

Into The Rabbit Hole



Newsletter, March 2021

*“The man who chases two rabbits, catches neither.”
Confucius (551 – 479 BCE), Chinese philosopher*

COVID, that once in a lifetime game-changing event, appears to have propelled us into a vortex of sorts, like falling into that dreaded “rabbit hole” where nothing appears the way it should. A lot of things seem obvious when you have hindsight, and although they have been staring us in the face all along, we are left pondering as to why we never thought of them in the first place! The internet search engine is an example of this: it seemed so evident that such a tool would eventually be needed to catalog and help sift through the rapid piling up of new websites! To be fair, coming up with the idea of a search engine is only part of the process. You also should be in the right place at the right time, have the right connections, not to mention the capacity to bring ideas to market. And even with all that, your survival remains uncertain; you also need good execution, and a generous amount of luck.

Those who experienced the early years of the internet will recall that Yahoo’s Alta Vista search engine came first, well before Google’s, but it floundered because its algorithms and marketing weren’t that great. There are instances were first movers that are also technically superior still fail. Anybody recall the Betamax vs. VHS videotape debacle?¹ And then there are the many cases of market leaders falling into the classic complacency trap for having rested on their laurels for too long. Remember how Samsung, with its flat panel TVs, almost decimated Sony’s dominant Trinitron CRT position, or how Apple, a computer company, managed to turn the entire mobile phone industry on its head with the introduction of the iPhone?

So, if certain events that do appear to be obvious with hindsight², but are not predicted in a timely enough manner to not jolt the markets, continue to happen in the present, it begs the question as to whether we have learnt anything, or is it that we have fallen into a rabbit hole? The recent GameStop-related market turmoil is one such example. Yes, it would appear with hindsight that what the markets experienced was bound to happen at some point. So, why were we totally unprepared for an insignificant “maverick” trader with a social media following moving markets substantially? Was it that we didn’t anticipate the multiplying effects of COVID relief paychecks combined with fractional trading platforms, just as confinement measures were forcing people to stay glued to their screens all day?

¹ https://en.wikipedia.org/wiki/Videotape_format_war

² ...and not because our mind is capable of building a narrative to explain almost anything that happened in the past in a coherent enough manner, even when that is obviously not the case.

Maybe we fail to see the obvious because the underlying triggers of events are almost never the same, which is another way of saying that different causes can lead to similar effects. If you lived through the hyperinflation years of the 70's you might think you have a pretty good idea of what can trigger it, but you are going to be waiting forever if you think that the next oil crises (assuming there is one) will lead to runaway inflation. When you realize how radically the world has changed in just a few decades, an oil shock is going to matter much less to economies that are increasingly "electrified". We should be more worried and prepared for the inflationary consequences of a surge in post-COVID consumption demand that will require a good amount of time for suppliers to match. The long-term absence of inflation from the landscape makes this point even more significant.

Apart from "empowering" certain segments of society and "penalizing" others, the pandemic has had a profound effect on the economy itself, namely through the acceleration of digital transformations and other processes that have been underway for some time already. This "time compression" of events is bound to be a source of major turbulences ahead, as it further accentuates the "digital divide" that has been a major contributor to the emergence of global populism. COVID is also creating other forms of disruptions. The recent meteoric rise in the valuation of bitcoin and other cryptocurrencies is no coincidence: the economic crisis has prompted governments to print money like never before in order to limit the severity of the recession.

When you combine rising indebtedness with four years of relentless Trumpism in which America's global leadership role has been trampled on, tainting the dollar's reserve currency stature even more, the appeal of cryptocurrencies becomes evident. Don't be fooled by Elon Musk's much publicized endorsement of bitcoin, however. The fact that bitcoin requires more energy to maintain than the entire country of Switzerland³ gives plenty of reason for skepticism, especially considering the period of growing awareness to matters that concern the environment that we are in. I'm not saying that cryptocurrencies are doomed, they are clearly here to stay, but as with anything imbued in mania, a cautious approach is advised, at least until a time when saner minds prevail.

Where Do We Go From Here?

After a somewhat botched beginning, the immunization campaigns that are being rolled out across the globe appear to be making significant progress (Israel being a case in point), and with the approach of spring and the warmer weather conditions, economic activity appears set for a major rebound that will prove difficult to manage in its early stages. The recent rise in bond yields is sucking the oxygen that has been used to propel stocks to their record highs, causing market jitters that are likely to remain as long as inflation is perceived a threat. The big difference with the anticipated pickup this time around is that we seem to be far closer towards achieving herd immunity than ever before, thanks to the combined effects of further infections and a greater percentage of the population being vaccinated.

The damage caused by the pandemic remains considerable. There are certain sectors of the economy that are going to take a good while to get back on their feet or anywhere near the levels that they were at before the first wave hit. The coming months will be a "race against time" where governments are going to have to increasingly steer their countries in a balancing manner, on the one hand limiting the pandemic's health threat on populations and, on the other, making sure economic activity is not constrained to an extent that it leads to a more severe and protracted slump. The food catering and travel sectors that have been bearing most of the brunt of the lockdowns are now on the brink of a major bankruptcy wave if conditions don't improve soon.

The other major event drawing attention in recent weeks has been the extent of damage caused by freak weather conditions in Texas. This classic example of a "black swan" event demonstrates the kind of dangers that can lurk when you combine relatively rare, fat tail events with policy decisions that are short-sighted, and greed driven. Denying climate

³ <https://www.theverge.com/2019/7/4/20682109/bitcoin-energy-consumption-annual-calculation-cambridge-index-cbeci-country-comparison>

change and not planning for extreme events is what led to the vulnerability of the infrastructure to such threats⁴. The environment is the real “elephant in the room” in this case. The steadily rising temperatures are causing weather-related catastrophes in an insidious manner because their frequency, although increasing, is still not enough to be picked up by the general populations.

We now know from numerous studies that the world is at an inflection point, and that concrete measures need to be taken in the present if we are to avoid a more destructive trajectory for the planet, one that could threaten our very existence. If altering our environment is part of the reason why the COVID pandemic emerged in the first place⁵, we can expect many more such threats and worse in coming years. The one certainty is that the world will be emerging from this pandemic with an altered mindset from the one it had at the beginning of last year. With Trump gone and as the U.S. attempts to claim back its leadership role on the international scene, the authoritarian and populism-driven regimes are going to be doing all they can to subvert these efforts.

In the past four years we have seen substantial setbacks in global trade, as populist governments have been increasingly calibrating their policies inwards, prioritizing their domestic needs to a greater extent than in the past. The pandemic has accentuated this process by highlighting certain strategic vulnerabilities that have risen as a result of the global outsourcing of almost everything. It has also led to increasing tensions between the more liberal West and the autocratic regimes of the East, as their competing forms of governance consolidate and position themselves strategically for an increasingly technology driven future.

So as the world steps out of the “rabbit hole”, there are going to be attempts to return to “old ways”, but the pandemic has had such a profound and crippling effect on such vast swaths of populations that the effects of these “traumatic” experiences are going to linger on for well after it is gone, irreversibly altering our landscape. With containment measures gradually loosened, and in the context of a less conflictual geopolitical landscape, the rebound this time around promises to be substantially more energetic than last time. This means that we can expect a more robust and sustained economic expansion and markets that are going to be breaking new records. There is reason to rejoice without getting carried away, there is always the risk of inflation and the formation of more serious bubbles on the horizon. It is good to keep a watchful eye.

Altug Ulkumen, cFA

Independent Contributor
aulkumen@gmail.com

⁴ <https://www.nytimes.com/2021/02/23/opinion/us-politics-texas-mars.html>

⁵ <https://www.washingtonpost.com/climate-solutions/2020/04/15/climate-change-affects-everything-even-coronavirus/>