



July 2020

The Road to Equality

*"A riot is the language of the unheard."***Martin Luther King Jr.**

Why?

As the more loyal of my readers will be aware, the last five Absolute Return Letters were dedicated to Morgan Housel's Five Lessons from History. Let me remind you of those five lessons again:

- #1: People suffering from sudden, unexpected hardship are likely to adopt views they previously thought unthinkable.*
- #2: Reversion to the mean occurs because people are persuasive enough to make something grow, don't have the kind of personalities that allow them to stop before pushing too far.*
- #3: Unsustainable things can last longer than you anticipate.*
- #4: Progress happens too slowly for people to notice; setbacks happen too fast for people to ignore.*
- #5: Wounds heal, scars last.*

Now, think of the rather dramatic incidents of the past few months, and it wouldn't be farfetched to argue that the world is not quite the same any longer. The mayhem started when an unsuspecting public was introduced to a weird little bug called SARS-CoV-2 (subsequently nicknamed the new Coronavirus). As if that was not enough, only weeks later, two American (now ex.) police officers decided to end the lives of two American civilians, both of whom were black.

The first incident in particular caused a massive uproar as it quickly became apparent that George Floyd was an entirely innocent man. The result? Major demonstrations worldwide under the banner "Black Lives Matter" which, although long overdue, was the last thing we needed in the middle of a major health crisis where social distancing is critical. Particularly in the US, at times, it has been akin to civil war in places. With many demonstrators not observing social distancing rules, no wonder COVID-19 is still not under control over there.

You will probably agree that, for society in general, the pandemic and the two episodes of police brutality have all been horrible experiences, but you may also be inclined to think that only the pandemic should be mentioned in a financial newsletter. If that's your opinion, I would have to disagree with you. The two episodes on the streets of Minneapolis and Atlanta

could have far-reaching implications, and that is what this month's Absolute Return Letter is about.

Before I start, I need to raise one more point. Coming from a small country like Denmark where police brutality is rare (but not unseen), watching those two incidents made me sick. Why couldn't they have been resolved with a pat on the shoulder and a "I suggest you go home now, and I am sure you'll have a better day tomorrow"?

Is rising inequality the problem?

As you can see from Exhibits 1 and 2 below, the ultra-rich (the top 0.1%) control about 20% of total wealth in both the UK and the US – actually marginally more in the UK than in the US – but that is about where the similarities end.



Exhibit 1: Share of personal net wealth in the US

Source: *Bridgewater Associates*

Whereas the wealthiest 0.1% in the US have doubled their share of total wealth since the start of the great bull market in the early 1980s (Exhibit 1), the same isn't the case in the UK where the ultra-rich have increased their share only modestly more recently (Exhibit 2).

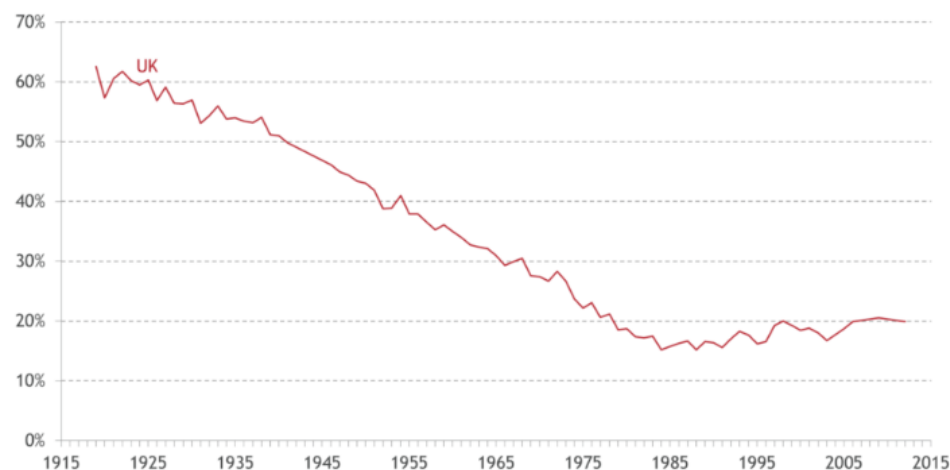


Exhibit 2: Top 1% share of personal net wealth in the UK

Source: [Resolution Foundation](#)

In the past, I have repeatedly pointed towards the growing socioeconomic problems emanating from the rising gap between rich and poor (which is, in fact, one of the six megatrends we

have identified). As I have stated before, falling living standards amongst the bottom 90% in society is a massive problem, and that problem is well-documented.

Usually, living standards are measured in absolute terms, but do not underestimate the impact it may have on behavioural patterns, even if the decline in living standards is only relative. When the rich continue to add plenty of wealth, and your own wealth only grows modestly by comparison, you will feel poorer even if you aren't.

Given the rapid rise in wealth amongst the ultra-rich, it is therefore no wonder that many Americans feel poorer today than they did a generation or two ago. Adding to that, for most American workers, real wages have hardly changed for more than 50 years. As you can see below, while US paycheques are almost ten times bigger today than they were in 1964, their purchasing power has barely budged (Exhibit 3).



Exhibit 3: Average hourly wages in the US (seasonally adjusted)

Source: [PEW Research Center](#)

Likewise in the UK, although the phenomenon is of a more recent date. As you can see below, earnings in the UK, when measured in real terms, have declined since the dark days of 2008 (Exhibit 4). According to the Guardian newspaper, a 2018 study found that UK wages are up to a third less these days than in 2008 when measured in real terms. You can find the Guardian's reference to that study [here](#).

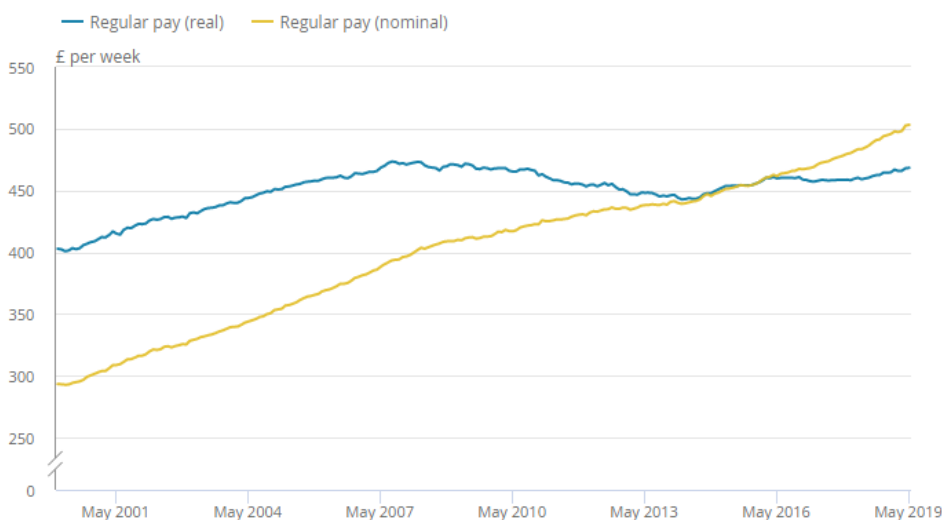


Exhibit 4: Average weekly earnings ex. bonuses (seasonally adjusted)

Source: [ons.gov.uk](#)

For long, I have argued that rising inequality is one of the underlying reasons why the electorate have made some unusual choices more recently. Think Brexit – with the average UK household under rising financial pressure, a scapegoat had to be found, and it didn't take long for political opportunists like Nigel Farage and Boris Johnson to take advantage of that.

The unlucky generation

My parents were both born in 1935 and belong to the lucky ones. As the great bull market started to unfold in the early 1980s, they were in their prime savings-wise. My generation has

not been quite so lucky but haven't done too badly. The big losers are the millennials with the average millennial walking into one crisis after the other.

High property prices haven't made life any easier for them, and the government added insult to injury by allowing universities to charge excessively high fees, which will almost certainly lead to many millennials *never* paying off their student debts. Lower earnings and lower wealth (Exhibit 5) is therefore virtually set in stone for many of these youngsters, many of whom may never recover financially (source: [Washington Post](#)).

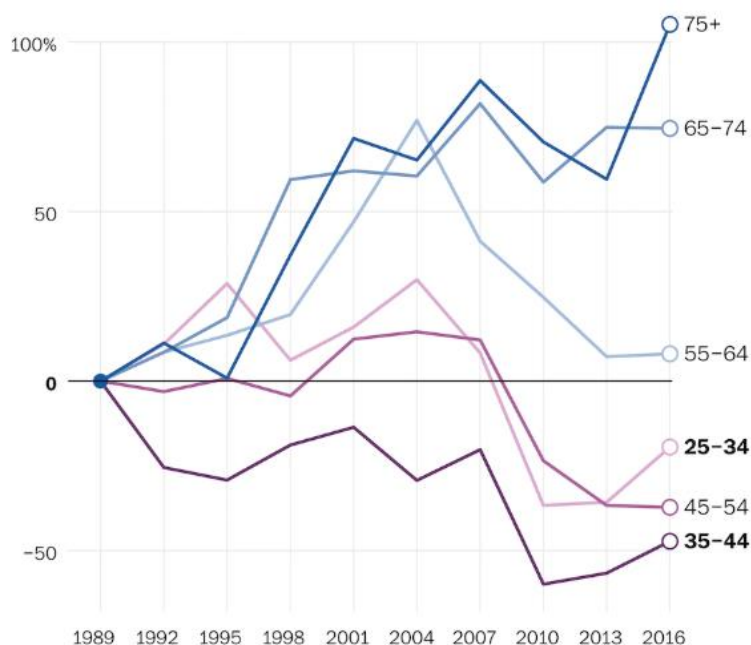


Exhibit 5: Change in US wealth by age group since 1989

Source: [Washington Post](#)

In other words, the younger generations of today have only a tiny cushion (if any at all) to help them through difficult times – caused by disease, unemployment or otherwise – and this is where COVID-19 enters the frame again. Americans in their 20s have taken by far the biggest hit employment-wise when corporates started to lay off staff in reaction to the pandemic (Exhibit 6).

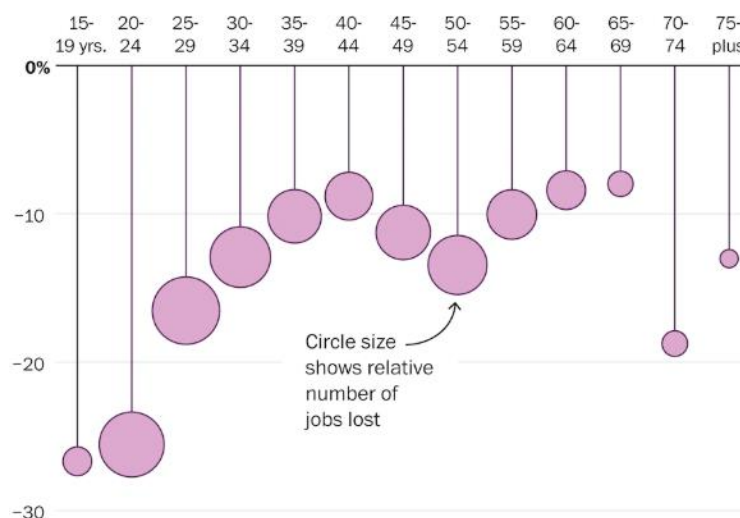


Exhibit 6: US job losses in March and April 2020 by age group

Source: [Washington Post](#)

The information in Exhibits 5 and 6, when combined, tell you more than 1,000 words – it provides another reason why young Americans have been on the barricades more recently. Of course black lives matter to them, as they do to all of us, but, by acting so resolutely, I think

the message from them is not only a message about oppression against blacks. It is also a cry for help to address rising financial insecurity – similar to the cry for help that came from the man in the street here in the UK in June 2016 when he wanted out of the EU.

My point is a very simple one – when financial insecurity is on the rise, issues that were previously under control suddenly aren't any longer. More importantly, the least likely way to address those sorts of issues successfully is more police in the streets and, if you want to make absolutely sure you fail, you arm them heavily. There is a much more peaceful solution at hand – 'just' ensure living standards amongst the bottom 90% begin to improve again.

The global inequality picture

The Gini coefficient is named after Corrado Gini, an Italian statistician who, in 1912, developed it to measure inequality across a distribution of statistical data and is used today mostly to assess either wealth or income equality. Theoretically, the Gini coefficient varies between 0 and 1 with 0 suggesting no inequality at all, but extreme values close to either 0 or 1 are rarely reached. Furthermore, as is almost always the case, the income Gini coefficient is typically much lower than the wealth Gini coefficient, so don't be surprised if a country is very equal when measured on income but not on wealth.

As you can see in the chart below, when measured on income, there is no clear pattern as to whether inequality worldwide has increased or diminished in the last 25 years, but there are certain trendlines: (i) OECD countries are, on average, more equal than EM countries; (ii) the average OECD country is less equal today than it was in 1990, and the opposite is the case as far as EM countries are concerned; (iii) there are certain geographical patterns – Latin America, for example, is high on inequality; and (iv) as the average Gini coefficient is falling, overall inequality levels are converging (Exhibit 7).

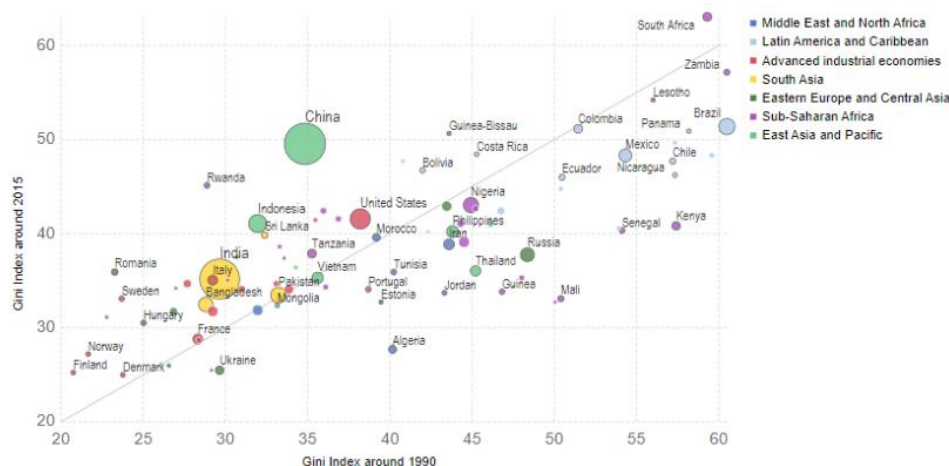


Exhibit 7: Income Gini coefficient by country in 2015 vs. 1990

Note: The Gini coefficient is a measure of inequality. The higher the coefficient, the more uneven total wealth is shared.

Source: [World Economic Forum](#)

The five Nordic countries are often regarded the most equal in the world, and the statistics from World Economic Forum support that view. As you can see, income is distributed more equally throughout the Nordic region than almost everywhere else. However, what is also interesting is that the Nordic countries have all turned less equal over the last 25 years (they are all above the diagonal line).

As far as wealth equality is concerned, not surprisingly, the US is the least equal OECD country (Exhibit 8). The chart only includes OECD countries but, if you glance over the global list of wealth Gini coefficients (which you can do [here](#)), you will note that the US is less equal than many EM countries. That raises the question – could American policy makers address current socioeconomic problems by tackling the inequality problem?

One could argue that this was (and presumably still is) the agenda of Bernie Sanders and Elizabeth Warren, both of whom lined up a programme during the US primary elections which

many Americans consider socialist, but maybe I could persuade one of my readers to call Trish Regan and tell her how Denmark differs from Venezuela?

What do I mean by that? You may or may not be aware but, back in 2018, the Fox Business anchor, Trish Regan, had the audacity to compare Denmark with Venezuela live on morning TV in the US. Back in March of this year, she went one step further by suggesting that all the concerns about the Coronavirus was “yet another attempt to impeach the president”.

Not even Fox News would tolerate that, and she was benched (to use the term they applied). Although she probably doesn’t realise it, at least on one point, she is spot on. In both Denmark and Venezuela, wealth is concentrated on remarkably few hands, but that is about where the similarities end. To argue that Denmark is similar to Venezuela was beyond a joke and only served to underline her political agenda which was (and probably still is) very pro-Trump.

The point I want to make here is that, years ago, the Nordic countries learned that the man in the street cares much less about wealth inequality than he does about income inequality, and that social stability is a function of the latter – not the former. In other words, if you want to foster inequality, make sure it is on wealth rather than income. That may at least partially explain why the wealth Gini coefficient is so high in the Nordics (Exhibit 8).

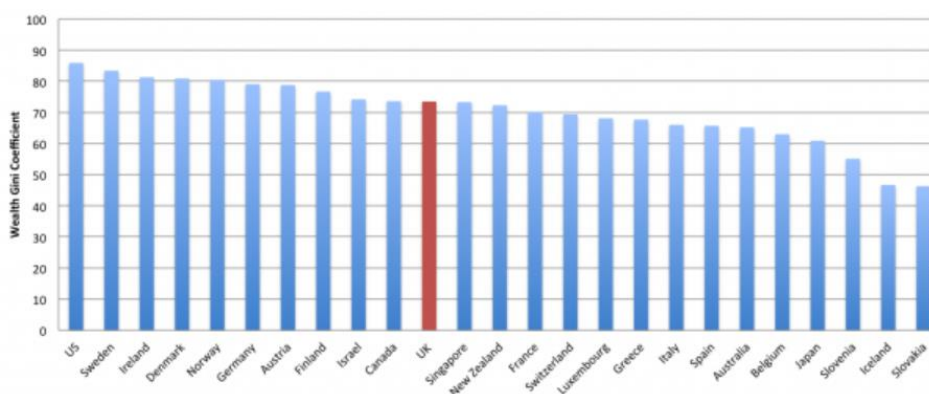


Exhibit 8: Wealth Gini coefficient by country (selected OECD countries)

Note: The Gini coefficient is a measure of inequality. The higher the coefficient, the more uneven total wealth is shared.

Source: World Economic Forum

Investment implications

Who will end up taking control of the White House, following the elections in November? The answer to that question will influence financial markets massively for years to come, so we need to look at both possible outcomes.

Trump first. Due to his mishandling of the Coronavirus crisis, he has already been written off by many, but that is premature, I believe. Election day is still more than four months away, and an awful lot can happen between now and then. 30-40% of all registered voters in the US will vote for him irrespective of what he says or does; hence, a relatively small number of people need to change their minds between now and November for him to win again, and that is by no means impossible. The key to a successful outcome for him is the US economy – how fast it will rebound, which is why he is desperate to kickstart it, regardless of the cost.

Let’s assume he wins. Corporate America will benefit, and the gap between rich and poor will continue to increase; i.e. social disorder on the streets of America will probably continue unabatedly. Having said that, US investors probably won’t care about that, so expect US equities to continue their rise, at least for some time to come, assuming Trump wins.

Longer term, his confrontational and isolationary policy programme will, all other equal, lead to lower economic growth *everywhere*, as international trade is an important driver of GDP growth. Expect the impact in the US to be relatively modest, though, as international trade is not as important to the US economy as it is to most other economies. US investors probably won’t bother too much about Trump’s nationalistic agenda anyway, so expect the feast of recent years to continue for a while longer with Trump in the White House.

On the other hand, should Biden win, US equities are not likely to perform as well in the short to medium term. Although Biden is not nearly as radical as Saunders or Warren, according to my source, he is fast becoming a puppet in the Democratic Party, which is increasingly left-leaning – at least by American standards, although most Europeans would laugh at that label.

The Democrats have come to realise that someone like Saunders will never win a presidential election, i.e. they need a calm front figure that the average American trusts and, for that purpose, Biden is perfect. However, behind the scenes, a more radical programme is planned (my source tells me), which will be good for America longer term but bad for the stock market in the short run. Over time, though, it will almost certainly prove more successful than Trump's bouquet of slapdash policies.

A few final words

Inequalities in society may not be at the forefront of your mind when you invest, and you are probably not alone in thinking that way. What you may not realise, though, is that more and more of your peers in the financial community are opening up their eyes, realising that the decisions they make actually have significant implications on society.

As an investor and a member of the financial community, whether you represent a pension fund, an investment management company, or you are an individual investor, you can play an important role in reducing these social inequalities. Furthermore, although it may seem like too large a mountain for you to climb, if we all in the financial community work together, over the years, positive change is achievable.

The COVID-19 pandemic has brought to light many inequalities. Companies all over the world have reduced costs to survive. That is perfectly acceptable but, if the staff has been saddled with most of the cost cutting while senior management continue to enjoy excessive levels of pay, a red warning sign should light up in front of your eyes.

Luckily, as a steward of capital, you have the ability to vote with your feet which is a very powerful tool. The UN runs a number of equality programmes, and one way to invest is to invest only in funds that subscribe to one or more of these programmes. You do have to be careful, though. Sometimes the investment manager will say that he is committed but, in reality, it is only a marketing gimmick.

Years ago, when I first learned about the concept of responsible investing, the more cynical side of me thought those who adopted the principles behind it did so to ensure that they were seen as being politically correct, but those days are long gone. Responsible investing has become a powerful alpha generator, as the principles behind it are followed by a growing number of investors. You may therefore not only get a kiss on the cheek from an adoring mother-in-law if you invest responsibly – you also stand a pretty solid chance of outperforming.

You won't hear from me again until after the summer - early September to be more precise. I wish you a splendid summer despite all the problems we have had to deal with this year. Most importantly, I urge all of you to respect social distancing rules.

Stay safe!

Niels C. Jensen

1 July 2020

PS. I have had an unusual amount of help from various colleagues when putting this letter together. Thank you so much to Shameek, Soham and Alison for making valuable contributions to this month's Absolute Return Letter,

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