

# Global Strategy

## Thematic Report

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## How We Think About Markets

In our view, financial markets are mostly micro-efficient but macro-inefficient. By which we mean that currencies, bond yields, equity indices and commodities are forever overshooting fundamental value by large though irregular amounts, before reversing and overshooting in the opposite direction. Moreover, when individual stocks do become wildly over or under-valued, macro factors rather than stock specific issues are usually to blame. By extension we believe that understanding the overshooting process in real time is typically key to sustained alpha creation, no matter which asset class you invest in. And that it can be highly relevant even if you are a smart and dedicated stock picker. *Indeed, at the most extreme moments (the tech bubble, the GFC, COVID for example) there is virtually no investment strategy in the world whose performance is not dominated by macro events.*

Our macro-overshooting focus leads us to think across three different time windows:

- 1) **Secular Trends** in asset prices driven mostly by structural change in the world economy and the long term valuation cycle. Time frame: years to decades.
- 2) **The Global Cycle** in production and trade, which drives intermediate trends in equities, bonds and investor risk appetite. Time frame: 36-40 months from trough to trough.
- 3) **The Short-Run:** dominated by news flow which either confirms or re-shapes market expectations (data surprises, policy shifts, elections etc). Timeframe: days to weeks.

We call this process *Cycling Down the Secular Path* where the cycle in global growth, policy and risk appetite tends to drive most of the overshooting around the longer-term secular trend, which is sometimes surprisingly linear, and sometimes subject to structural breaks or shifts in slope. Shorter-term data surprises and policy events usually affect the path more than the ultimate destination of the medium and longer-term cycle but can be important for market timing.

Our research framework our beliefs about how markets work, while acknowledging how challenging it is to turn good analysis into smart investment decisions. By definition that's always a work in progress that can never be "finished". But three things are perhaps especially important. First, we think it's much better to be broadly right than precisely wrong, especially at key turning points. Lots of detail is psychologically comforting but often a barrier to effective decision making. Second, because markets are forward looking there is a premium on the ability to make good judgements in real time based on incomplete information. There is no substitute for experience in doing that. And third, there are usually only a few moments or themes in any year which make a really big difference to investment outcomes. The never-ending challenge is to keep some mind space free to recognise them a little in advance.

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