*Pulling it all together.* **Article 5 of a series of articles on the global economic challenges impacting investors by Investment Strategist Peter Lucas.**

This final article in the series pulls together the strands of the previous four to explain why the long-term outlook for markets is so challenging.

Before we get stuck in, a quick update on the short-term. The champagne has been put back on ice as another wave of COVID-19 infections has come along to spoil the party. That said, the market reaction has been far from disastrous. The US value index has given back roughly a third of its post-March gains and the NASDAQ has recorded new highs for the year. The resilience of equities and commodities in the face of copious warnings from analysts and the recent COVID-19 news has been impressive and is probably explained by the determination of the authorities to do whatever it takes to get the global economy through this sticky patch. The worse things get, the more fiscal and monetary firepower will be unleashed. Whilst COVID-19 remains a drag on economic activity, the glamour growth stocks will remain the focus of speculative activity, but that will probably change when the recovery proper begins in earnest. Watch the bond market closely for clues as to when that is starting to happen.

The last four articles have described a world of extremes: massive debts, a chasm between the haves and the have nots, overvalued equities (at least in America) and interest rates at multi-decade lows. Volatility has perked up in recent months, but given the backdrop, one might have expected it to have spiked sooner and more dramatically. The fact that it has not is testament to the efforts of policy makers to keep the show on the road, but as my articles have hopefully explained their hard work has merely stored up a bigger problem for the future.

Each extreme creates its own challenges, but the interaction between them could make for a particularly tough environment. Take for instance income inequality, which is feeding a rise in political and social instability. Going forward, as the populists wrench power from the mainstream parties, we can be pretty sure that the quality of policy making is going to decrease. Capitalism and globalisation have been blamed (unfairly) for the world's ills and are likely to be under increasing attack. That probably means that the medium to long-term outlook is for higher inflation. One way or another, that was always the most likely endgame for the debt bubble anyway.

Accelerating inflation would be really bad news for fixed income securities, which are currently priced for a very different scenario and offer no inflation protection whatsoever. Contrary to what many think it would eventually be bad for equities as well, because, although company assets and profits are to some extent inflation-proofed, equity valuations are determined by the level of and volatility in the rate of inflation. Valuation analysis is already telling us that many financial assets are priced to produce low or even negative real returns in the next 10-20 years. But if valuations are driven into undervalued territory, the drawdowns experienced by investors will be that much bigger. If there is a wealth effect, people spending more because asset price inflation has made them feel wealthier, poor or even negative market returns will provide the economy with a headwind when big debts say we need all the growth we can get. Furthermore, poor market returns will be a hammer blow to pensions that are already underfunded. People will not be happy if their so-called gold-plated pensions prove to be anything but. If all of that stokes voters' discontent, there is every risk that our leaders will take us down even more blind allies. And so on, and so forth.

So, the bad news is that the long-term prognosis for life and markets in the West is pretty depressing. The good news is that this is the last article in this series and probably the last time that these long-term challenges will be featured for a while. Instead, it is much more productive and gratifying to focus on the many opportunities that the big reflation will create for investors in the next couple of years.

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