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MONTHLY INVESTMENT COMMENTARY FROM LMCG

Is My GLOBAL Equity Portfolio Relevant in 2017?


The Magazine > December 2016 > Is This The End Of Globalization? Thursday, March 30, 2017

Is This The End Of Globalization?

From Occupy Wall Street and the Arab Spring to surprising victories for Brexit and Trump, citizens around the globe are pushing back against their leaders' policy choices.

DECEMBER 08, 2016 | Author: LAURENCE NEVILLE


ECONOMICS & FINANCE

The End of Globalisation?

Michael A. Witt, INSEAD Affiliate Professor of Strategy and International Business | November 22, 2016


Opinion: Why this era of globalization is coming to an end

By Rebecca Keller

Published: June 7, 2016 2:46 p.m. ET

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Manufacturing is moving to shorter supply chains, and that will provide fewer opportunities for the developing world

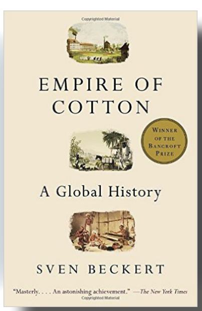

The End Of Globalization?

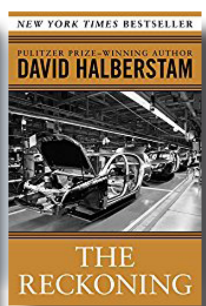
02/02/2017 - 3:37pm 3 Comments by Ceri Parker

With headlines like those to the right, investors in our Global MultiCap strategy might be wondering if their portfolio should be more US-centric. A good dose of history is one of the best ways to put the current debate about trade agreements and the "end of globalization" into proper context. Two books help frame the argument. Sven Beckert's Empire of Cotton: A Global History is a gripping, sobering, and highly relevant story for today. A finalist for the Pulitzer Prize, Empire of Cotton focuses on the social impact and "race-to-the-bottom" history of cotton growing and processing over the past 2,000 years. The abandoned warehouses and gutted factories that populate America today are relics of just a recent phase of the very long process of globalization, and the lessons are urgent. But what are the practical lessons of this experience for investors?

First, the lesson from the cotton industry's history is that it is a futile struggle to protect an industry for the long term when a competitive disadvantage cannot be overcome. Many factors impacted the competitive advantage to regions that, through the millennia, traded places as the center of cotton production. Climate, location, transportation, technology, but ultimately, cheap labor were at different times the driving force of relocation, and massive disruption. Government policies, whose efforts were directed to attract and retain the cotton industry on home soil had mixed short and intermediate results, but ultimately the industry found its way to locations that satisfied its need for the lowest possible cost. You may recall, America had a tussle over the protection of that competitive labor advantage around 1861.

Second, through the ages, a select few people profited from the dislocation - "one percenters" in today's parlance. But today, global equity markets have made it possible for the rest of the population to build an intelligent approach to profit from globalization's often brutal reallocation of jobs. In a more sensible way of putting it, good management can help diversify some of the risks for those who may be affected.





The great globalization book of the 1980s, David Halberstam's monumental history of the fall of the US auto industry, The Reckoning, was a stunning cautionary tale that continues to resonate today. In an *Unfiltered* article last year, we presented the graphic shown on the next page to illustrate what the auto industry looks like today for public equity investors. How could anyone profitably invest in the auto business over the long haul with only Ford, GM, and their suppliers in their investment universe?

This profound change to auto makers and American manufacturing was accelerated during Ronald Reagan's administration when the US dollar rose to a huge peak in 1984, which made the massive shift of manufacturing to Asia a devastating and forgone conclusion. Autos, steel, textiles, including the last remaining cotton production, were lost. The strong dollar was not responsible for the decline, but it became an accelerant.

This tale of history is at the heart of our evangelism about globalizing equity portfolios today. The US dollar has benefited richly from our early (but below par) growth following the financial crisis of 2008, and that rise once again is creating concern. The critical currencies today still include the Japanese Yen, whose valuation is being explicitly managed down as a part of "Abenomics" policies in Japan, the Euro, whose underlying political instability has made it cheap, and the highly managed Chinese currency, the Yuan, whose valuation is as important as nearly any indicator of future industrial dislocation.

In sum, we evangelize about becoming good at globalization for the following reasons. The promise of the return of manufacturing jobs to the United States is difficult to imagine unless the US Dollar declines significantly. Jawboning companies to open factories in the United States is a temporary and illusive fix. Improving corporate tax structure can help a lot more near and long term.

- If you want the return of low cost labor jobs, you need the low cost labor to support it.
- A strong dollar makes it cheap to invest in certain competitively advantaged industries in Europe, Asia and the Emerging Markets.

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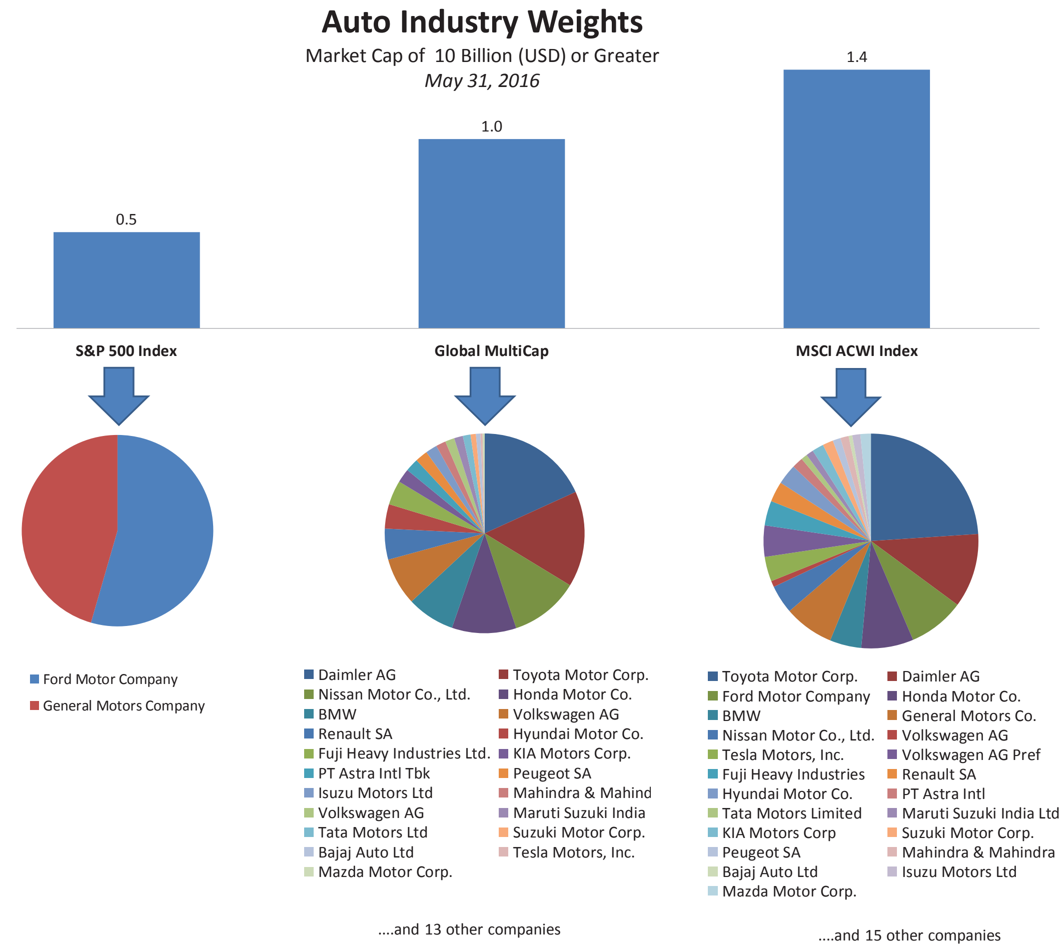

Holdings of a Global MultiCap representative account as of 5/31/2016. References to portfolio holdings are not intended as investment advice. LMCG may have already bought or sold or may in the future buy or sell these securities on behalf of its clients. Source: MSCI

- The good news is that the United States is still the home of more competitively advantaged industries than nearly any other region in the world. In terms of equity investing, that would, in the long term, still favor biasing the world stock indexes towards the United States. The caveat: valuations continue to be stretched here.

Here is what to watch for in the near term:

1. The impact of changes in trade agreements, including border adjustment taxes, is new territory for economists, policymakers and investors. We are resisting knee-jerk reactions to certain protectionist policy proposals and keeping well read on the subject. We are paying special attention to the potential winners and losers. Dislocation will certainly result.
2. Theorists believe some new trade restrictions meant to help protect American workers may boost the dollar higher, creating the opposite of the intended effect.

The bottom line: History's lesson is that globalization doesn't end. Trade wars, regulation, short-term dislocation may abound but, ultimately, there is a limit on what a country's government can do to protect its jobs and its valued industries. So much of surviving the pain of globalization's dislocation is the ability to stay ahead of change, in your job, in where you choose to live, how you vote, and in your investment portfolio.

Jeffrey P. Davis, CFA | Chief Investment Officer, Investments
200 Clarendon St. | Boston, MA 02116 | T. 617-380-5646
jdavis@lmcg.com | www.lmcg.com

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