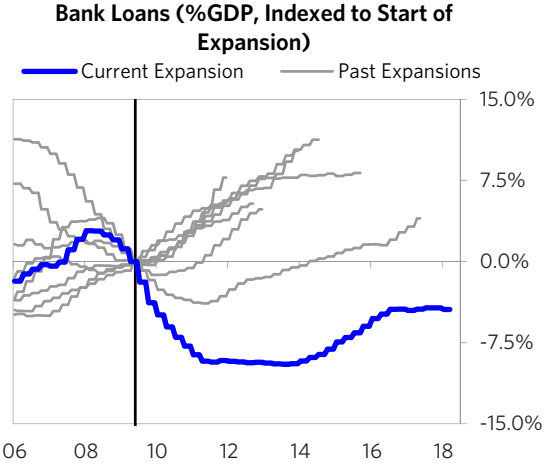
US Government Bond Issuance (%GDP)



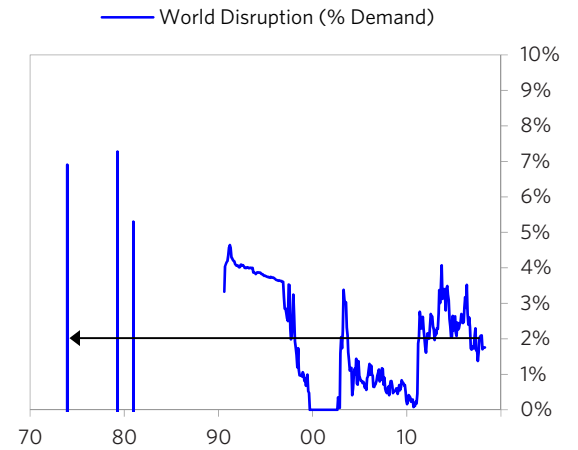
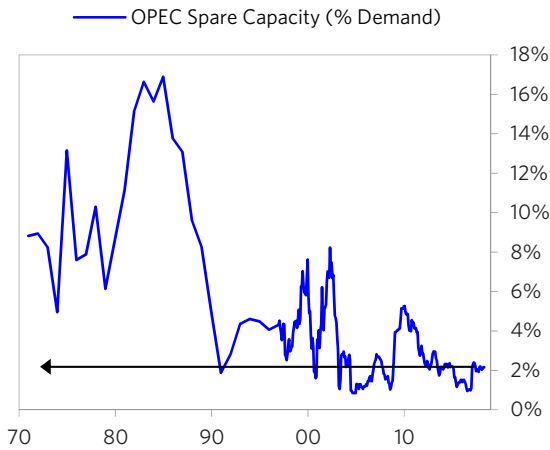
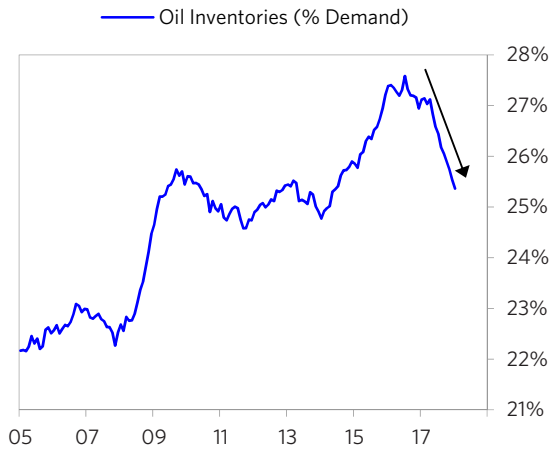
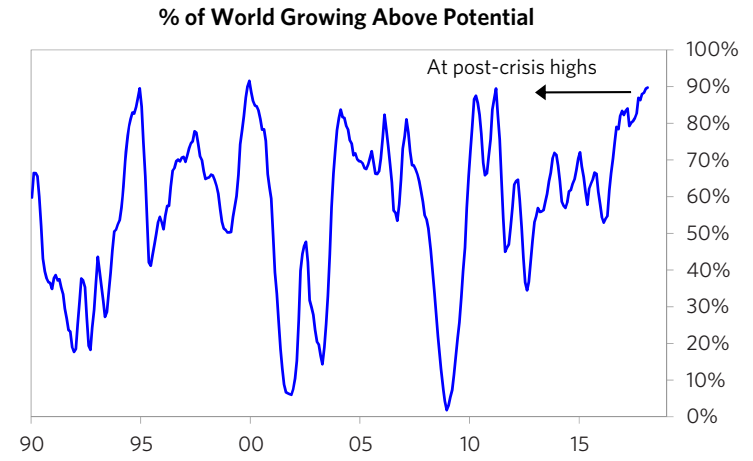
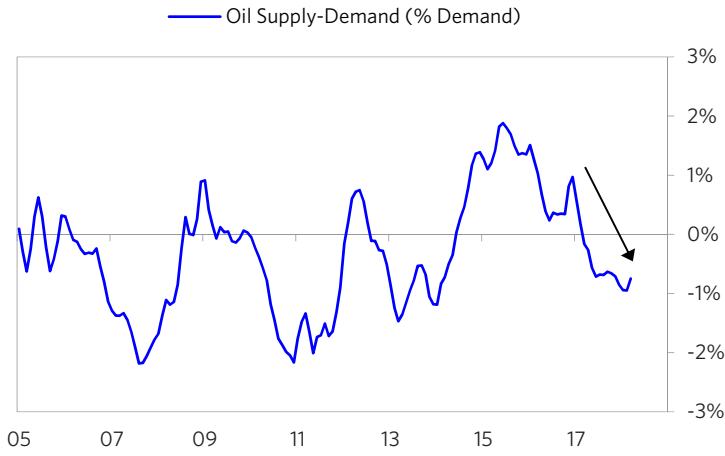
US Federal Government Budget Balance (% GDP)



# UNLIKE PAST CYCLES, LOW FINANCIAL LEVERAGE REDUCES VULNERABILITY



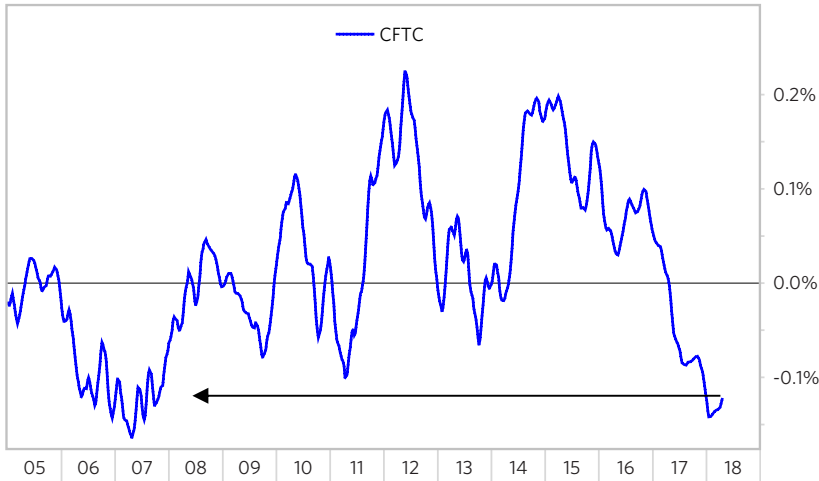
# THE OIL MARKET HAS TIGHTENED SUBSTANTIALLY



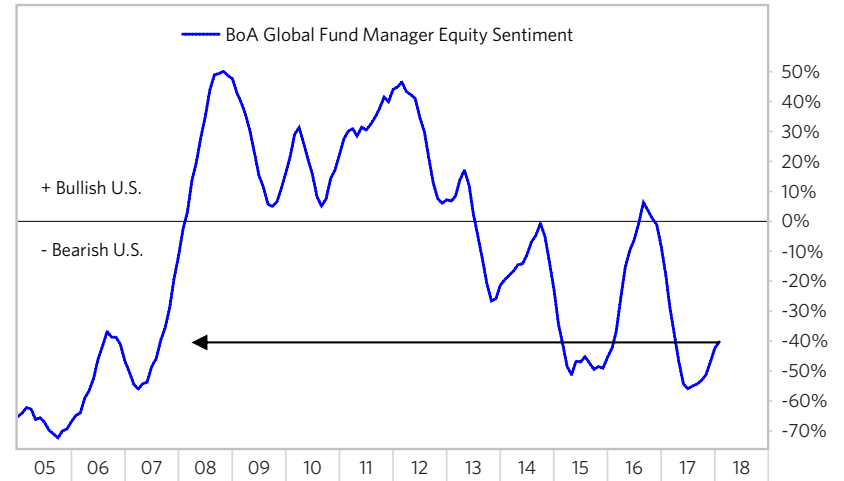


# U.S. DOLLAR REMAINS ATTRACTIVE

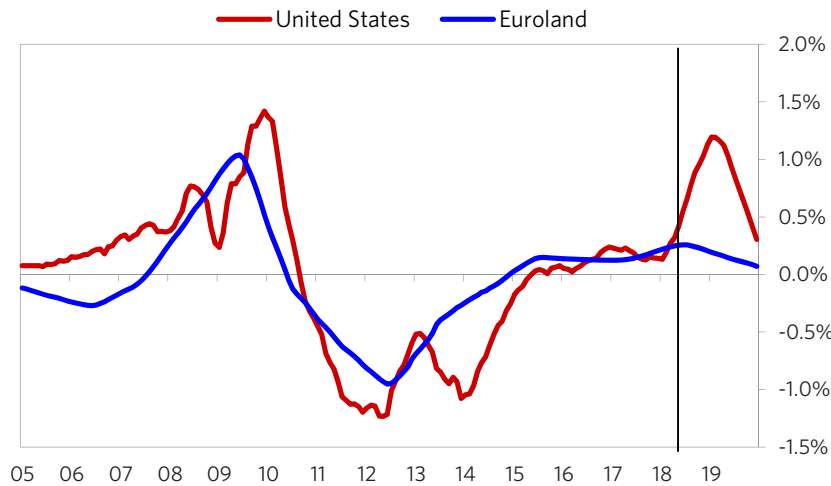
USD vs EUR Speculative Positioning (%GDP)



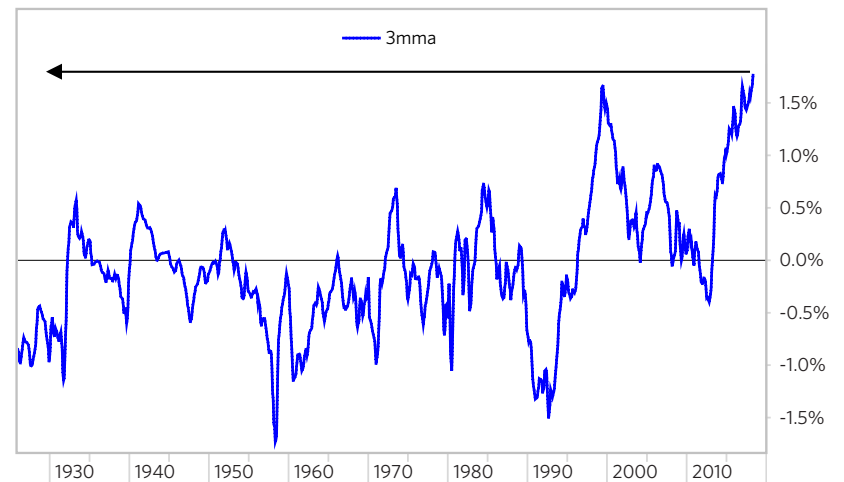
U.S. vs Developed Equity Sentiment



Government Impact on Growth (%GDP)



US vs Developed World Real Yield (10yr)

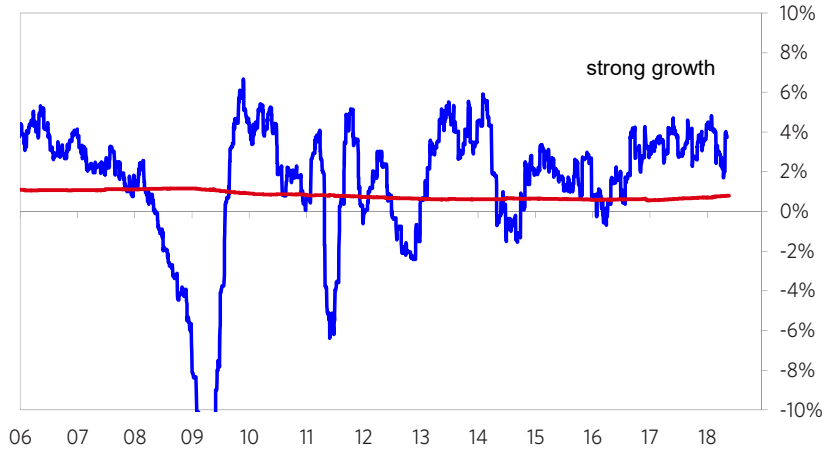


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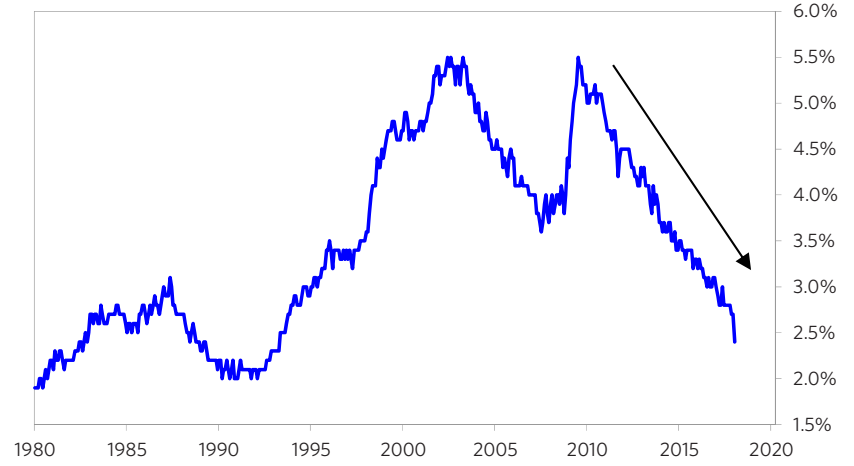
# JAPAN: BOJ HAS A LONG PATH AHEAD

**Japan Growth**

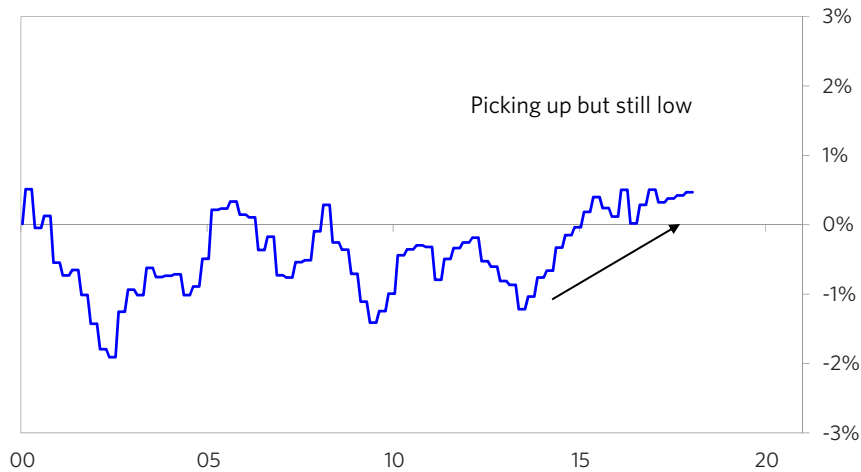
— Growth — Potential



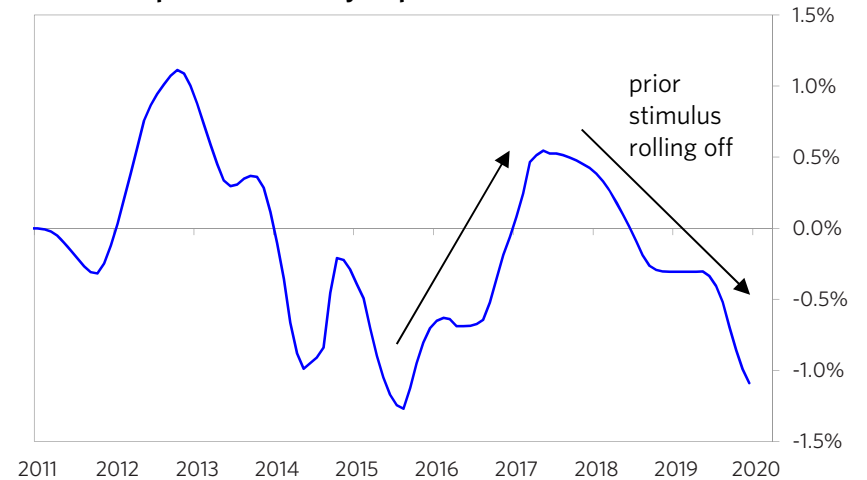
— Unemployment Rate



**Wage Growth**

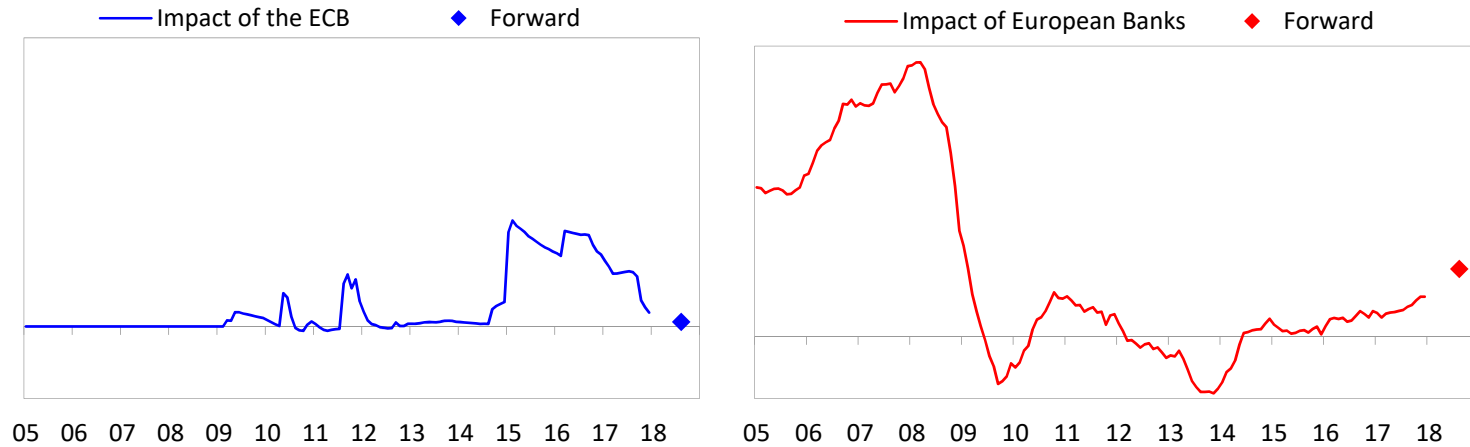


**Japan Fiscal Policy Impact on Growth %PGDP**

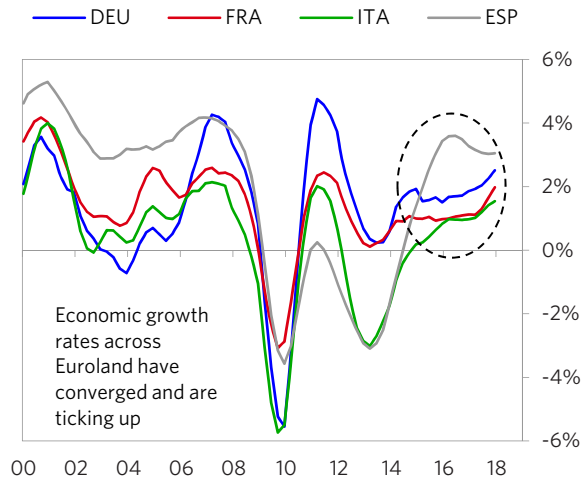


# EUROPE: PRIVATE CREDIT SUPPORTING GROWTH AS ECB PULLS BACK; DIVERGENCES REMAIN

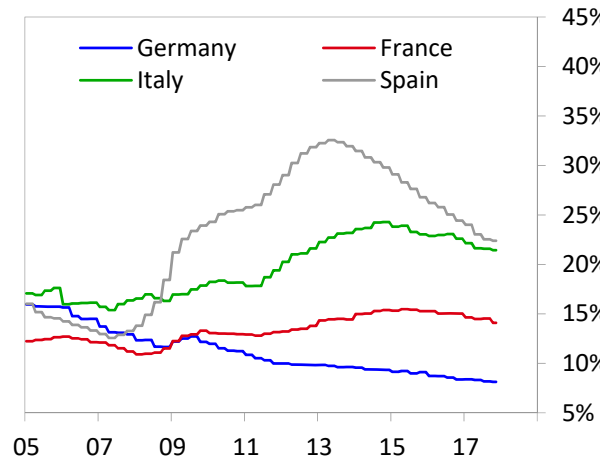
## Private Sector Credit Replacing Money in Euroland



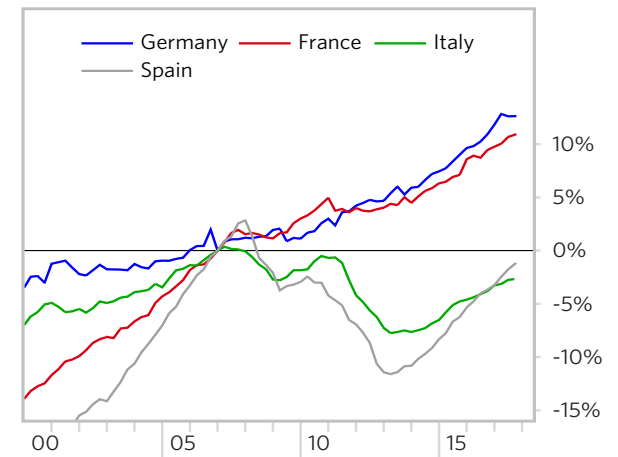
### Real GDP Growth



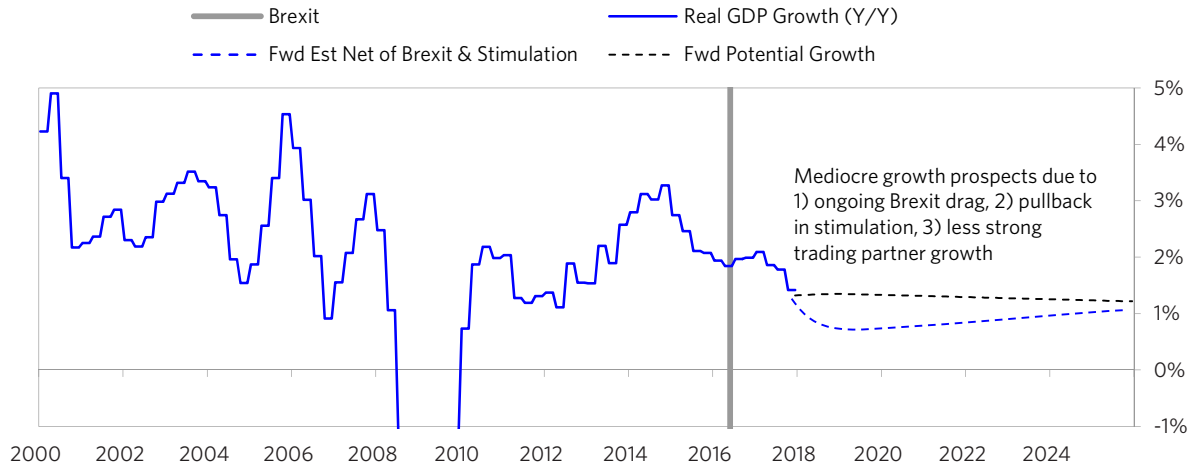
### Adjusted Unemployment Rate



### Consumer Spending (Indexed to 2007)



# U.K.: TRACKING THE IMPACTS OF BREXIT

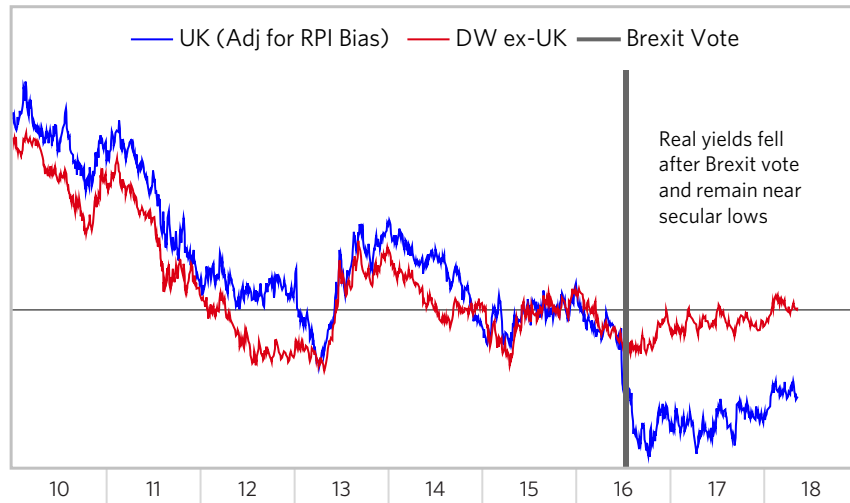


## Brexit Impact on Growth (Annualized)

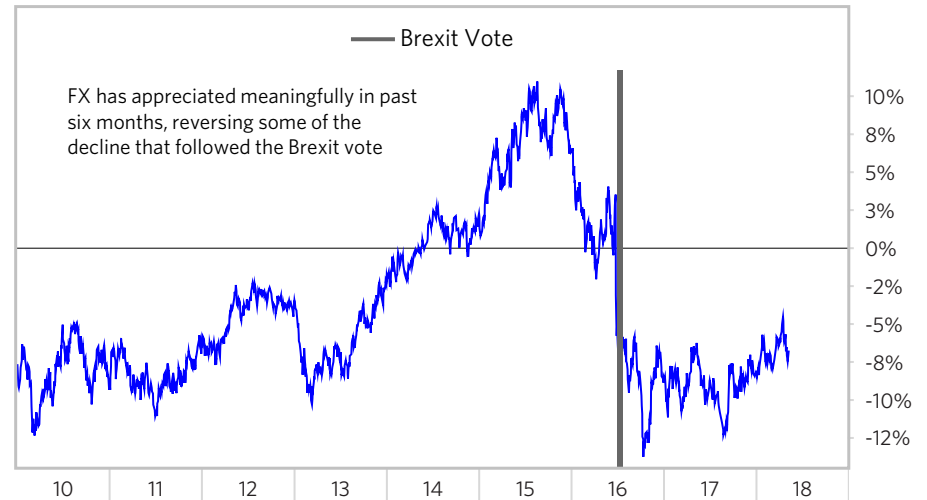
	Since Mid-2016	2018 Estimate
Consumption	-0.6%	-0.3%
Investment	-0.3%	-0.2%
Trade & Transfers	-0.2%	0.0%
<b>Total ex Govt</b>	<b>-1.1%</b>	<b>-0.5%</b>
Government Spending	0.1%	0.2%
<b>Total</b>	<b>-1.0%</b>	<b>-0.3%</b>

Brexit has been a -1% per year drag on growth, with a cumulative impact on the level of GDP of about 2% by the end of 2018

## Real Yields



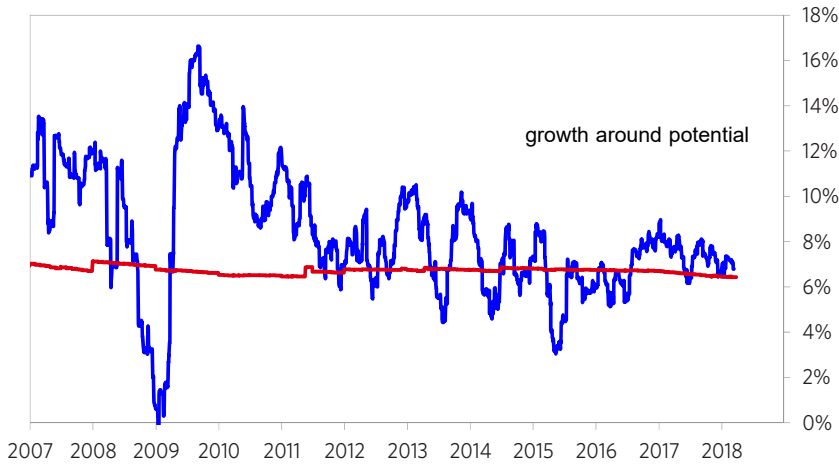
## Spot FX vs. TWI



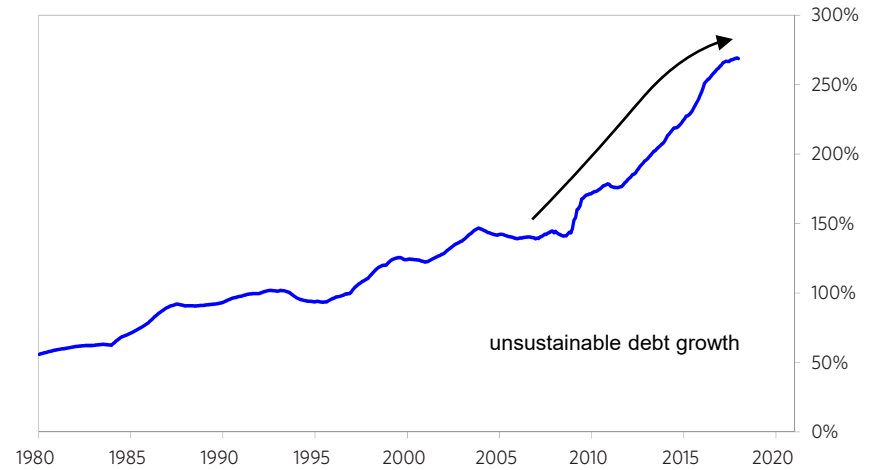
# CHINA ATTEMPTING TO CAP CREDIT GROWTH WHILE MAINTAINING ACCEPTABLE GDP GROWTH

**China Growth**

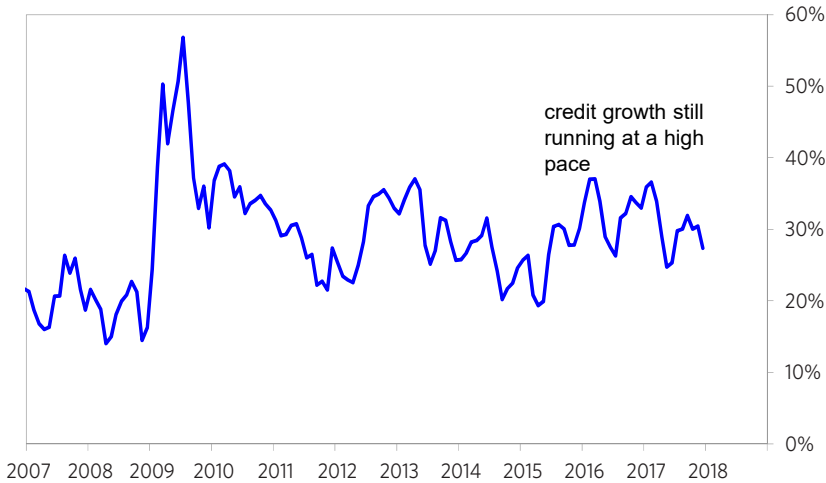
— Growth — Potential



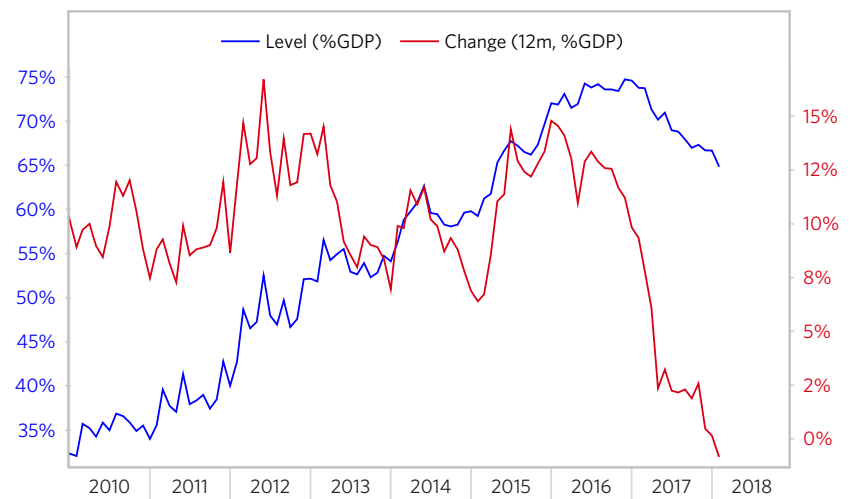
**China Total Debt (% GDP)**



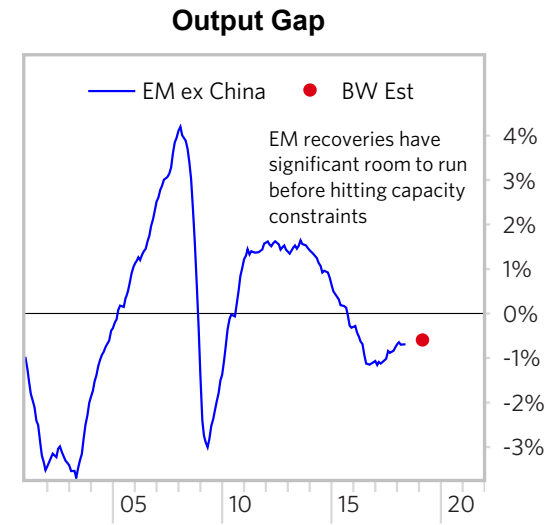
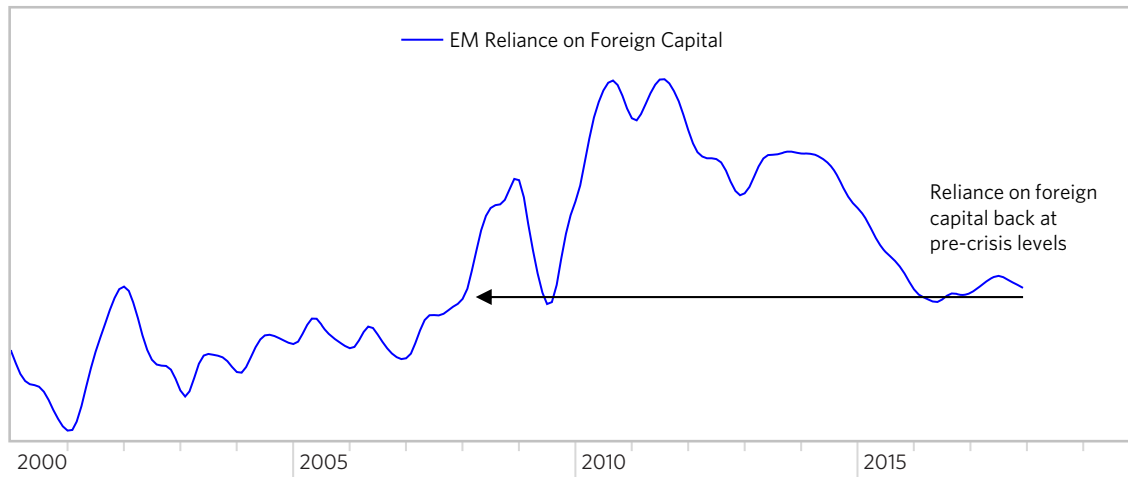
**China Non-Financial Credit Creation (%GDP)**



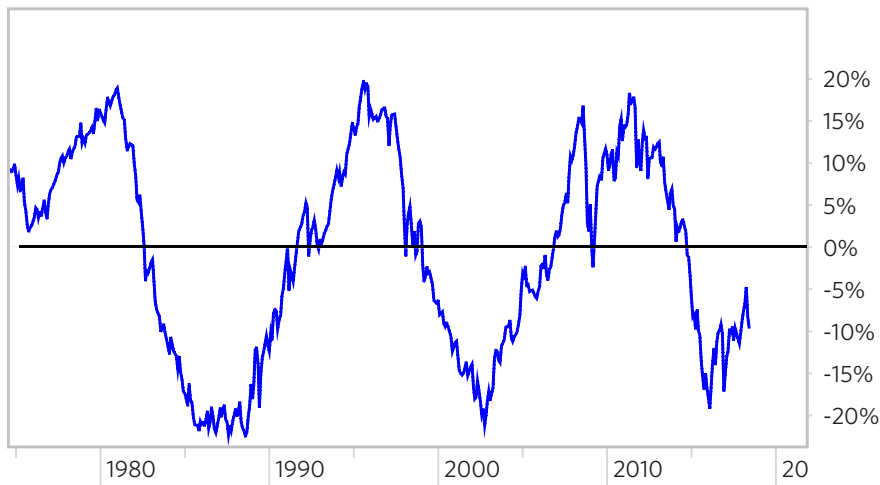
**Bank Claims on Financials (NBFIs and Other Banks)**



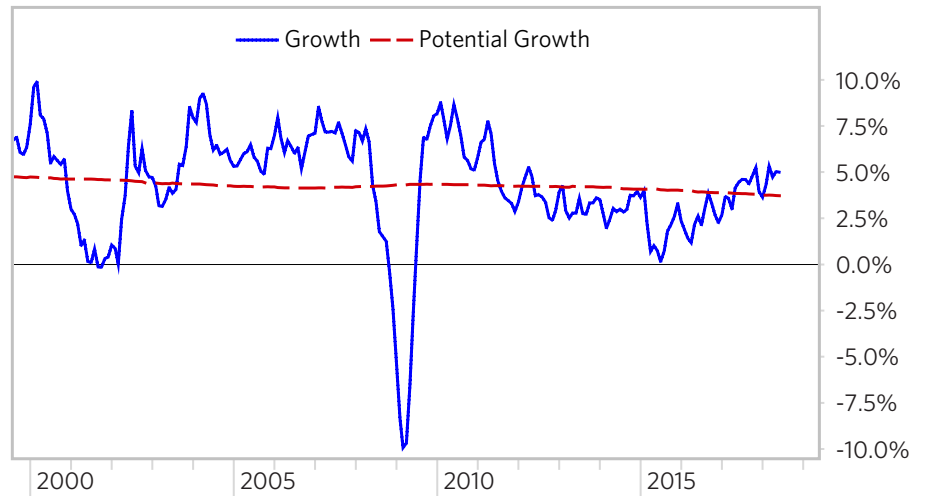
# EMERGING MARKETS ARE LESS VULNERABLE TO PULLBACK IN CAPITAL



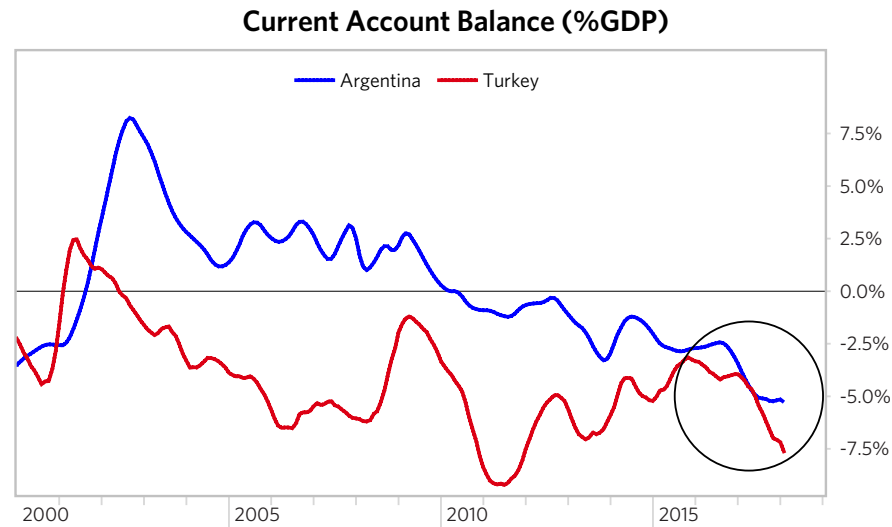
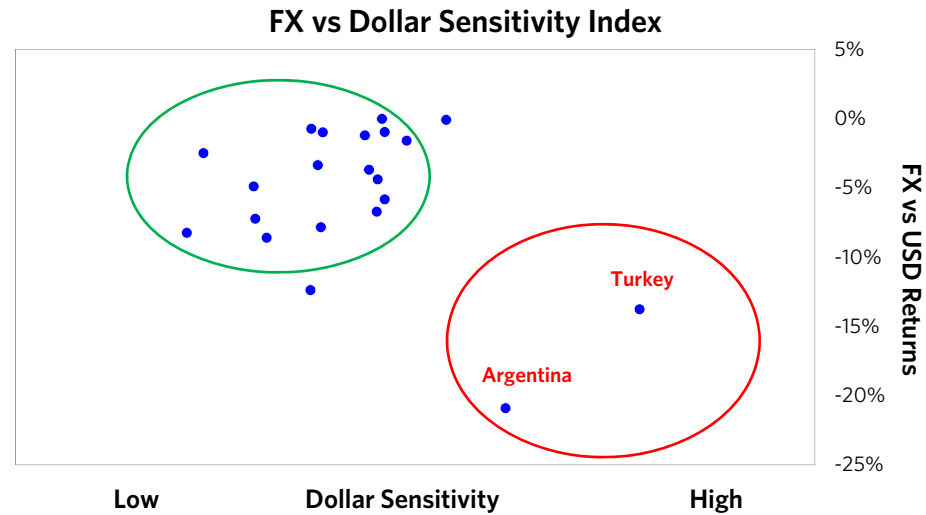
**Emerging Market (ex-China) Real Exchange Rate Index**



**EM ex-China Growth**

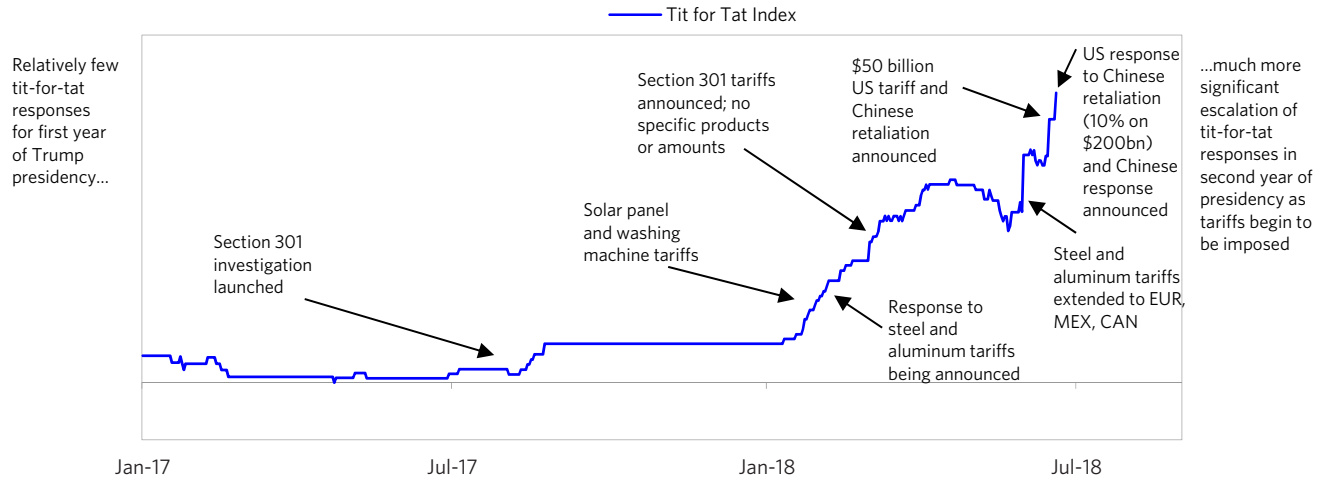


# ARGENTINA AND TURKEY'S HIGHER RELIANCE ON DOLLAR FUNDING HAS DRIVEN DIVERGENT MARKET ACTION

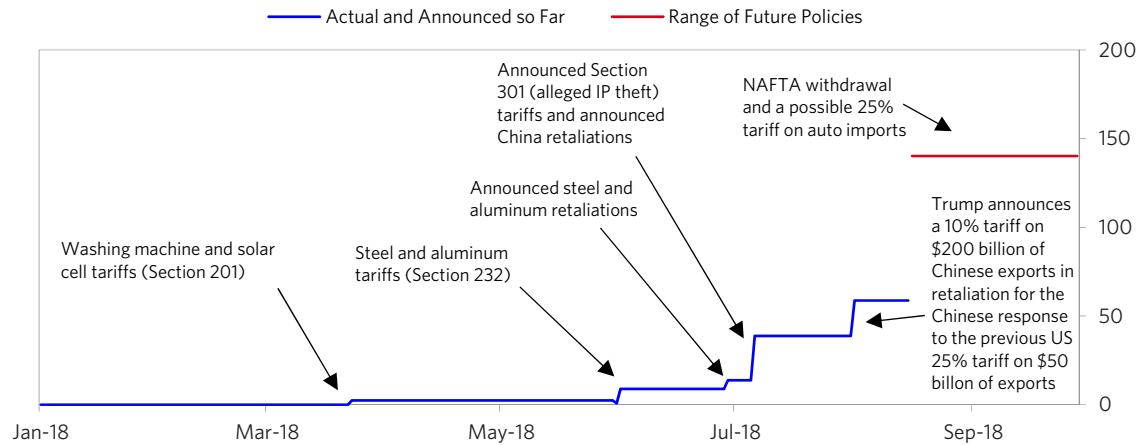


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# TRACKING THE ESCALATING TRADE TENSIONS



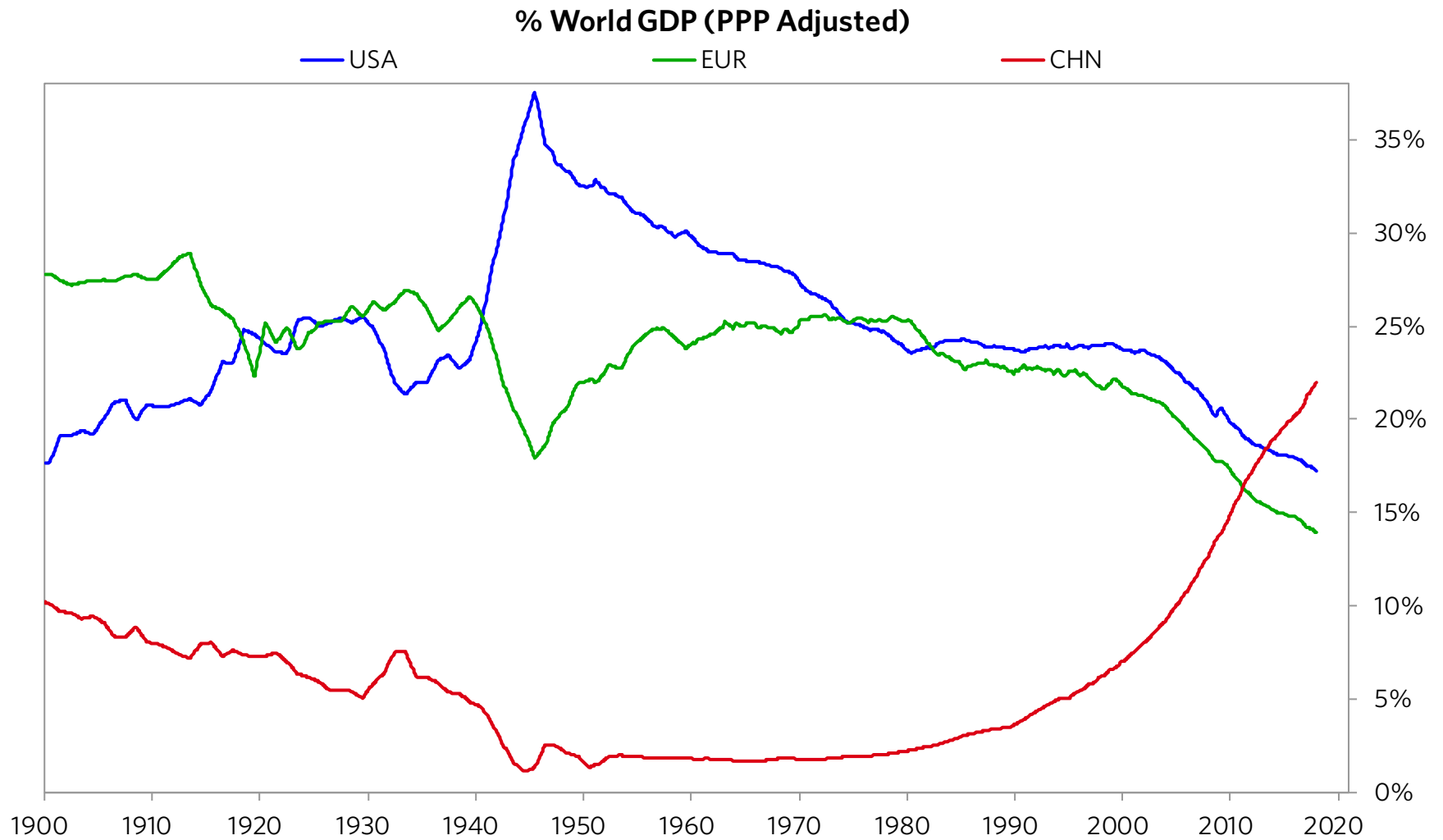
## Impact of US Tariffs and Trade Partner Responses (USD, Bln)



Data shown as of June 2018.



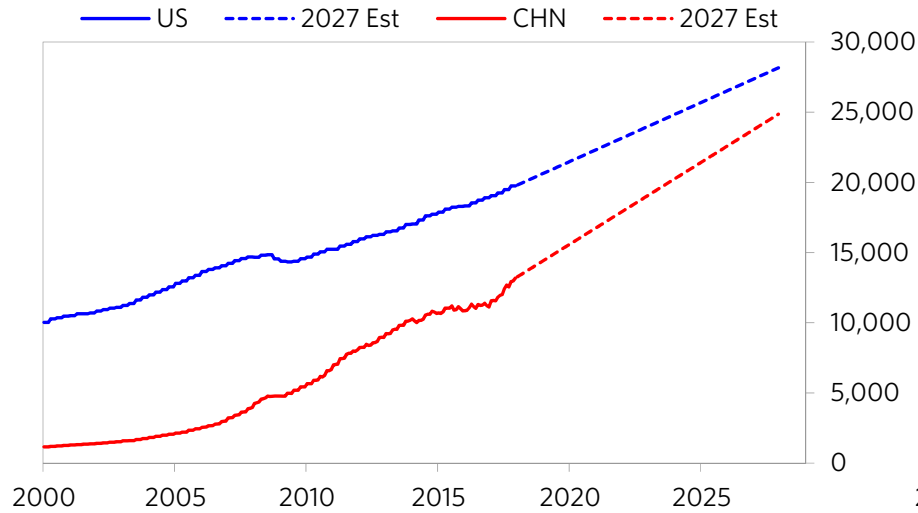
# CHINA'S RISING SHARE OF GLOBAL WEALTH



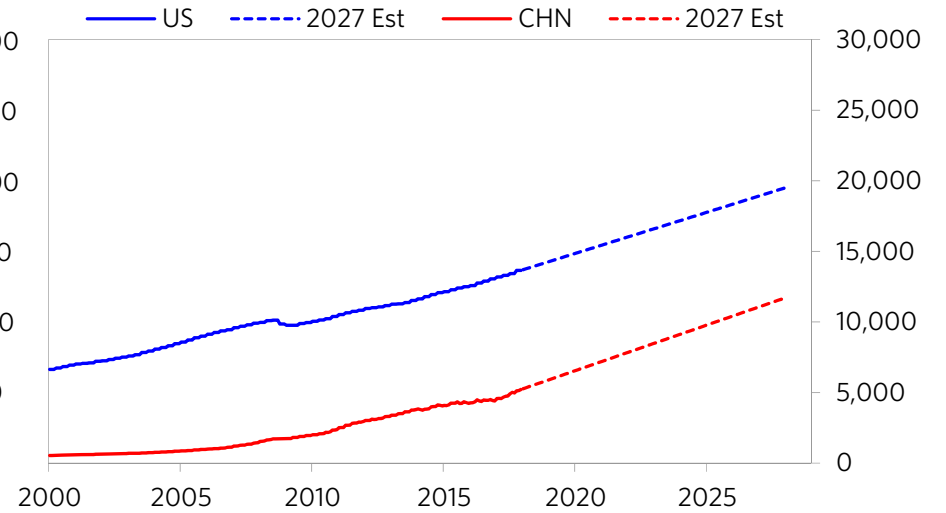
Data through December 2017.

# CHINA'S CASHFLOWS ARE MASSIVE

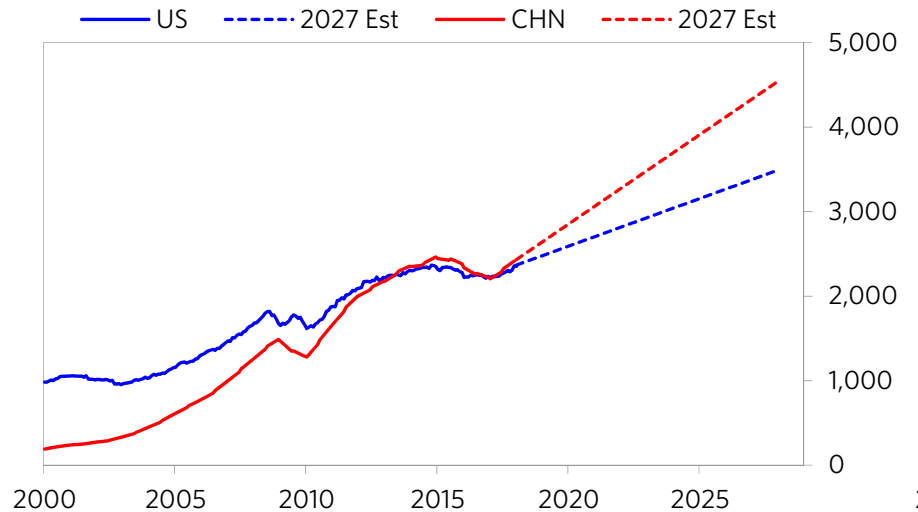
### NGDP (USD Billions)



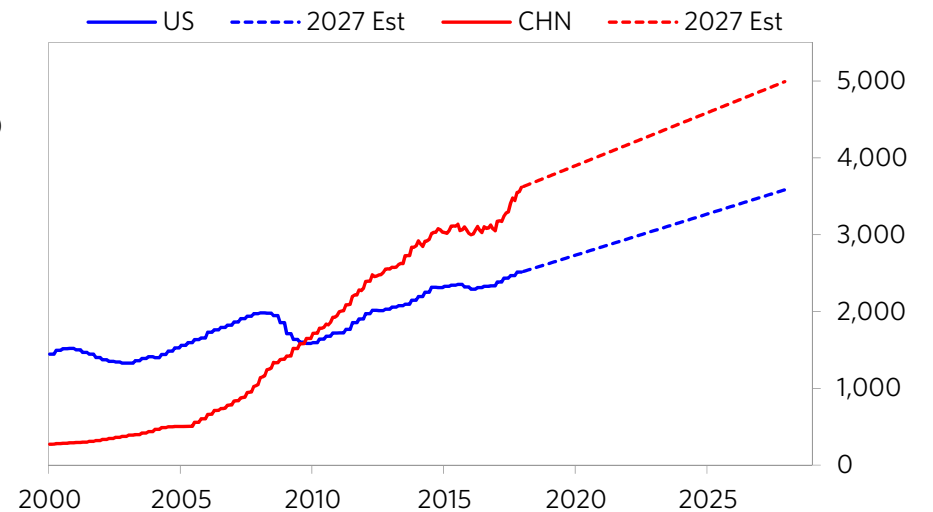
### Household Consumption (USD Billions)



### Exports (USD Billions)



### Capital Expenditure (USD Billions)



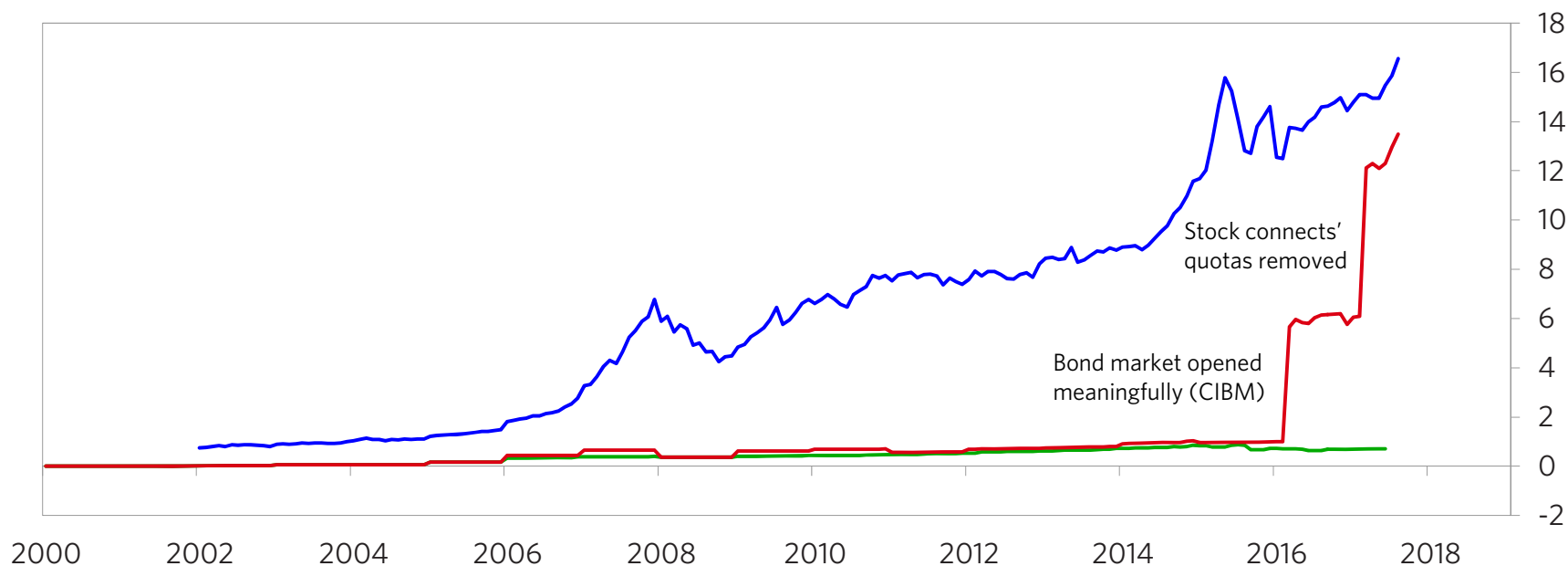
# MARKETS ARE LARGE, LIQUID, AND OPENING UP

## Global Rankings of Asset Markets (USD, Bln)

Rank	Equity Market Cap		Gov't Bonds Outstanding	
1	United States	\$27,469	United States	\$14,180
2	China	\$9,291	Japan	\$9,540
3	Japan	\$5,444	China*	\$5,828
4	United Kingdom	\$3,074	Italy	\$2,295
5	France	\$2,417	France	\$2,285

## Chinese Asset Markets (USD, Tln)

— Total    — Held by Foreigners    — Accessible to Foreigners



Data on Global Market Cap and Government Bonds Outstanding as of Jun 2017. \*China Gov't Bonds Outstanding includes policy bank bonds. Data on Chinese Assets (bottom chart) through August 2017.

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