

Drivers of change

We believe these drivers include:

Renewable energy - The production/generation of electricity is shifting from fossil fuels to renewable energy sources.

Have versus the have-nots - The “have-nots” are being continually bombarded with information about the gap between themselves and the “haves”. Real-time communications and social media have turned this into a powerful force.



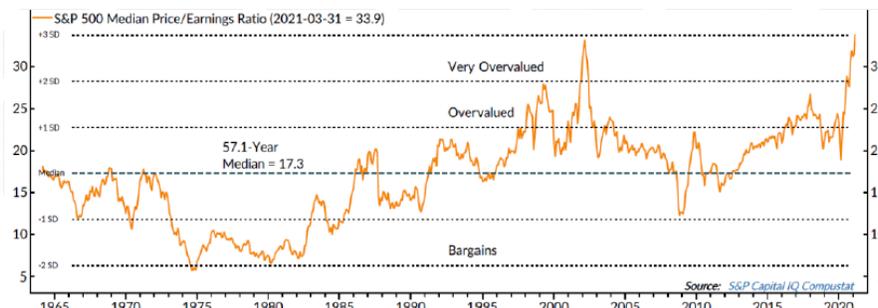
China - China and the United States have entered into a multi-decade long cold war.

Velocity of money - The velocity of money has reached an unsustainably low level and will have to rise (significantly). This is important because it may promote problematic inflation and undermine the Federal Reserve’s ability to pursue helpful monetary policy.



Interest rates - Inflation-adjusted risk-free interest rates have reached unsustainably low levels and will have to rise (significantly). Today, a 10-year Treasury bond is paying about $-\frac{1}{2}$ % after inflation. Such a level amounts to Mr. Market saying “*Yay, the economy won’t ever grow again, and is in a permanent recession.*” In growing economies, inflation-adjusted interest rates remain positive - in other words, investors expect to get paid for lending out their money.

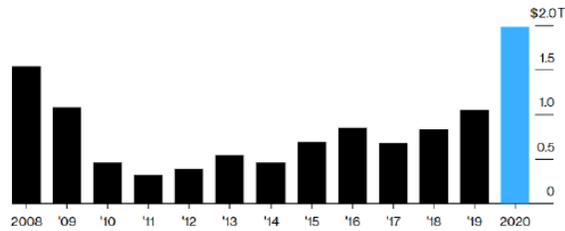
Valuations - The expected return for the most popular risk premia are overly compressed and will have to rise (significantly). In other words, valuations are stretched.



Zombies - There is an unsustainably high number of zombie companies, this will self-correct. Zombies are companies who are negative cashflow, and are only able to persist due to the temporary abundance of endless ultra-cheap credit.

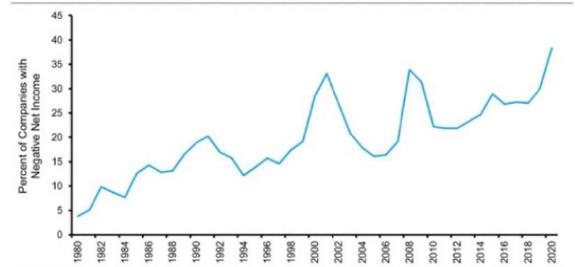
Undead Debt

Zombie firms are sitting on an unprecedented \$2 trillion of obligations



Source: Bloomberg
Note: 2020 figures are as of most recent quarterly data

Exhibit 5: Percentage of Companies in the Russell 3000 with Negative Net Income, 1980-2020



Source: FactSet
Note: Constituents of the Russell 3000 Index as of year-end.

Environment and demographics -

Environmental and demographic shifts will result in a meaningful increase in geopolitical conflict.

Creative destruction - There is a large and growing gap between those countries who maintain a robust ability to adapt, innovate, and engage in creative destruction . . . and those nations who are becoming increasingly rigid and inefficient as they attempt to avoid the pain of reinvention.



Creative Destruction is the essential fact about capitalism.

- Joseph A. Schumpeter -

AZ QUOTES

Future investment success

Directional change of this type and magnitude is nothing new, although we only experience it perhaps twice each century.

An important observation - Looking back at history, we appreciate that the opportunity for a successful investment journey is neither diminished nor made less likely during such turbulent times. Instead, as has been observed by others *“Change is the parent of opportunity”*. Our experience teaches us that future investment success is likely to require:

- Humility,
- Forward-thinking,
- Independent thinking, apart from the crowd,
- Forbearance against *“picking winners”* or *“predicting market turning points”*,
- Equal focus on possible market opportunities and potential market risks, and
- An appreciation that the future will be quite different from the past.

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