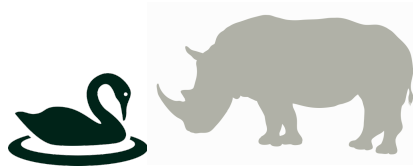


Somewhere Between Black Swans and Gray Rhinos

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*“Evolution was a random walk across a minefield, not a pre-ordained trajectory, onward and upward toward perfection.”
Greg Egan (1961 -), Australian science fiction writer and mathematician*

Most times, we only have a fleeting notion of the risks we face, whether willingly or by chance. There are certain risks that are always the same, we have the tools to prod and measure them to our heart’s content, we know pretty much what to expect and can easily handle them. Then we have the “Gray Rhino” type of risks, examples of which include climate change and pandemics. We see them heading straight towards us but because they usually move at a snail’s pace, we tend to forget about them, losing track and our resolve until it is too late¹. Last but not least are the notorious “Black Swans” that are by their very nature improbable and yet happen more frequently than we would like to think.

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We almost never see them coming and even in those few instances where we do, it still feels like being ambushed. We naturally fear the black swans most when we should instead be focusing on the gray rhinos that not only contain similarly nasty outcomes, but we also see them coming at us. Many of these risk types, black swan included, are almost never of random occurrences, most are just a combination of events or the cumulation of a concentrated few over time. They usually go through protracted build up phases, raising red flags along their way, which doesn’t seem to make us any more likely to do something about them.

It is of course impossible to reconcile experiencing an event for the very first time from the lessons you derive from a hindsight-driven narrative. The threat may seem more obvious with the power of hindsight, but it won’t prepare us for the “next time” if no two events are identical. And then there is the fact that we are constantly being blindsided by our “usual suspects” of cognitive traps. We, for example, tend to see and think linearly in a world that is anything but linear, let alone predictable, and we look at events with granularity, in a vacuum when in fact we should be focusing on the “big picture”, the forest instead of the trees.

Our attention span is limited as most of what happens tends to be “boring”, and even when punctuated by the “exciting stuff”, we still suffer from a mild form of amnesia. Not only does our hard-wired survival instincts attempt to continually

¹ The Gray Rhino is a term coined by author Michele Wucker to describe the threats that we can see and acknowledge yet do nothing about: the ton thing that should be hard to ignore, but from which we look away even though it’s in our interest to get away before it charges. It may be pawing the ground, snorting, and getting ready to charge at you; or it may still be a way up the road when you still have time to manage things before they become urgent.

shield us from the more unpleasant experiences, but it also forces us to think and plan for the near term and thus tactically, rather than strategically in the long term. And just when we thought we had seen it all with two straight years of a very damaging COVID pandemic, here comes another mega crisis, one that could potentially pose an even greater existential threat to our kind.

It wasn't like we didn't see this one coming: just as with the pandemic, there was a clear Gray Rhino build-up phase with plenty of "red flags" along the way. The purpose of Russian troops amassing across the Ukrainian border in the months preceding the attack or even the 2014 invasion of Crimea, a clear "dress rehearsal" to what would come next, couldn't have been clearer. The west failed to prevent this attack in part due an awareness and appreciation of the risks involved, but also possibly because nobody really thought that Russia would be bold enough to do what it did. We would have to go back many decades to find something remotely comparable; our collective memories have clearly become stale over time.

The Russian invasion unleashed a cascade of mini Black Swans unfolding in rapid succession. Nobody really expected the Russian military to suffer such humiliating setbacks, that Ukrainians would put up such a remarkable fight, that the conflict would just linger on or that we would witness an extraordinary degree of unity and solidarity in the west, especially with European populations and their respective governments in applying sanctions and welcoming the huge influx of refugees². Black Swans and Gray Rhinos are inflection point catalysts, they have the power of changing the course of history and it would appear that we are in the midst of one. The unleashing of massive scale targeted economic sanctions on Russia has exposed a major vulnerability for autocrats: a globalization-driven overreliance on a weaponized financial system in the hands of "liberal" democracies.

These revelations will not only serve to accentuate the growing rift and mistrust between the belligerents, but also create a further dent in the globalization drive that is still reeling from the COVID pandemic³. The risk here is that the world plunges back into a cold-war mindset, which would create a major setback for globalization and the global recovery as rival platforms are sought to replace and compete with existing ones (the swift banking system and the US dollar reserve currency come to mind). The emerging crisis may also be fueling another form of risk that carries potentially serious geopolitical repercussions. Inflation is quickly becoming the "elephant in the room" as it trickles down into a broader array of goods including food. We may have forgotten that the Arab spring of 2010 began with a spike in food prices in 2008, triggering riots in 48 countries.

Where Do We Go From Here?

Russia's assault on Ukraine and its growing conflict with the west is adding to the turbulences in trade and causing energy prices to rise further, which means that inflation is becoming of even greater concern across the globe. The unexpected increase in military spending amongst NATO members could create additional burdens for manufacturing that is already stretched from the "post-pandemic" pent-up demand and its various logistical and supply chain issues. The timing of the recent surge in COVID cases in China could not be worse, forcing the authorities to impose lockdowns or limit activity on large manufacturing center, amplifying an already challenging situation.

The disruptive conditions that have been fueling the inflation spike are likely to extend over the longer term, especially considering recent events, as geopolitical tensions prompt rivals to take on a more comprehensive drive towards a "structural rebalancing" of manufacturing and global supply chains. With the sharp rise in commodity prices trickling over a broader range of goods and services, world poverty is also likely to worsen substantially, creating even greater

² The overwhelming support for Ukrainians by populations, businesses and governments across Europe is in sharp contrast to the handling of refugees and migrants from the Middle East and Africa or the Bosnian massacres of the 1990's and could serve to further widen the divide between the west and the rest of the world.

³ <https://www.forbes.com/sites/imperialinsights/2021/01/08/does-covid-19-mean-the-end-for-globalization/>

imbalances which could trigger major turbulences down the road⁴. An increasingly challenging landscape that appears to be unfolding ahead of us will make it more difficult for central banks to engineer their planned “soft landing”.

The Fed has been lately exhibiting a more hawkish stance to tackle the inflationary spike that is proving to be both stubbornly persistent and is spreading across the broader economy like wildfire. The recent surge in inflation means that real interest rates have suddenly become far more accommodative, which means that more aggressive action against stimulus may be warranted to avoid overheating. The great uncertainty at this stage is how households and businesses are likely to react if current conditions persist or get worse. If they start to integrate higher inflation rates into their expectations, the Fed’s job will likely become far more challenging as they attempt to break that “anchor” which risks plunging the economy into recession.

The present conflict will eventually subside, it is the inflection point to which the world has been propelled that is cause for concern. Decades of globalization brought immense wealth to large swaths of populations, diminishing the huge disparities that had existed before, particularly between developed and emerging economies. China’s rapid ascent to become the world’s second largest economy has been largely credited to its autocratic leadership. It is perceived by many, including in the west, as a compelling alternative to that of “liberal” democracies.

It is with the emergence of populism in the west, indirectly triggered by climate change-driven migration that major cracks and fault lines in the world order began to appear. Two years of a harsh global pandemic followed by Russia’s overt conflict with the west seem to have further accelerated and amplified the various grievances between the “liberal” democracies and the rest of the world, ushering us into what may be the start of a new cold war era. Mind you, there is nothing new about wars or pandemics, the world has experienced both countless of times throughout history. It is the context in which they occur that matter most, because that is what is likely to determine their eventual outcomes. Even armed with such awareness, however, there is only so much we can do.

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⁴ The Russian attack on Ukraine has caused the largest disruption to global grain markets since a Soviet crop failure in 1973 and has the potential of provoking the biggest disruption to oil markets since the 1990 Iraqi invasion of Kuwait. If oil continues to hover around \$120 a barrel, nearly double the \$71 average in 2021, inflation will not only likely persist, but the recovery could be further dented by such strong headwinds.