
Deep Water Waves: Fixed Income Insights

Webinar: Analyzing powerful long-term drivers facing investors

Powerful forces are reshaping our world, with major consequences for investors. In conversation with **Franklin Templeton Investment Institute's Kim Catechis** (author of the research paper, Deep Water Waves), **Michael Bazdarich** of **Western Asset Management** and **Anujeet Sareen** of **Brandywine Global** discussed how these waves of change are having an impact on markets, and what this may mean for fixed income investors. Here are key takeaways from their discussion.

Demographic Wave: Aging populations and maintaining productivity

Addressing the demographic shift, Kim Catechis highlighted that the main drivers of global growth in this generation (U.S. EU, and China) all have aging populations. Previously, immigration may have been used to address this issue, but there is growing resistance to open borders across the world. Anujeet Sareen said that because long-term demographic trends were negative for growth prospects in developed nations, innovation would be key to maintaining productivity. Michael Bazdarich added that an aging Western population is not a new phenomenon; rather, something that has been taking shape over the last 25 years. The development of technology is therefore crucial, particularly in the private sector, and through that productivity and living standards can continue to rise in the years to come.

Technology Wave: Education and developing a skilled workforce

For both developed and developing nations, how they harness new technology is likely to determine the overall success of their economies. That's the case in sub-Saharan Africa, but as Michael Bazdarich pointed out, also the United States, which is struggling to produce the skilled workforce needed for the digital economy. How this new economy is developed is not a case of robots replacing human workers, he said, but finding workers with the required education and skills to operate these machines. Anujeet Sareen said this skills mismatch is limiting productivity in the U.S., and the private sector may need to take a leading role in providing training. Kim Catechis added that education is the main determinant of success and economic prosperity for countries, and used the example of Germany, which embraced technical schools as a means of training its workforce to suit its labour market. All the speakers agreed that the private sector was stepping up as companies in many countries are actively promoting specific technical skills courses that are relevant to their industry.

Debt Wave: MMT and inflation worries

One of the key talking points of the COVID-19 period, especially in investment circles, has been the huge levels of debt taken on by governments. Inflation has risen above levels central banks usually feel comfortable with, so interest rates are expected to increase in the new year. Anujeet Sareen explained that Modern Monetary Theory (MMT) has moved into the mainstream during the pandemic, but whether this approach should continue after the crisis is debatable. The high levels of government spending by wealthy countries since 2020 also can't be replicated by emerging economies with tighter fiscal and monetary constraints. Michael Bazdarich said MMT or other methods of wealth distribution, such as a wealth tax, are problematic and may not be appropriate when governments move out of a crisis. Kim Catechis suggested that whilst MMT might be impractical, investors are likely to see some unorthodox experimentation as countries try to reconcile their growing debt piles.

Geopolitical Wave: China/U.S. relationship and global influence

Current tensions between the U.S. and China have many people concerned about a new Cold War. The growth of the Chinese economy in recent decades has been spectacular, which Anujeet Sareen attributes to huge investments in its people and infrastructure. With its Belt and Road Initiative, China is also keen to assert its influence internationally, as well as repositioning itself as a more service-based economy at home. While its education and infrastructure investments will certainly help with this change, Michael Bazdarich highlighted that issues with rule of law and intellectual property rights are both significant roadblocks to China rivaling the U.S. in this area. The relationship between the two superpowers is also likely to mean changes to the global supply chain, as the U.S. and other Western countries begin to produce more goods domestically than relying on China. The risk of this overdependence was emphasized at the outset of the COVID-19 crisis when it came to sourcing PPE. More onshore production would therefore mean the current model of "just in time" delivery would be replaced by "just in case inventory building," with directed onshoring of production for certain essential products.

Climate Change Wave: Finding consensus

Coming in the same week as the UN Climate Change Conference in Scotland, Kim Catechis asked the fixed income specialists at Brandywine and Western Asset how they factored in climate change risk in their portfolios. Anujeet Sareen said perceptions of climate change have changed a lot in the investment industry over the last decade. In bond markets, he believes corporate issuers are leading the way on this issue rather than governments, who have more factors to consider when setting policy. His clients also tend to be split when it comes to climate change, with some adopting a risk-reward approach for investing in companies with a large carbon footprint, while others actively exclude such firms from consideration. Michael Bazdarich added that this is a highly complex issue, and that anti-carbon measures could hinder economic development in some of the world's poorest countries. The fact that climate change and the production of fossil fuels has winners and losers across the globe explains why it has been so difficult to find consensus, in his view.

Franklin Templeton Investment Institute

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Deep Water Waves Research Paper

[Deep Water Waves](#) represent the powerful long-term drivers that face investors; fundamentally altering the economic, political and public policy foundations for asset prices. Accelerated by COVID-19 and intensified by socioeconomic pressures, climate change and geopolitics, these forces will exert themselves on every facet of investment portfolios for years to come. The Franklin Templeton Investment Institute serves as a catalyst both inside and outside of our investment organization to provide a forum for investment insights and their practical application. Deep Water Waves reflects that mission of our strategists to drive the conversations with our clients and our specialist investment teams. We expect the conversation we will have in the coming months will build on these waves and continue to expand our understanding.

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