GEOPOLITICS CAUSE SWINGS BUT NO DIRECTION

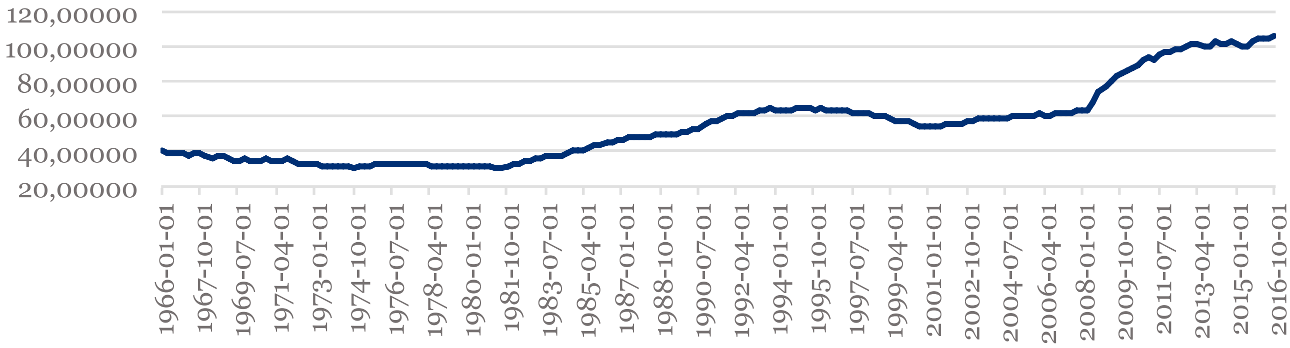
Peter Lundgreen, CEO Lundgreen's Capital

> Right now the world is in the midst of a period where many governments are reshuffled - this should lead to reforms and new political impetus which always is interesting for investors.

The U.S. presidential election last November sparked a changed focus in the financial market. Geopolitics moved much higher on Wall Street's agenda after surprising election results in the United Kingdom and United States. At the same time the quantitative easing started to lose importance in the United States. Monetary policy was set aside and among American investors, and I suddenly explored an unusual discussion about significant European elections in 2017. Now we are already in the middle of the geopolitical year 2017 and the fact is that geopolitics so far has not played the key role it was expected to do just half a year ago - maybe because many expect geopolitics equals with direction or alternatively change a direction?
In about three months the financial markets, economists, supervisory boards etc. are already in the process of looking into 2018. With the focus on geopolitics at the beginning of 2017 it will be natural to consider the weight of the geopolitical factor when looking forward.
Not only this year, but throughout the period after the financial crisis, the political impact on the economy, including the financial markets, has weighted heavier than before the financial crisis. A distinct example is the quantitative monetary policy initiated in the United States and copied by many countries since then. One could argue that central banks are behind the monetary policy, which is correct, but these actions are either wholly or partly politically determined and would never have been implemented without political acceptance. Another example on the bigger political influence on the economy since the financial crisis is the development in the government debt as share of GDP. Graphic one shows the development in the U.S. sovereign debt during the past 50 years. In the 40-years period from 1966 to 2006, the government debt moved between 30 and 60 pct. of GDP. The political counter reaction to the financial crisis was a highly expansive fiscal policy that sent the public debt to the current 106 pct. of GDP. Thus, since the financial crisis, the politicians operationally have participated more actively in the U.S. economy than before the financial crisis. Exactly the same picture is found in many other western countries (Germany excluded).

The significantly stronger political influence on financial markets through the quantitative easing policy and expansionary fiscal policy is well known. The initiatives have had great influence across markets and borders but none of the initiatives have been described as „geopolitics". The reason might be that quantitative easing and expansive fiscal policy generally are regarded as economic cure the world economy is going through before self-sustaining economic growth reassumes again. Furthermore many in the financial markets maybe have not registered the measures as geopolitics. The quantitative easing and expansive fiscal policy is very comfortable as assets have gone up in value almost every day and therefore the politics / policies have not generated critical comments in any

USA - GOVERNMENT DEBT AS PCT. OF GDP FROM 1966 TO 2016



Source: FRED, Fed St. Louis, USA

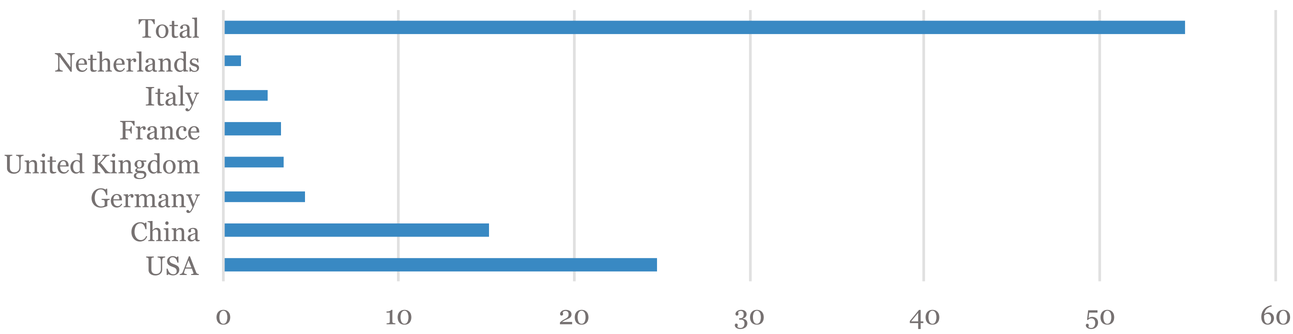
large scale. The geopolitics that the financial markets consider as a higher risk since President Trump was elected I perceive more as the unpredictability of election results rather than a risk of political change of direction. It's a fair question if this is not just a discussion about words - if the majority of voters change their position there is a political change of direction? I observe that differently, since it is extremely important to determine when a risk can occur. In a geopolitical context it is currently when parliamentary elections and important national ballots takes place. The predictability of an election result has obviously become completely impossible which the parliamentary election in United Kingdom 8th June once again proved.

I categorise that kind of uncertainty as an „event risk". Therefore, I expect investors to be more active than earlier in hedging a larger part of their portfolios ahead of important elections. It will be more demanding concerning the timing of the hedging and I expect larger market fluctuations around elections than the financial market has experienced since long. This is actually the biggest geopolitical impact that I expect the financial markets will experience the next 9 to 12 months but thereafter it could be different. Graphic two shows all countries that represents minimum one pct. of the global GDP and where there has been, or will be, an election or a new government in the period from November 2016 to May 2018. In total, 18 countries in the world have a share of at least one pct. of global GDP. Out of these 18 countries the 7 countries in the graphic represent 54.8 pct. of global GDP. This could provide the financial market with the hope that a new geopolitical direction will now emerge after almost a decade with quantitative easing and expansive fiscal policy.

Concerning the most recent election results I argue that it is primarily the electorate fleeing from the existing political landscape rather than a genuine choice of a new political direction. Even the convincing election victory for President Macron in France is founded on an escape from the Socialist Party which has been wiped out. My assessment of Macron's policy remains that it does not contain strong reform measures although some may want to argue so. In the United States there is a lack of direction and the same is a certain risk in Great Britain after Prime Minister Mays defeat. Depending on who one listens to in China some hope that in President Xi's second legislature, starting in November, China will experience a completely different reform speed - one can choose to believe in this hope….

I interpret the geopolitical focus in the financial markets as higher expectations about new impulses or directions. The reshufflings in governments in the leading economies should support the trust in new initiatives and reforms. But I am on the contrary increasingly concerned that geopolitics won't give any significant impulse or direction. The reason is very simple - I don't see any government coming up with new directions which could play an important role in mowing economic growth to a higher level. In my conviction model I now give a higher weight to this situation and it will in particular be a negative factor for stock markets in about 12 months' time.

COUNTRIES WITH NEW GOVERNMENTS 2016 - 2018 SHOWN PCT. OF GLOBAL GDP



Source: GDP data is from IMF

Hammerensgade 1, 2. sal, DK – 1267 København K
Telephone +45 70 26 88 55 VAT. Nr. DK 30 73 72 45
www.lundgreens.com

Media Contact: Melissa Vergara
Communications & PR, Lundgreen's Capital
melissa.vergara@lundgreens.com