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ADVERSITY QUOTIENT (AQ) & TEX-THE NEXT BIG TRADE

By Jordi Visser, President & CIO

Three years ago, my grandmother died at the age of 97. Growing up in Texas and being a strong woman, she was affectionately called Tex. According to her, she got that name from the factory she worked in that was producing equipment for World War II. My grandmother and I had a very close relationship. There were many reasons for my affection for her which to tell in this paper would involve hours of writing and multiple breaks for emotion. I know this because I went through it while delivering her eulogy after she died. To summarize her eulogy, I described how she taught me the keys to navigating life's ups and downs and specifically the importance of AQ; Adversity Quotient or Adaptability Quotient.

She was born in 1920. This means when she was just 19 and about to embark on her journey as an adult, she had just lived through the Great Depression in a family fighting for enough food to survive. If that wasn't enough of a challenge, she was now about to spend the next six years experiencing the devastating effects of World War II. As a child hearing her talk about these horrible experiences and the everlasting fear of debt, it always struck me that she had the ability to balance these memories with the



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Structurally higher inflation and higher nominal GDP will lead to a different investing future than 2009-2020 as we come out of this crisis.



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good times as well. I remember how her eyes would light up when she described the emotional experience of watching Babe Ruth circle the bases and recognizing the important underdog stories of the actual Cinderella Man, and listening to Sea Biscuit vs. War Admiral on the radio. She taught me so much, but most importantly, life is not fair, but life is good, and out of adversity comes new growth. Be grateful for the good things in life because it will help you get through the bad times. When you make it through challenges, those become memories of accomplishment and survival and help provide strength the next time life is not fair. I will always remember her simply as one of the strongest and most loving people to others that I have ever met, despite her growing up during one of the worst periods in the world in the last 100 years.

I thought a lot about her during the pandemic knowing this was as big a global event as I have seen in my life. It has now been over 18 months of Covid dominating the news. Usually, markets can look past the news, but even now, the narrative in markets as we leave the summer centers on fears of the Delta variant. As we enter the final four months of 2021, I think our brains need to move on to AQ and focus on what new growth and changes will come from these tragic times. Regardless of cases rising again and front-page fears on where new variants may go in the future, September is upon us, which brings people back to school and work. Unlike last year, there is a proven vaccine, and we have data on the new variants. I am certain that although Covid will impact us in some ways, there is more certainty for the next year than what existed last September. While the next four months may be choppy, I think markets are pricing in near-term uncertainty, while looking towards 2022. Although anything is possible, I can't imagine the next big trade for 2022 is about Covid again.

At the same time, people seem to keep waiting and looking for reflation and higher interest rates as the big trade of 2022. Although I believe both will be part of next year's story, I also think that was the trade this year that caused pain since the end of Q1. Reflation only comes after deflation by definition, and we are currently the furthest from deflation in my career. There is no question



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that we have already passed peak growth, and I believe the inflation we have seen so far this year is most likely the fastest we will see in a long time, if not our lives. So, without the Covid deflation/reflation, nor a rate rise as the next big trade, where should we look for 2022?

As Tex taught me, global events of this magnitude, The Great Depression, World War II, or even The Great Recession in 2009, always create new growth from the adversity. That is the power of the adversity quotient. Whether it is a single person's experience or a major global crisis, these lead to significant changes to ensure the same thing does not happen for a long time. I always say, the seeds of the next crisis were planted in the prior crisis. What that means for 2022 and the next few years is that the strongest trends to ride will be driven by the political, regulatory, innovation, and behavioral changes created in response to this Covid crisis.

After The Great Recession, China made changes to its fixed-asset investment growth, governments around the world regulated the banks and focused on austerity to try to bring down debt, fracking helped drive energy prices down to eventually negative prices, and the iPhone helped to bring money into the software space while fueling a period of exponential innovation. All of these contributed to a period of disinflation. During the last decade, I wrote many papers about GDP no longer being a good measure of growth because of exponential



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technological innovation and the deflationary pressures it brought. It forced all businesses to embrace innovation in a world with lower nominal GDP. At the same time, demographics were entering a major shift with the first of the baby boomers hitting retirement age just after a serious financial hit to their net worth. All of these contributed to downward pressures on inflation.

This time, I see a very different scenario. Since I have written and [presented webinars](#) for over a year about higher inflation going forward, I want to make one thing clear: I am still 100% a long-term deflationista (self-described!). I continue to see a world with abundance much sooner than the brain can comprehend. So despite this paper on structurally higher near-term inflation post the pandemic, remember, more inflation always leads to more innovation to arbitrage it out. To find that inflation-driven arbitrage opportunity, we must start by looking at the areas in the economy where we can see scarcity.

In 2020, the scarcity was a vaccine. We needed a vaccine for a pandemic in a time never thought possible, but innovation brought MANY vaccines in record time. Not only did we get the vaccines, but we got ones with levels of efficacy that boggle the mind. Just before The Great Recession, there was a scarcity of oil. Peak oil was the topic as oil prices were at 150 per barrel. Then fracking came in to bring abundance to solve the problem of oil scarcity. Similarly, software came to help address a scarcity of nominal GDP and make businesses more efficient.

Coming out of this crisis, I think the most important scarcity for the next decade is labor, especially cheap labor. I understand that it is a difficult concept to visualize with the current unemployment rate and the total number of unemployed. However, at this stage, we are looking into 2022 and beyond. For me, this is the biggest story and will impact our world of investing in ways not seen in a long time.

The first driving factor for this scarcity that occurred from Covid was related to the government's ability to fight off the economic and asset fall in the markets with unlimited money, as discussed [in this webinar](#). Using the



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experience and programs from The Great Recession, assets and personal income jumped significantly despite the entire global economy shutting down. The amount of money was meant to offset the unknown time it would take for job creation to get us back to pre-2020 levels.

By way of background, after The Great Recession in 2009, baby boomers were in a state of fear from the collapse of consumer net worth. It took about 5 years for the overall net worth of the country to get back to where it peaked in 2007. Worried about having enough money for retirement and many with their homes left with negative equity, it forced many to work past retirement.

This time, the moves by the government and the Fed, not only prevented a similar fall in assets and housing, but they led to a 14 trillion dollar increase in consumer net worth for 2020 during a pandemic! To put this in perspective, from the end of 2007 to the end of 2013, consumer net worth increased only by 11.4 trillion. Already, 2021 is on a pace to surpass last year. At the same time, all assets have exploded higher, so did personal income and the savings rate. The baby boomers are in a much better overall financial situation, particularly with a strong housing market. Psychologically, a year locked up has reminded many people that life is short, and many will undoubtedly reassess their work-life balance. As of now, it is showing up in the data with the largest number of baby boomers leaving the workforce in 2020. Despite the vaccines, there is no doubt that the vulnerability of an older population to an endemic virus has contributed to early retirement.

These structural changes related to asset wealth and demographic-driven retirement come at a time when the US and China [have recently divorced](#), leading to a need for more onshoring. Unlike the focus of debt and austerity coming out of the last crisis, the government is focused on the distribution of wealth problem and continues to use unlimited money. In addition to the printing last year, in 2021 we initiated the child tax credit and food stamps are set to increase in October, effectively beginning a form of universal basic income. Blend all this together and labor has gained the upper hand.



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The data to support this is everywhere from company earnings releases, the ISM Manufacturing Index reports, the various employment data points or simply if you travel the country and look at the hiring and \$15+ hourly wage signs advertised. I fully expect higher wages from this unexpected acceleration of a shortage which was evident before Covid but now is further ahead. Higher wages combined with higher net worth and savings will lead to higher structural inflation and higher nominal GDP. Structurally higher inflation and higher nominal GDP will lead to a different investing future than 2009-2020 as we come out of this crisis.

Higher nominal GDP driven by wage growth rather than purely commodity and bottleneck-driven reflation will lead to new winners and losers. Investors need to focus on asset inflation, pricing power, and finding areas not significantly hurt by higher wages. It is more about margin pressures at this stage of the recovery. Areas that benefit from higher inflation and higher rates will differ from the last decade of disinflation. At the same time, the regulatory focus of the government will shift from financials to mega-cap technology, reversing what happened after The Great Recession. This means I continue to see value as doing well with the revenge of the old nominal GDP and inflation part of the economy. Although this will feel like reflation for a short period and rates should move higher, I think energy, materials, and interest rates will grind higher and outperform in the coming years in a choppy manner with energy/materials swimming against the tide of ESG and the focus on green. Fighting this tide will make the groups choppy and subject to sharp falls when commodities have corrections. At the same time, the scarcity of yield and growing retirement needs will keep yields below inflation in my opinion. On the other hand, I believe the sector that benefits the most in the coming years will be financials.

One other theme coming out of the pandemic that I believe will shape investments for the coming decade will be the official rise of Asia as the dominant regional story. Asia has about 60% of the world's population and contributes over 60% to annual global GDP growth. Coming out of the last crisis in 2009, China's GDP was about 5 trillion dollars. Now it is greater than 15



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trillion dollars. Asia and China will not have the same labor shortage situation, which will lead to less of an inflation problem. I see this as a major advantage from an investment standpoint in the coming decade. One area to play this is through a weaker dollar vs the Asian currencies. The Asian Dollar index is unchanged since 2006 despite taking over the global GDP lead. I believe this was all about the benefits the US gained from software and continued outsourcing labor and supply chains to Asia. With the China-US divorce and the labor shortage in the US, I see this as a massive shift. In the coming weeks, I would watch this index closely. Although the US has led the world in reopening, Asia has been in lockdowns since Q2 2021 which has driven the Asian PMI down to 44.6 in August. This has delayed the global reopening, which, in my opinion, has been the frustration investors have felt over the last six months. Once Asia reopens and their second derivative turns up, I think we will get to a shift in the FX market.

In terms of innovation that will speed up due to this crisis and change the world in even more significant ways than the iPhone, fracking, and software, I would look to the blockchain and human longevity driven by software updates to the body. Both will help address the higher nominal GDP switch and the labor shortage. I will write much more on these in the coming months. For now, I don't think many people are seeing the need for faster adoption of the blockchain post-Covid, and too many keep focusing on the coins as a bubble. In the future world of the blockchain, think of Bitcoin as gold and Ethereum as oil or the fuel for the ecosystem. At this time last year, Ethereum was below 500 and now it is above 3000. So far this year, Ethereum has outperformed bitcoin by over 150%. More importantly, the amount of dollars in this ecosystem has grown dramatically globally. The iPhone came to the market in 2007 and helped fuel the software boom post-Lehman. Higher nominal GDP and wages to me will make Covid and money printing the iPhone moment for the blockchain.

Although software adoption will continue to be important for companies and efficiency, I don't see it surprising as much as the period from 2009-2020. I do, however, think we are transitioning into an area though, post-pandemic, that will grow exponentially



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from small levels all because of Covid which will leave a lasting impact on the future of longevity. This is the revolution of software for the body led by mRNA and CRISPR technologies. Because of their net worth and aging, baby boomers have always been a part of major investment themes and will now hit the exponential button because of the data and money provided by governments and the private sector to fight Covid.

In the same way that the Manhattan Project and World War II sped up the advancements of computers, I see the global coordination around Covid as speeding up longevity. I see these technologies as being massively disruptive to many areas of healthcare but especially to the pharmaceutical industry as these technologies will turn our bodies into medicine-making factories.

I will expand my thoughts on all of these in the future but as we exit the summer and focus on 2022, I am reminded of the lessons I learned from Tex, that although life is not fair, life is good. I think it is time to move on from this most recent challenge and look for new opportunities and the next big trade.



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More than a market neutral pioneer, Weiss invests in people, partnerships, and a purposeful future. Our mission is to make our expertise in alternatives universally accessible. Jordi Visser is the President and CIO of Weiss. He joined the firm in 2005. Previously, Jordi was the founding Managing Partner of Anchor Point Asset Management, a global macro fund. A former Managing Director at Morgan Stanley, he traded various global equity derivative books for nine years. He opened the Morgan Stanley office in Sao Paulo, Brazil, and managed the derivative sales and trading effort there during the 1997-1998 emerging market crisis. Upon his return to New York in 1999, he managed index derivatives and ETF trading and was a member of the Equity Division Risk Committee. Jordi is a magna cum laude graduate of Manhattan College and a board member of the School of Business at Manhattan College.

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