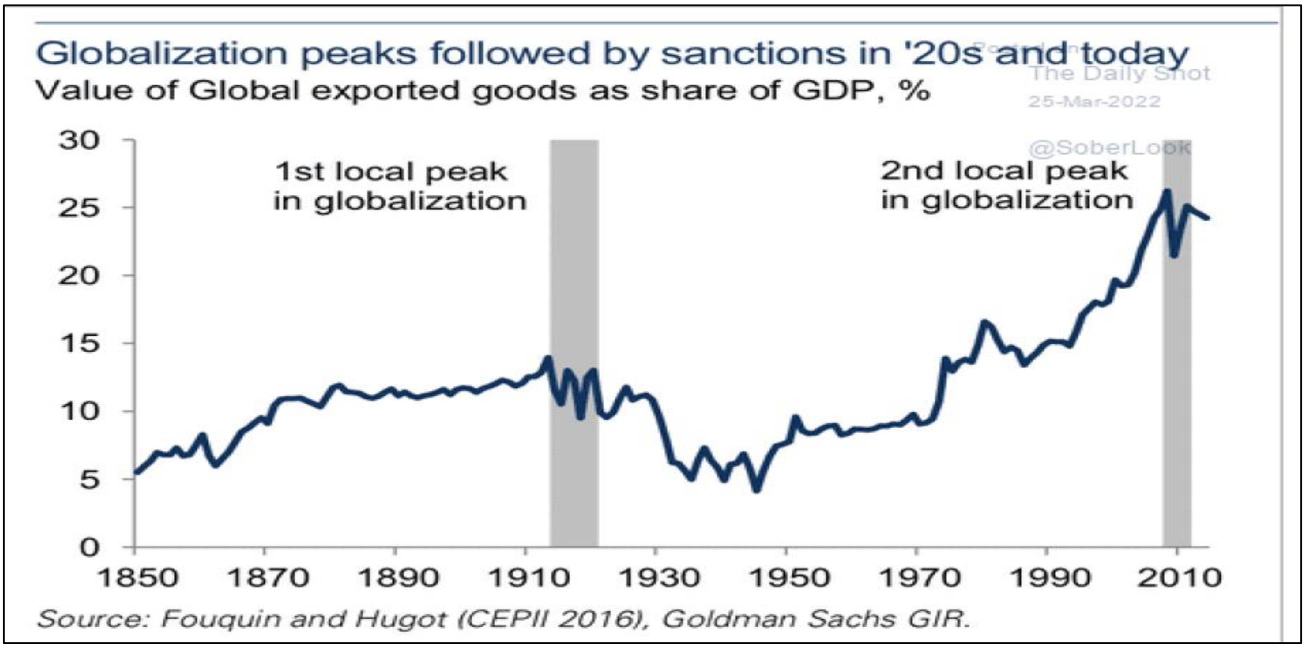
Globalization & Inflation

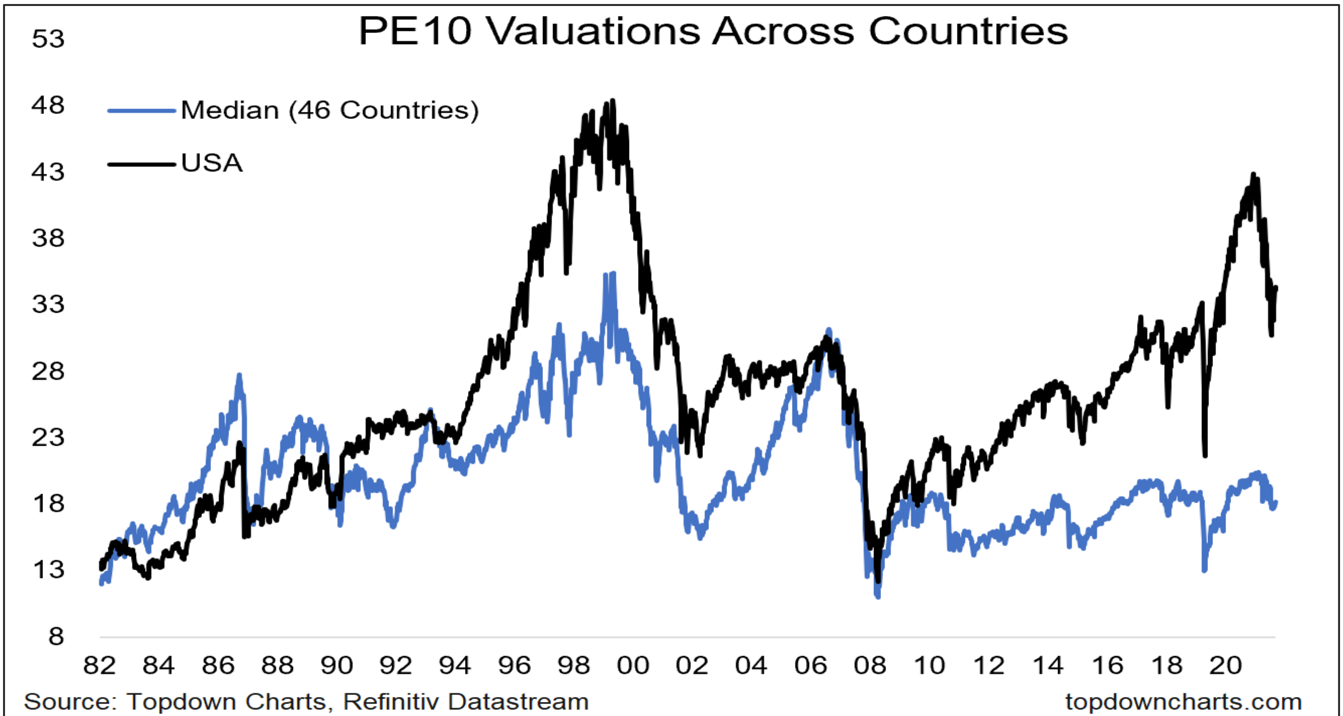
- Past 150 years have seen 2 local peaks in globalization, 1914-20 & 2008-11. In the immediate aftermath of 1st peak, inflation surged globally. It took until 1970s for globalization to resume its previous march upward when de-globalization costs proved too expensive to maintain in face of commodity & price inflation.
- When globalized system was re-initiated after WW2, the idea was US would look after global security & that meant transport would be fine ensuring secure movement of materials & intermediate products across economies. Globalization was bribe to member countries (NATO) in exchange of a security plan.
- But, something changed after end of cold war (1991). US military deployment dropped by half in 1990s & eventually moved closed to zero in countries like Germany, Korea, Japan with an exception of middle east.
- Shale revolution first with natural gas in 2004 & then with oil in 2008-09; accelerated this change and pushed US to take a backseat in certain aspects of international market; because, from being world's largest importer by 2017-18 they moved to be a net exporter of every sort of energy.
- US has been shifting away from land based military placements to improved Naval strike capacity. They have 11 super carriers that can be used to over throw any government; but they no longer have smaller vessels that would be necessary to patrol global oceans and keep commerce safe.

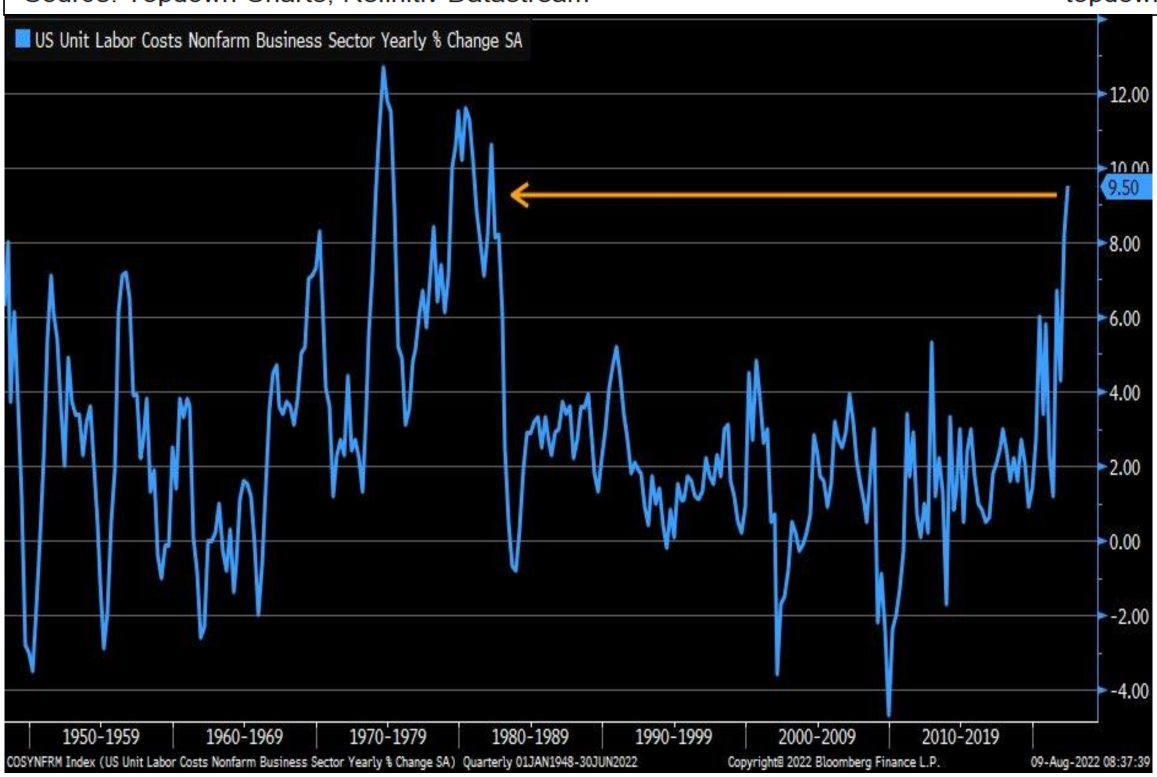
Source: Peter Zeihan



We're getting back to an environment that predominated before WW2, where hard power & the ability to maintain economic coherence was far more important role for government than shaping societal reforms. The level of inflation, interest rates & size of central bank balance sheet will vary across economies as 'each one gets on their own'.

PE10 Ratio (price to 10-year average of trailing earnings -- designed to smooth out the sometimes-gyrations in EPS through the cycle) for USA as well as the median PE10 across 46 countries (aka “global“). We should see this valuation difference coming down as and when USD tops out.



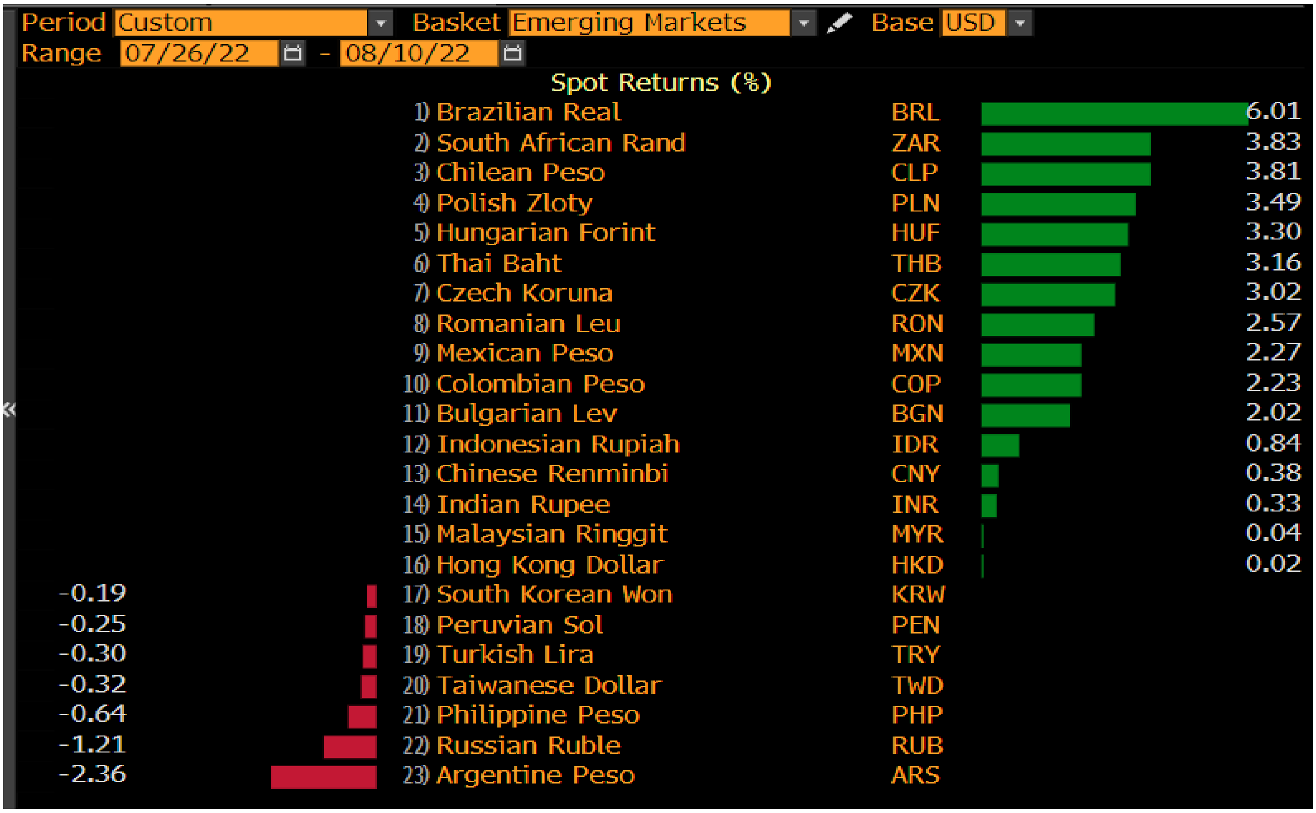


Bigger worry for Fed is not inflation but rising labor costs. Unit labor costs in US soared by 9.5% YoY in 2Q22, largest spike since early 1982.

Charts that Matter!

PineTree Macro

US CPI came below expectations, but EM currencies were already appreciating since last FOMC meet anticipating Fed pivot. Liquidity should start moving to EMs with least negative real rates.



China has been a net seller of US Treasuries for years, with that trend accelerating in the first half of 2022. What will happen as the Treasury increases issuance by 2.5x this quarter with foreign appetite waning and the Fed stepping back?