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From blockchain to the economy, our CIO weighs in

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The future of blockchain, how long the economy can maintain this pace and today's biggest risks.

Q: You recently attended an online blockchain course through the University of Oxford. What was that experience like?

Colin: The course reinforced the transformational power of distributed ledger technology (the most commonly known is blockchain). It's been too heavily associated with Bitcoin and cryptocurrency, but it has much broader applications. Our research analyst, who covers the consumer discretionary sector, recently gave us an update on Home Depot as an example of a company testing the usage of a distributed ledger (blockchain) to improve the data quality between their supply chain and finance departments. It could even have an effect on emerging markets. Workers in the U.S. who transfer money back to their families in other countries are currently charged upward of a 10% fee on the transaction, but with blockchain technology, charges may fall to a few cents on the dollar **and** the transactions will occur faster. I can even see applications for blockchain in my own responsibilities managing our investment and research processes. We could run a crowd-sourced research project by making small payments to large numbers of people as a way of extending how we do research on major thematic topics.

Colin Moore
Global Chief Investment Officer

It could also give financial advisors the ability to offer increased client identity security, which may ultimately make clients more comfortable sharing their information. The medical field has found that patients are more willing to participate in medical studies if they're confident that only part of their files will be shared as opposed to the whole thing.

There are still some issues though. The number of transactions you can process per second using blockchain is still low (under 10). And if you compare that to something like Visa (tens of thousands of transactions per second) there's a long way to go. But there are many large firms and a consortium of banks examining these issues, and I believe, as more people and companies adopt the technology, the flaws will eventually be resolved.

Q: Do you think the Federal Reserve is on the right path as they raise interest rates?

Colin: It's a major debate as to whether normalizing interest rates (removing extraordinary policy intervention) is different than tightening interest rates (raising interest rates

from already normal levels). Think about it in terms of driving a car: Braking to avoid a dangerous object in the road is different than simply taking your foot off the accelerator. You slow down in both cases, but one is more aggressive than the other. I think the Fed is taking its foot off the accelerator by injecting less money into the financial system, rather than braking hard. I remain convinced that the projections the Fed gives us for interest-rate increases (through their so-called dot plots) represent their best current thinking, and if things change, they will slow down the rate of increases. I'm confident that the Fed is vigilant, and I don't think they'll just raise rates just for the sake of doing it. I believe they're on the right path.

Q: The Fed may be watching for the yield curve to invert as a sign of an upcoming recession. What do you think?

Colin: An inverted yield curve occurs when yields on short-term debt are higher than on long-term debt. I've read the Fed reports on this topic dating back to 1996. The general consensus is that 6–18 months after an inverted yield curve, a recession will follow — regardless of what causes it. I have no reason to doubt the Fed's consensus will hold true again other than the fact that we've never had the experience of coming out of an extraordinary period of Fed policy intervention. But if you go back and review the recessions preceded by an inverted yield curve, they weren't terribly bad for the stock market because they were reasonably short-lived, the drop in the equity market was reasonably mild and the economy recovered fairly quickly thereafter. So to take dramatic action around an inverted yield curve seems unwarranted to me.

Q: What are the biggest risks right now?

Colin: I'm concerned about trade and tariff issues. There are inflationary aspects to tariffs that could force the Fed to move off their path of interest rate normalization, but I'm hoping the Fed sees it as a one-off price adjustment rather than ongoing inflationary pressure. We're starting to see some slowdown of world trade activity, which will at least raise levels of uncertainty. And when you have uncertainty in the market, the amount of return investors expect for taking on risk also rises. I think investors' level of concern on trade and tariff discussions depends on what community they live in and what industry they're associated with. If you count on soybeans to make your living, you may be feeling concerned. We know that the tech industry is worried. How the automotive industry will be affected is up in the air.

There's been a lot of divergence between U.S. and international equity market performance this year. I believe it's too early to tell the extent this divergence reflects potential winners and losers from trade conflict.

Q: Any additional thoughts you'd like to share?

Colin: I would be a little cautious about straight equity beta right now (which tracks the overall direction of equity markets). We believe investments should be focused on long-term secular trends, rather than the overall direction of the market. The last decade has been pretty good for investors, and although we still expect positive future returns, they may be more modest than they've been in the last 10 years. We also expect higher volatility, especially given the uncertainty over the longer term consequences of normalizing interest rates and trade disputes.

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