THE DIGITAL ECONOMIST

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Investing In The Post-covid World

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Investors in 2021 are faced with what Deutsche Bank is calling "The Age of Disorder". The rapid change sweeping the world has created an environment with more uncertainty than has been seen for the last 20 years. Meanwhile, drastic central bank interventions have had profound and subtle effects on the market and led to widespread zero or negative interest rates, leaving investors with precious few options to find yield.

One certainty is that macroeconomic factors will play an important role in investment decisions going forward. We go over some of these key factors in our paper "What the Future Looks like". Some of the key questions it addresses: How will the role of governments change? What will be the impact of the growing digital economy? How will the tug of war between US hegemony and multipolarism play out? And how will climate change factor into all of this?

In times of great change, there can be great opportunities. At The Digital Economist, we take a macroscopic look at these factors, and share our findings with investors to help them navigate complex environments. Here are some of the most compelling directions we have identified.

Hedging the risk of uncertainty by investing in change

One foreseeable certainty is that the rate of change will increase. In market regimes of stable growth, keeping capital in blue chips or indexes can be a reliable way to achieve returns. This no longer holds true when volatility is high. Over 40% of the S&P 500 has withdrawn or withheld either quarterly or annual guidance due to the impact of COVID-19, showing that even the largest companies are not immune to macroeconomic events.

For investors with the right horizon, one way of addressing this is to invest in change head on with “antifragile” assets. These are assets that retain or increase in value in times of rapid change. While this can be as straightforward as a consistent strategy of strangle trades, one asset class that has become much more interesting in this regard is venture capital.

In past years, venture capital became notorious for underperforming indexes while saddling investors with high risk and low liquidity. However, VC is also known as a volatile asset class. The US Venture Capital Index outperformed the NASDAQ during both the Dot Com bubble and the 2008 financial crisis, and had its best year ever in 2019. The logic behind this is straightforward: Both bubbles and recessions are times of rapid change, which benefit nimble companies that solve concrete problems, such as startups. Startups start from a clean slate and can pivot to new market conditions rapidly, enabling them to create economic value in otherwise unfavorable environments.

Earning yield by investing in impact

According to the International Finance Corporation (IFC), small- and medium-sized enterprises (SMEs) in low- and lower-middle-income countries face a US$ 930 billion financing gap. Meanwhile, in low-interest environments, investors struggle to receive meaningful returns in their medium-term and long-term debt portfolios. Given that private debt is the largest asset class for impact investing (Forbes via GIIN, 2018), it represents a path to better returns for investors in low-yield environments, while bridging capital gaps for social projects and businesses.

In this context, three areas to look at are AgTech, HealthTech and EdTech. These sectors are both crucial for a speedy economic recovery in the post-COVID period and robust enough to withstand demand shocks. This robustness is often a result of high demand across these sectors in emerging markets, further insulated by a healthy middle class. The AgTech sector will boost food security, increase smallholder farmer incomes, reduce food wastage and create decent jobs in emerging markets. The HealthTech sector offers innovative delivery around basic health services, increased access to health insurance and medical services which will serve to improve health outcomes during the pandemic and in the post-COVID era. EdTech models increase access to education and improve educational outcomes through delivery of innovative and hybrid teaching models. And access to capital to enable innovative entrepreneurs who are post-revenue – and have in many cases received other investor capital – to continue to grow their businesses through new hybrid or digital delivery models will create more resilient economies.

New opportunities in digital assets

Some of the most exciting new asset classes in the last decade are digital assets. These can encompass a wide range of assets, many giving investors exposure or liquidity that would have previously been impossible.

The most visible and liquid of these assets is Bitcoin. As Fidelity Digital Assets writes in its report "Bitcoin Investment Thesis", the "unknown consequences of record low interest rates, unprecedented levels of global monetary and fiscal stimulus and deglobalization" can all be tailwinds in Bitcoin's favor. Bitcoin has consistently shown exceptionally low correlation to other assets, and the recent block halving has triggered significant price increases after the previous two events.

Bitcoin could be a particularly compelling investment due to the massive amount of central bank intervention in 2020. The potential for high inflation due to loose monetary policy has led hedge fund manager Paul Tudor Jones to state that Bitcoin is "the best inflation trade".

Hedging against a breakdown

Amid the many shock events of 2020, one concept that has come up more and more frequently is the long-term decline of human society. Each of the investment directions listed above relies on many things we take for granted, such as a banking and financial system, interconnected and low-cost Internet access, and a relatively peaceful geopolitical environment. Above all, we assume stability amid small deviations from the status quo. It could be prudent to think outside these parameters.

The breakdown of complex systems is certainly nothing new, as Jared Diamond made painfully clear in his 2005 book “Collapse.” Further examples include the degradation of the Roman Empire’s vaunted road system as it began its decline.

In the event of a minor or major breakdown of complex, globalized systems, we may no longer be able to assume that global distributed blockchain networks or lending agreements bound by regional law will continue to sustain themselves. In such a scenario, we should consider investing companies trying to address issues lower on Maslow's hierarchy of needs.

So, does this mean investors should withdraw from innovative or high-tech assets in favor of traditional exposures concentrated on basic human needs? No. In fact, the convergence of technology and human needs is where we expect exponential growth. Developments like digital and vertical farming, delivery of essential goods like medicines via drones or decentralized finance (DeFi) to enable fast and cheap transnational remittances are all areas that we think deserve special attention. With an eye to tech development linked to real human needs, we think investors can do well and do good. But above all, 2020 has shown us that we need to be alert and agile in a VUCA (volatile, unpredictable, complex, ambiguous) world. The future belongs to those who can respond to change. Hold on tight – this is going to be a rough ride.

About

The Digital Economist is a global impact organization with the mission to drive technological convergence towards a human-centered digital economy by bringing investable opportunities, in line with the Sustainable Development Goals, to the fore. For press inquiries, please reach out to press@thedigitaleconomist.com. For partnerships please contact directly : navroop@thedigitaleconomist.com.