Better prepare for a long landing | The latest view of our portfolio manager Maurizio Novelli

We translate and publish the market view of our portfolio manager Maurizio Novelli, taken from Focus Risparmio. The original article in Italian can be found at this link: https://shorturl.at/esOPR

It is time for investors to buckle up: the landing will not be as hard as feared but it promises to be **very long**.
Maurizio Novelli, manager of the **Lemanik Global Strategy Fund**, is convinced of this, according to which it is now increasingly clear that if the 'landing' turns out to be soft it will only be because of the ability of the United States to "massage" the GDP data. The proof is in the numbers: in the U.S., consumer credit totals more than 20 percent of gross domestic product (up from 10 percent in the pre-2008 period) and so far has been, along with the expansion of public debt that continues inexorably, the real engine of growth.

> *Despite all the government subsidies, the economy is slowing, consumption has begun to sag, and credit default rates have begun to rise anyway*

– warns Novelli, pointing out how accounting tricks to keep a negative gross domestic product from showing up and flaunt a robust job market contrast with leading consumer confidence and other indicators. "Multinational corporations retain profits made abroad in tax havens, pay no taxes to the U.S. government and use these 'tax free' resources to make buy backs in order to prop up the stock market. Investment and real incomes have been steadily shrinking for years, and the

New York financial center has become the leading indicator of 'wealth' for an economy that produces super-concentrated profits in a few sectors," he clarifies.

So far, according to Novelli, the mechanism has been facilitated by an environment of high inflation: that is, the application of a deflator significantly lower than the actual figure has allowed governments to **'produce' inflated real GDP figures**. Now, however, the U.S. economy appears to be focused on **trying to sustain a development model based on unsustainable public and private debt** and a financial market that cannot afford to buckle. "This mechanism can only hold if the wealth produced is distributed widely throughout the system and fuels general income growth that supports a constantly accumulating debt. This is currently not the case," the expert points out.

Trying to change this system now seems quite difficult. "Inflation has already unhinged the system and the stock market index remains the last bastion of defense on mass psychology before the crisis, but to hold up requires exaggerated deviation from fundamentals. Which in turn displaces investors in favor of speculators," he warns. To sustain such a market, the few companies that can afford it must continue to buy back, diverting resources from real investment and exacerbating the stagnant economy, which then requires constant public debt. In short, according to Novelli, only a crisis could be the way out of a system already in crisis.

> *The problem is not only to be found in the errors of monetary policies because it would be appropriate to ask whether the U.S. model, built on quantitative easing policies, deserves the colossal bet that markets are pricing in, he notes*

Meanwhile, the impact of higher rates is beginning to create **obvious damage**: real estate in crisis, banks in trouble,

pension funds in need of bailouts, sagging consumption, tightening bank credit and rising insolvencies.
“Because of the stock of debt accumulated in the system at very low rates, we are not able to afford a rapid deleverage as in 2008. The system would not hold up. So it is very likely that there will be an attempt to undertake a slow and controlled deleverage,” argues the Lemanik fund manager, who says all debt incurred at low rates will have to be rolled over at higher rates. And many economic players will not be able to withstand rollovers at current rates, with the result that defaults will remain a structural phenomenon in the economy.

“The slow process of absorbing defaults on debt, which is not bearable at non-zero rates, sets up the **Balance Sheet Recession scenario we are entering, which we euphemistically call soft landing**,” he adds. And the debt to be rolled over has an additional problem because it is probably contracted to make investments at profitability no longer compatible with such an economy. This, for Novelli, has two effects: reduction of debt positions that support investments no longer compatible with high rates, liquidation of assets that are collateral to the debt. Commercial real estate is a typical example of this and is the tip of the iceberg of the system’s.

For Novelli, the **entire world economy**, from the U.S. to the U.K. via Australia, Canada and China, **has accumulated liabilities to buy assets at profitability compatible with very low interest rates**. Except that Qe lasted 14 years and the size of those positions is unknown but certainly colossal: “The reason why the soft landing could be ‘Japanese’ is therefore related to what we have done in 14 years.”

Another example is government bonds, which provide the problems for bank balance sheets. And for the expert, of course, the same principle should be extended to real investments as a whole and to other segments of the real economy.”

At this point, while trying to convince everyone that the 'soft landing' carries no risk, no one can know how long a prolonged 'soft landing' will hold, and whether it does not instead risk turning into a 'hard landing' as it goes along.

That is why I remain extremely negative about the resilience of this system, as at best it remains packed in a long-term slowdown that may exacerbate structural problems rather than solve them," he comments.

Meanwhile, the major countries at the center of global exports, such as China, Japan and Germany, continue to show sagging global demand. "**Japan has been the main competitive 'devaluator' over the past 12 to 18 months but its global exports are not growing, in fact they are falling. Germany and Europe are exposed to U.S. geopolitical decisions, which have led to the elimination of the low-cost energy supplier (Russia) and now aim to scale back trade with China**," he explains.

As for Beijing, according to Novelli, the economy is in dire straits due to deleverage in the real estate sector, increased control of local governments' fiscal policies, and deglobalization triggered by the US. And the **China Reopening** has been a theme sold to investors to support the idea of global recovery, but in reality Beijing no longer wants to be the locomotive of the world economy on debt and hopes to initiate a controlled deleverage of the system.

In short, Lemanik's fund manager has few doubts that **we are in a cyclical situation where, for a variety of reasons, the world's major economies are facing long-term structural problems that are coming to maturity all at once**, with a burden of public and private debt accumulated at zero rates to support investments whose profitability is no longer adequate to the current level of the cost of debt

Virtually nothing has happened yet, except for a market

correction in 2022, but the breakdown of the system built on Qe has only just begun, and the criticality of this soft adjustment depends on its duration, which, because of the leverage accumulated over 14 years of 'free debt and go', promises to be quite long

Maurizio Novelli

With more than 35 years of experience in portfolio management and proprietary trading, Maurizio Novelli in 2007 launched one of the first Luxembourg UCITS funds with a Global Macro strategy, of which he is currently the Senior Portfolio Manager, boasting one of the longest track records in the asset class…

View Maurizio Novelli's complete profile

Share This Article