Investment update

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The way we were

Statistically long conventional government bonds

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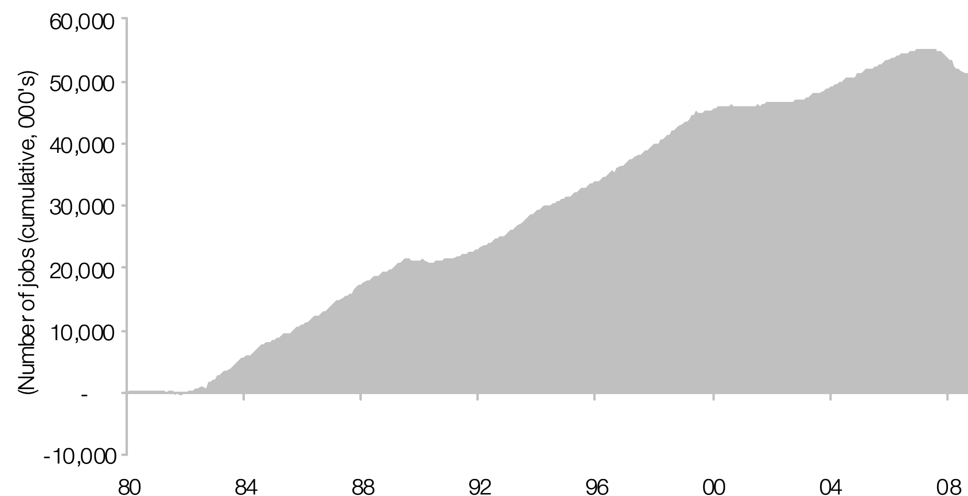
Stewart joined OMAM in June 2009 from Newton Investment Management where he held a similar role and managed the Newton International Bond Fund and BNY Mellon Global Bond Funds, both rated AAA by Standard & Poor's. He has more than 20 years' experience of global fixed income markets, having begun his career in 1987 as a broker before subsequently switching to fund management.

The narrative arc that defines any politician's career is in an unnaturally steep descent for President Barack Obama. Watching a recent Channel 4 news item about Americans being given free food parcels was shocking enough, but to hear "I don't know why I voted for him; what's taking him so long to get us back to where we were?" signaled that lots of people haven't realised just how long 'change' takes to implement.

The main focus is, naturally, on jobs. Since the era that saw President Ronald Reagan come to power, job growth has been pretty consistent, with only rare periods when it has declined in absolute terms. If you add together all the jobs created in manufacturing and services since 1980 then, at its height, an astonishing 55 million positions were created in the US economy (see chart 1). Within the headline numbers there is another story to tell. As manufacturing has declined, the government and service sectors have stepped in to take up the slack. In recent years about three million of those positions (mainly from the private sector) have dropped away, but you get the sense there are many more to go if things don't improve again soon.

Chart 1: US job creation since 1980



Source: Bloomberg

Part of the problem for the Obama administration is that, over time, there has been an almost one-for-one transfer of jobs out of manufacturing and into central government (see chart 2). This creeping and silent culture of growing dependency on central government expenditure kept the whole ship afloat in successive presidencies, but at the same time meant that central government spending increasingly became a fixed part of the economy. If the life support machine of government-created jobs was switched off, even briefly, millions of people would be thrown out onto the streets. It would be unlikely they would vote for the person responsible again.

So unless President Obama wants a political backlash that will cast him as a one-term president, government jobs will be maintained and the budget deficit is fixed and unlikely to

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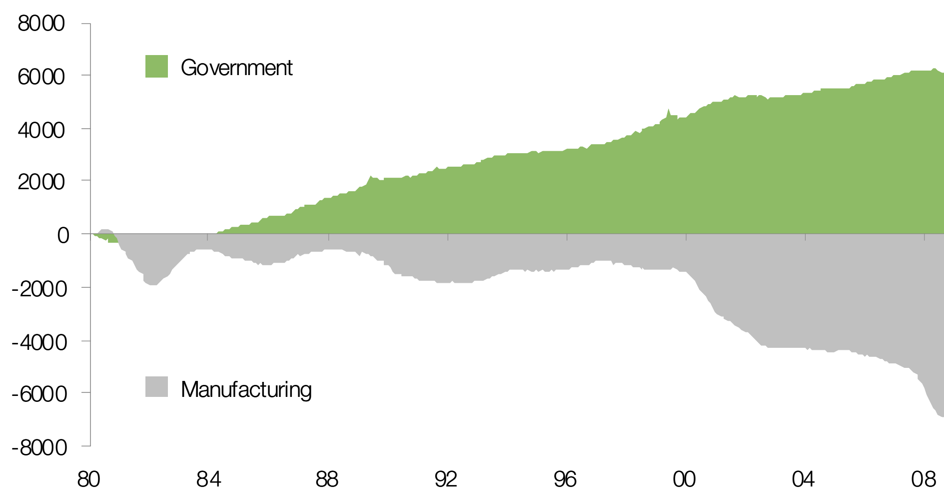
dip below $1 trillion dollars a year for some time to come. Even at its most optimistic, consensus estimates of the US budget deficit stand at around $750 billion by 2012 (6% of GDP), still breathtakingly large.

Chart 2: US government and manufacturing job growth since 1980



Source: Bloomberg

This also creates problems for the US Federal Reserve and for interest rate policy. The aim of the Fed is to create full employment and stable prices. In days gone by there was a fairly good predictive model for interest rate policy based on the change of jobs within the US manufacturing base. However, since the turn of the century it has become less and less useful as manufacturing has been supplanted by services and government-inspired employment. For instance, if you were to follow the model strictly, US interest rates would currently be 3%. Theory and practice have parted company and if, as we expect, inflation falls away by the middle of this year, the Fed will have no alternative but to keep interest rates at current ultra-low levels into 2011, or until employment starts to show decisive gains. A sustained low interest rate policy will tempt investors into the bond markets, allowing US bond yields to fall as 2010 progresses.

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