CCSIF Guest Lecture
Medium run macroeconomic forecast with portfolio suggestions

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20 November
Week 6, MT 2020

Self-intro and disclaimer

A short introduction and disclaimer first ⏩ Disclaimer

I first became interested in the FX market in 2008, and later on in the financial markets in general. ⏩ An old pic.

And in 2014 I made a bet with my family's portfolio manager from Citibank that Nikkei 225 will get up to 25k by the end of 2020. ⏩ N225

I was going to become a PhD in Economics at Cambridge, but decided to switch to Mathematics after reading my MPhil in Economic Research here in 2018.

Cited / Extensive readings

1. The history:
    - John Campbell (2000), Margaret Thatcher The Grocer's Daughter, *Jonathan Cape London*
    - Margaret Thatcher (1993), The downing street year, *Harper Collins*
2. Monetary Theory:
    - Frederic Mishkin (2019), The Economics of Money, Banking, and Financial Markets, *Pearson*, 10th ed.
    - Parley Ruogu Yang (2018), Money and Monetary Policy: a contemporary and historical review, *parleyyang.wordpress.com*
    - Peter Howells and Keith Bain (2008), The Economics of Money, Banking and Finance, *Pearson*, 4th ed.
3. Macroeconomics and Finance: too broad to enumerate.

An inflationary trajectory towards a capitalistic social reform

Remarks from the history

Figure: PM Margaret Thatcher at the Conservative Party conference in 1989 (Reuters)

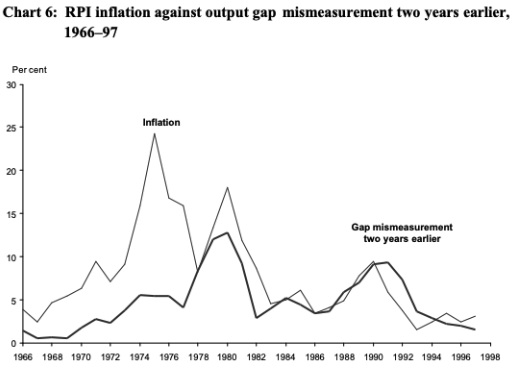
Campbell (2000, p.150): On Thatcher's speech in her constituency during 1962:

> She warned that the country was paying itself more than it earned and must compete in world markets to maintain its standard of living.

Two blocks here are quoted from Margaret Thatcher's Speech to Conservative Central Council in Mar 1976

> Let me say this. There is no such thing as "safe" Socialism. If it's safe, it's not Socialism. And if it's Socialism, it's not safe.
> The signposts of Socialism point downhill to less freedom, less prosperity, downhill to more muddle, more failure. If we follow them to their destination, they will lead this nation into bankruptcy.

Let them learn that it is not a function of the State to possess as much as possible.
It is not a function of the State to grab as much as it can get away with.
It is not a function of the State to act as ring-master, to crack the whip, dictate the load which all of us must carry or say how high we may climb.
It is not a function of the State to ensure that no-one climbs higher than anyone else.
All that is the philosophy of Socialism. We reject it utterly for, however well-intended, it leads in one direction only: to the erosion and finally the destruction of the democratic way of life.



[1]

Figure: Inflation at those times, bearing in mind some mismeasurement that modern economists would argue.

[1] Nelson and Nikolov (2001), UK inflation in the 1970s and 1980s: the role of output gap mismeasurement, Bank of England Working Paper

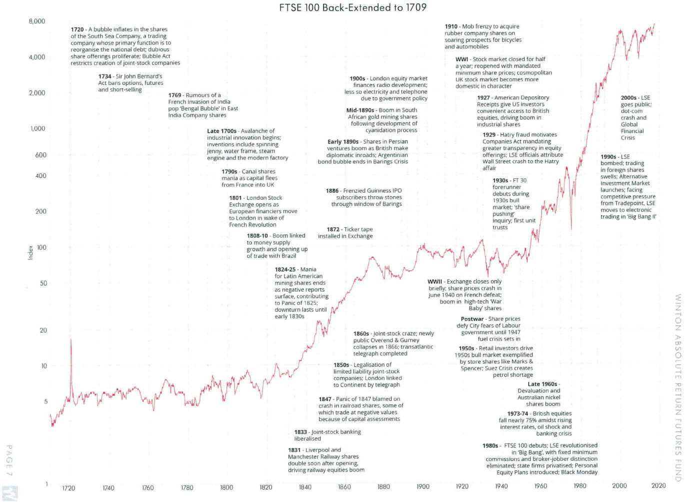


Figure: FTSE 100 (backward-induced) prices from the early 18th history. Note that the scale is logarithmic. Source: ABFM

White Board: Clarification on the difference between a demand-shock and a supply-shock, and a thought about the inflationary trajectory.

White Board 2

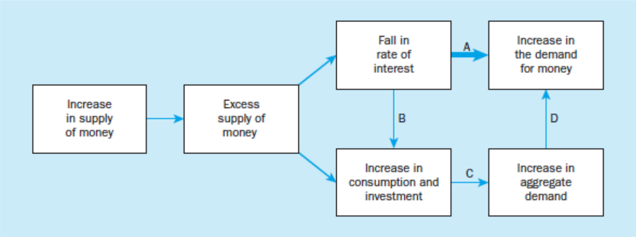


Figure 13.2 Simplified Keynesian view of monetary policy

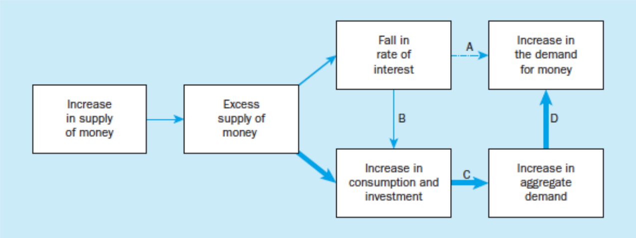


Figure 13.3 Simplified monetarist view of monetary policy

Figure: Howells and Bain (2008, p.268)

White Board 3

Fisher's equation of exchange $MV = PQ$ &
Fisher's equation of interest rate $r = i - \pi$

Roadmap to the future

A capitalist[2] way to solve a few social problems[3]

[2] As oppose to a socialists' revolution.
[3] Many of which are long-term issues

On the word "Society"

Thatcher (1993, p.626):

> Society was not an abstraction, separate from the men and women who composed it, but a living structure of individuals, families, neighbours and voluntary associations.

Roadmap to the future

- A capitalist way to solve a few social problems:
  - P1: Wealth inequality: housing problems in particular ▸▸ Figure
  - S1: Equity re-distribution through inflationary trajectory

- A capitalist way to solve a few social problems:
  - P2: Population dilemma Figure
  - S2: A Japanese style[4] of acceptance towards the population decline, while having a mindset of inflationary targeting via forceful expansionary monetary policies.
  - PX: Even more issues — debt, pension, ...

[4] A few references in my undergraduate dissertation may be helpful for understanding the meaning of "a Japanese style".

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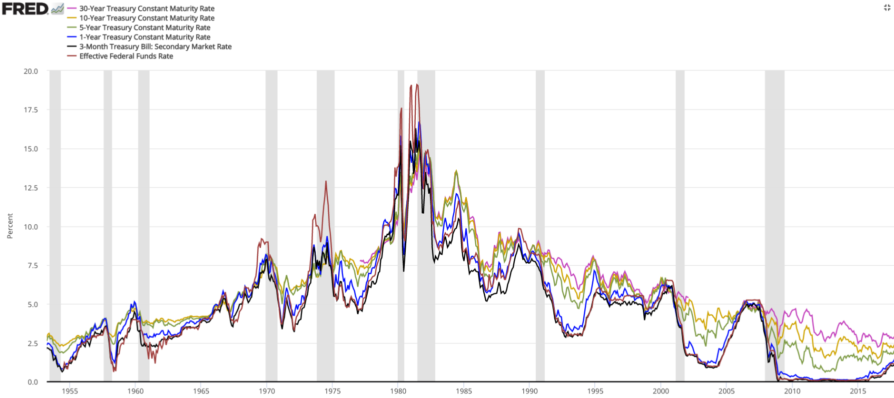


Figure: An extension: the history of interest rates in the US

[5] Source: FRED

Milton Friedman (1970):

> Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output

Key forecasts for 2021, 2022, or 2023: [6]

- A gigantic cyclical unemployment plus an unusually large structural unemployment [Short-term event, A.S.]
- Raising public debt to a level that it becomes theoretically unaffordable under the 2% inflationary assumption and continuous structural deficit [Continuous event, H.L.]
- Tory to dominate the popularity with continuous expansionary monetary and fiscal policies. More monetary-fiscal collaboration to be foreseen. [Continuous event, H.L.]
- Feeding up big banks to be deliberately avoided by the government, but benefiting capital markets in general is unavoidable. [Continuous event, A.S.]

[6] Roughly speaking T and $T+1$ where T is the year that COVID-19 is successfully contained, potentially through a herd immunity via vaccination.

- There will be a re-bounce, potentially uncontrollable re-bounce of inflation at a rate of $> 10\%$ (ann.) for a short period, accompanied by a jump in the equity market at either an immediately-early or a later stage [Short-term event, H.L.] [7]
- The solution to the above trouble is:
  - by firstly contracting certain capital or even the commodity flows (potentially by regulating the financial institutions or even the commercial ones) [Short-term event, H.L.]
  - and later re-designing the monetary policies and potentially entering a new era of technical micro-driven fiscal-monetary coordination [Long-term event, L.]

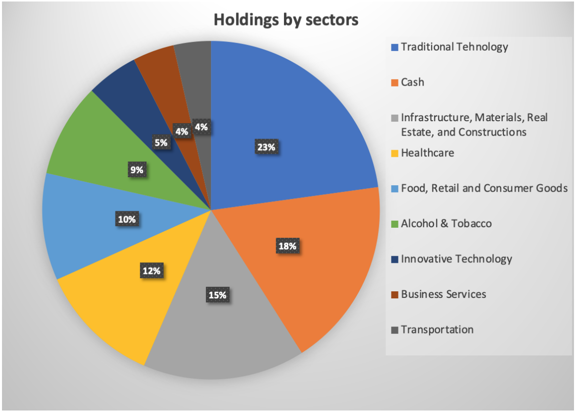
[7] Related economic concept: domestic hot money, liquidity bounce, free capital flow.

An inflationary trajectory towards a capitalistic social reform

The equity market under high inflation

- Ones to watch:
  - Utilities [E.g. National Grid]
  - Consumer Staples [E.g. Tesco, ABF]
- Ones that we need to be more careful about, despite potential benefits from high inflation:
  - Potentially being overvalued at its current state:
    - Innovative Technologies [E.g. Rightmove]
    - Healthcare [E.g. Astrazeneca]
  - Potential sunset companies:
    - Certain industrial commodities [E.g. RDS]
- Uncertain ones:
  - Mid-Sized Banks [E.g. Metrobank, Lloyds]
- More uncertain ones:
  - International Banks [E.g. HSBC, DB]

Portfolio Review via a Pie chart



- Generally diversified, though ones in the TT and IMREC to watch out for, at a Micro-level. AZN overloaded.
- No Financial Services (doesn't mean we need) and no Utilities (we probably need)

Stocks suggestions

A bit of technical background:

- Dividend discount model

$$PV \approx \int_{t\geq 0} \frac{D(t)}{r(t)} dt = D(0) \int_{t\geq 0} \frac{g(t)}{r(t)} dt$$

- Interest rate structure with an aged example

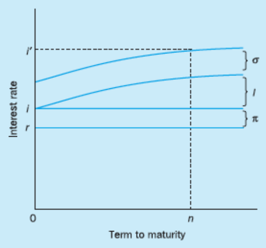
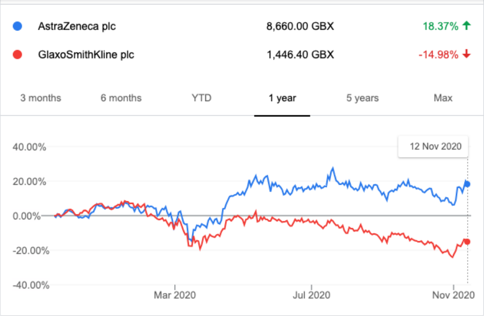


Figure: Howells and Bain (2008, pp.213 – 221)

Company / Ticker	Industry	Div Yield (ann. %)
SSE	Utilities	5.8
GSK	Healthcare	5.5
NG	Utilities	5.1
United Utilities	Utilities	4.6
Tesco	Retail	4.3
WHSmith *	Retail	4.2
Pennon Group [8] *	Utilities	4.2
Morrisons	Retail	4
Severn Trent	Utilities	3.9
Sainsbury's	Retail	1.6

- Only FTSE 350 companies are considered, due to the restrictions as per the charter. The ones with * are in FTSE 250, and the rest are in FTSE 100.
- Data collected on 12 November.

[8] Owns South West Water



	AstraZeneca plc AZN (LON)	GlaxoSmithKline plc GSK (LON)
Mkt cap	113.65B	72.57B
Employees	70,600	99,437
P/E ratio	60.20	11.42
Div yield	0.025%	0.055%

Figure: GSK vs AZN (Source: Google Finance)

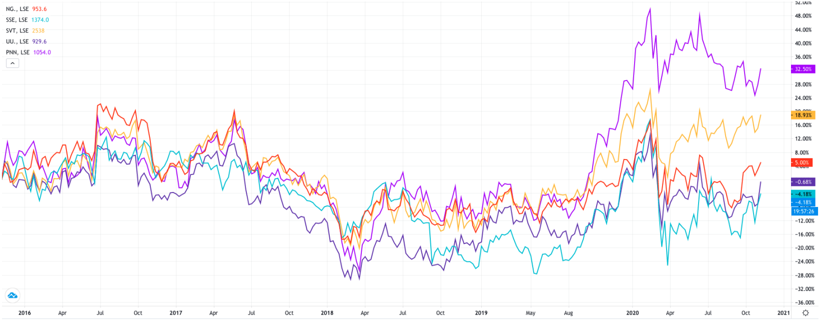


Figure: Comparisons within the Utilities' lists (Source: Tradingview)

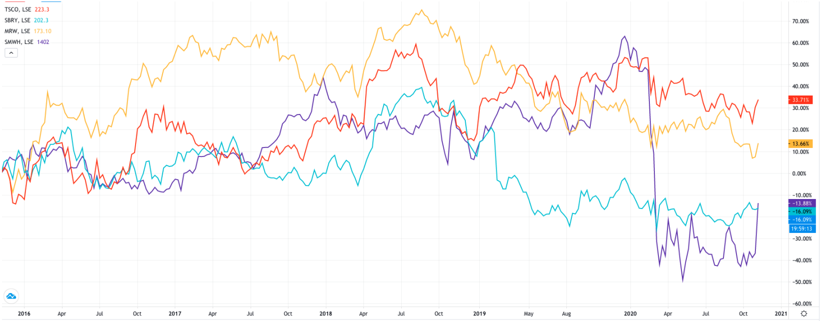


Figure: Comparisons within the Retail's lists (Source: Tradingview)

> "The only function of economic forecasting is to make astrology look respectable."
>
> — Professor Ezra Solomon (1985)

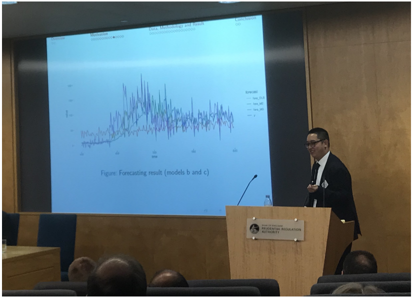


Figure: My BoE presentation in 2019

Figure: Nikkei 225 since 2011 (Source: Tradingnomics)

Figure: A screen shot of my interview took place in 2011 (CCTV Documentary)

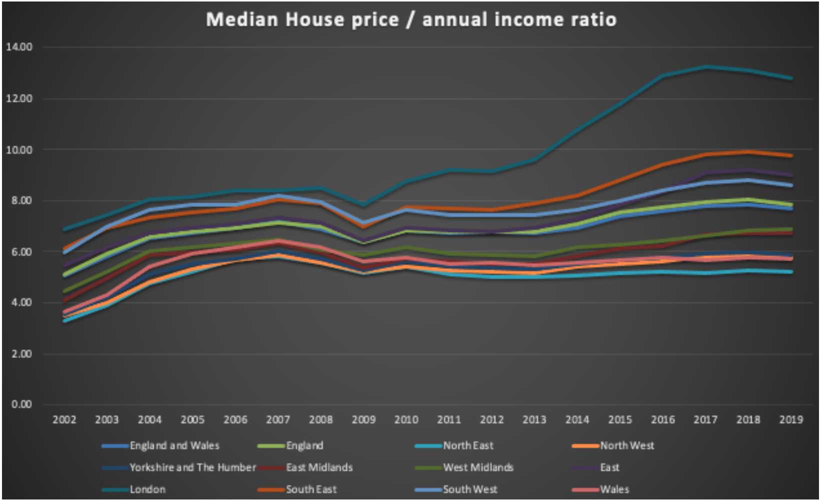


Figure: Data: ONS

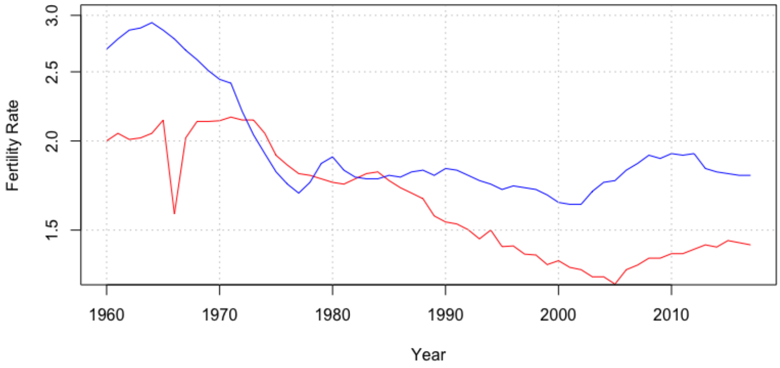


Figure: Blue is the UK, and red is Japan. Data: the World Bank

Back

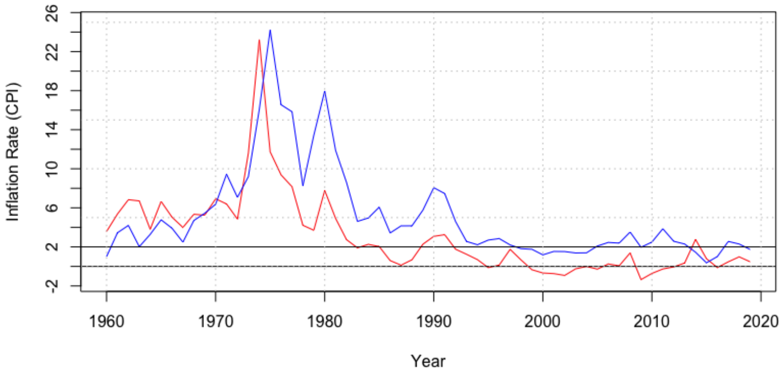


Figure: Data: OECD

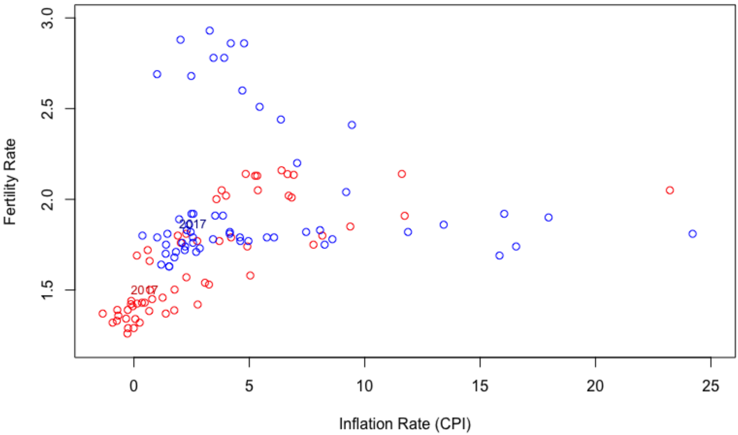


Figure: Data: OECD and the World Bank