# THE GREAT NORMALISTION

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The story begins back in October 2008 – the economic world as we know it was about to end. Capitalism had received a lethal blow and the banking sector was melting down – the Great Financial Crisis was in full swing. Lehman Brothers had collapsed and many others including Royal Bank of Scotland, which had grown quickly to become the world's largest bank was in severe financial difficulty. The world's leaders met to discuss coordinated action and how best to rescue the situation.

It was the British government's decision, announced on 8 October 2008, to take a controlling interest in three major banks that prompted the Europeans, followed quickly by the Americans, to do likewise. The Europeans followed suit on 13 October and the Americans, prompted by Gordon Brown, the next day. It was the turning point.

The following April Brown, chairing the G20 summit, would also take the lead in persuading world leaders to inject an unprecedented trillion dollars or more into the IMF and the World Bank with a view to stabilising the global economy.

Interest rates were slashed to near zero and further measures were investigated to stimulate economies recovering from the biggest exogenous shock the financial system had perhaps ever been dealt. Whilst the Bank of Japan first executed quantitative easing (QE) things really kicked-off under Federal Reserve Chairman Ben Bernanke and this set the tone and direction until very recently. QE was designed to stimulate the economy in a zero-interest rate world.

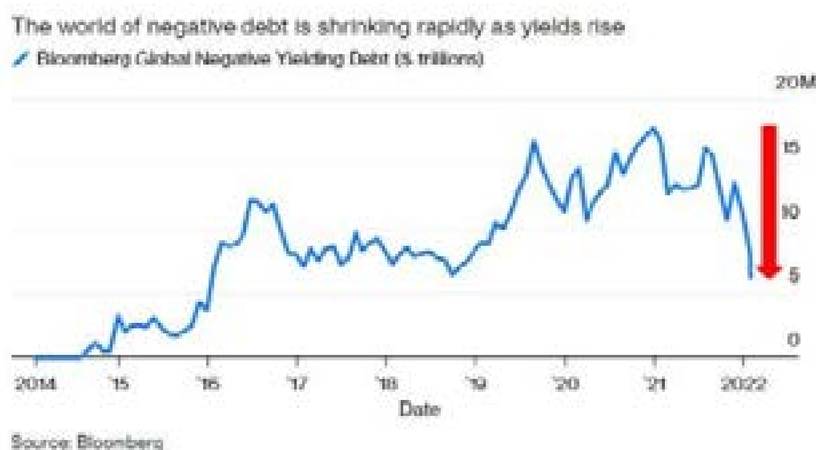
The mechanics of this effort entailed central banks buying up assets such as Treasuries, mortgage-backed securities (MBS), corporate bonds, and stocks, in some instances. By buying up these assets and essentially removing them from the economy, central banks were increasing liquidity in the system.

If there is a criticism of Ben Bernanke it is that his actions were not bold enough and an economic recovery took a full decade to manifest. "Go big and go early" was very much the phrase to describe actions of the Federal Reserve under its new Chairman Jerome Powell, when faced with the next major global issue in the unwelcome guise of the first pandemic in a century. Central bank intervention was again credited with saving a major market collapse and thus preventing a deep and prolonged recession. QE certainly had a very material impact on risk appetites which do have an inadvertent effect on the economy through the so called 'wealth effect'. Holding interest rates at emergency levels as well as the overall impact of financial repression has in many ways forced investors into risk assets and propelled their valuations.

Impacts resulting from stimulating economies with huge quantities of financial adrenalin in the form of QE coupled with disrupted global supply routes and a colossal supply shock caused by the pandemic have reawakened the financial vampire called inflation.

This spectre sucks the life out of vulnerable savings and provokes volatility in markets as central bankers and finance ministers muse a remedy. Terms such as "transitory" when referring to inflation are out, words such as "elevated" are in. QE is out, and QT is in.

Negative rates are out, and rate hikes are in. And so, the great normalisation begins. QT is a relatively new central bank weapon, used to suck liquidity out of the economic system without impacting the real economy. Cooling a red-hot economy is no walk in the park. We cannot be totally confident about the efficacy of the medicine prescribed but a reversal of, and the antithesis of what has gone before is most certainly under way. There will be less liquidity circulating in the economies of developed nations at the end of 2022 than at the beginning. The risk of an inflationary spiral must be controlled with eyes trained upon wage settlements. In lieu of heightened wage settlements inflation is likely to plateau and then begin falling later this year.




The vast supply of negative yielding bonds has flipped positive. Annuities are once again a legitimate consideration for retirees. A one-way bet for equity investors and the "everything rally" of the past several years is a thing of the past. Close correlations between global markets are less close than before. The synchronicity of economic cycles is now less global but more regional. As financial adrenalin is steadily withdrawn from developed economies there are bound to be reactions from markets as they adapt to real life without stimulus. The economy is strong and as the patient once again learns to walk unaided after 13-14 years' worth of adrenalin there are bound to be wobbles, however the long-term future certainly looks more healthy and more sustainable without vast injections of QE.

A greener, fairer future with advances in modern medicine and a robust digital infrastructure beckon. Sure, there's much work to do, but the opportunities are there for us to secure and make our own. Companies with the wherewithal to deliver the future will continue to prosper and portfolios holding stocks shaping the next 20+ years are set fair.

Written by the Alpha Beta Partners Investment Team.

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