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FREEDOM IN A FRACTIONAL RESERVE SOCIETY II
Long-Term *Winners* From the Pandemic

Two weeks ago, we wrote an essay discussing the delicate balance in a free society of security and freedom (Long Term Losers From The Pandemic). Before discussing the potential losers in this brave new world – China, globalization, the Euro, illiquid private investments, high-priced college instruction, etc. – we came to the conclusion that anyone in a position of leadership who must think about the lives of others is likely to err on the side of prudence in a post-COVID-19 world. Businesses and societies will no longer be able to organize themselves, like banks, in the fractional reserve manner that has been so in vogue since the end of the Cold War. Ultimately, higher reserves mean less leverage, lower growth, and skinnier profit margins. Today, we turn our sights on to the long-term beneficiaries, rather than the losers, of such a world.

On-Shoring/Domestic Labor: Perhaps it was too good to be true for free-traders and capitalists alike to have an entire society embrace the tradeoff between profit margins and access to cheap foreign goods and the rapid disappearance of the working class in the United States. Shockingly, no new Dick Gephardts emerged to question the long-term utility or wisdom of such an arrangement. That was, with the benefit of hindsight, largely a function of the fact the well-heeled elites from both sides of the political aisle benefitted disproportionately from it. In a not-insignificant amount of time, there will be real and justified anger over the embrace of the ersatz free trade arrangements the West accepted with China. This will inevitably impair profit margins and increase labor's share of corporate income.

Nationalism/Populism: Human beings tend to become more tribal in times of stress rather than more cosmopolitan. It seems rather pointless to bemoan or celebrate this fact of life - anthropologically, we aren't all that different than the other species that occupy our planet. A little more than four years ago, the Brexit movement was seen at first as a joke and then as idiosyncratic. A similar phenomenon occurred when Donald Trump was elected President. For the past several years, *The Economist* and the *Financial Times* have attempted to place a flag in the ground on the "peak populism" story. Occasionally a local election in Germany or Italy or a southern state in America gives them hope that this was all a bad dream and that people will finally come to their senses. It hasn't happened and the magnitude of the global recession we are about to face would suggest that populists – either from the right or from the left – will have the upper hand in democracies.

<u>Gold:</u> To the extent to which one believes that globalization contributed to both stronger growth and lower inflation in the aggregate over the past 30 years, a fair-minded person would need to acknowledge that greater parochialism is likely to lead to lower growth and higher inflation over time. While the global response to the coronavirus is manifestly deflationary in the short-term, the underlying bid to gold in almost all major currencies suggests that investors have less confidence in fiat money than they did six weeks ago. This seems reasonable to the extent to which politicians in democracies often derive their power from giving things away rather than taking them back. A Fed balance sheet north of $6 trillion and budget deficits approaching 10% of GDP will be difficult to unwind. As H.R. Haldeman once cautioned John Dean "once the toothpaste is out of the tube, it's going to be very hard to put it back in."

<u>Public Equities:</u> Unfortunately, in the aftermath of the Global Financial Crisis in 2008-2009, many asset allocators in charge of large sums of money started to conflate the concepts of risk and volatility, viewing them as largely the same thing when they are demonstrably not. The primary allure of difficult-to-mark private investments was, in the final analysis, the fact they were unlikely to embarrass you at the next investment committee meeting. The impairments on private assets will be large and real now. In the absence of higher inflation, only a demand-side shock of this magnitude could reveal the weaknesses of this line of thinking. Many state pension plans and other fiduciaries find themselves loaded with highly illiquid investments at the same state and local revenues are falling precipitously. Ultimately, many may have no choice but to double down on equities to make up the shortfall. After this episode, however, liquidity will trade, as it should, at a premium.

<u>Active Management:</u> Naturally, consider the source. I have been saying that it was time for active management's place in the sun for the better part of 10 years. This may have something to do with the fact that all of Strategas' clients are active managers. In retrospect, the greatest enemy to active management was not a lack of talent – it was the "everyone gets a trophy" nature of financial repression and lower, and far less volatile, rates of inflation. While rates are likely to continue to stay low for the foreseeable future, access to the capital markets is likely to be rationed for a long-time to come. Quality will count more in such an environment. So will stock pickers. The likelihood of greater volatility may also render mutual fund cash levels an important driver of alpha once again.

Telehealth: It seems reasonable to assume that if your average consumer might feel queasy about, let's say, going grocery shopping, he might also be less inclined to visit a doctor's office or a hospital filled with potentially sick patients. In just the last five weeks there has been significant deregulation of the "practice of medicine using technology to deliver care at a distance" according to the American Academy of Family Physicians. Passing only about a month ago on March 17th, the first significant piece of COVID-19 legislation greatly expanded telehealth reimbursement to in-home patient care. It also eased some of the geographical hurdles inherent in receiving coronavirus care. Regulations were eased further with the passage of the second COVID-related piece of legislation on March 31st. It is a fractured industry of private players but Teledoc (TDOC), UnitedHealthcare (UNH), and Anthem (ANTM) should all benefit greatly.

On-Line Education: In another area of government subsidies that have led to price increases multiples of the rate of inflation, it would seem that education is also a prime target for dislocation. As we discussed two weeks, ago it would not be surprising, due to both the depths of the recession we are about to enter and common sense, for students and their families to start to question the exorbitant costs of a college education. It also seems likely that more people will realize that one can pursue a higher education and also work in the trades for a good salary simultaneously. The idea that young people must make a choice between pursuing a college education and forgoing a fulfilling and economically prosperous life will have been revealed to be a false one.

This is by no means an exhaustive list, simply a representative one. The trend toward e-commerce was well established before the coronavirus and seems likely to only accelerate. Please send us your ideas for additional potential winners. We will update our lists as time goes on.

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