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Booms & Busts Report

Given they leave out from the inflation indices the prices of goods and services that are going up, official inflation (RPI - Retail Price Inflation) is, now, 11.1% p.a. (April 2022, the highest in over 40 YEARS!) And this is with the fraudulent calculation methodology.

Imagine if they kept in / put back in what they leave out / artificially lower... such as home energy, vehicle fuel, food - you know, unimportant things...

If they did that, as you know anyway, the true inflation rate is higher than 15% pa - not far off 1970s peak levels of inflation! (When they more honestly published inflation.) The 1970s was when we had 3 day weeks and power shortages because the power workers went on strike, as the government employers kept paying less than the workers' costs of living increases.

Is your pay keeping up with true inflation?

Is your (Pension/ISA etc etc) investment portfolio prepared for, indeed benefitting from long term, rising inflation? (True costs of living increases of above 15% pa.)

It is unlikely to be doing so if it has been holding a lot of Cash or holding Government Bonds over the last two years, as some 98% of investment portfolios still do. If you have been holding Cash, your Cash has lost at least 20% of its purchasing power. What a waste.

And, incidentally, Government Bonds have fallen in price, on average, by 20% over the last some two years.

This is the May 2022 Booms & Busts Report. I publish these, free, every two months.

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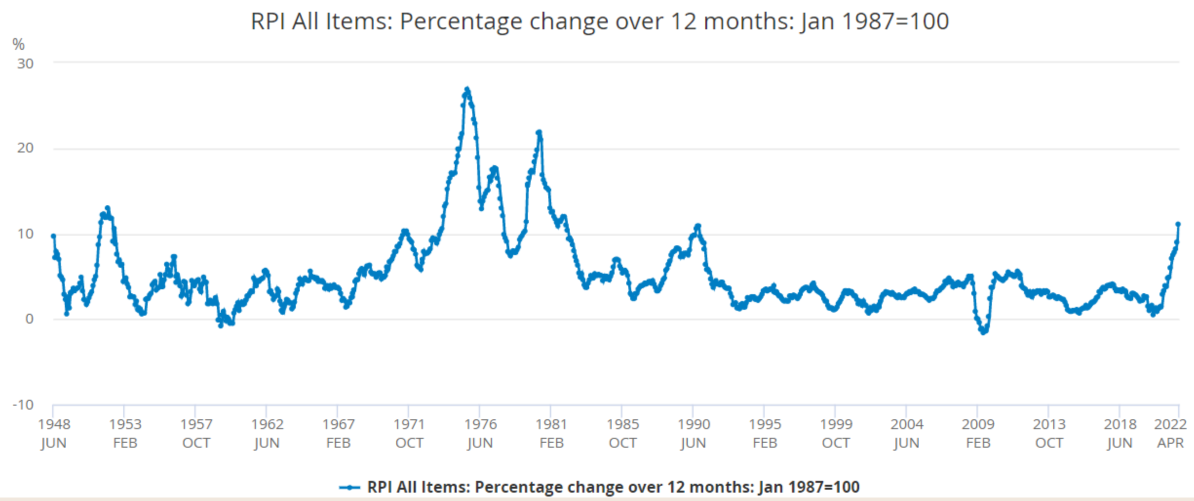
In this edition of The Booms & Busts Report

- **RPI and the costs of living**
- **Recession?**
- **Investing**
- **Collectables**
- **House prices**
- **Business students and professors**
- **China**
- **How to follow on Twitter, without having a Twitter account.**

Inflation



So, even with - self-evidently - fraudulent stats*, we have the highest rate of inflation in our costs of living and of doing business in over 40 YEARS!

Even though I have been writing of coming inflation and then of rising (soaring) inflation, for years, even I am surprised how quickly it has soared. Do you know the year-on-year inflation was merely 0.9% in November 2020. Well, that was the month our clients starting building what became a large part of our portfolio in Oil and Gas company shares. With sub 1% inflation, it was clear to me where this was going. It was baked in. Of course, as you know, fuel has rocketed since then (pardon the deliberate pun!), as has inflation.

As have our clients' portfolios.

* Ever heard of Hedonic Adjustments?
They started using them in inflation statistics around 30 years ago.
In a nutshell, for example, you know and I know that new cars have soared in price, over years. The bureaucrats, though, say they haven't because... they are better value (faster, more MPG, more electronics, more spacious, safer etc). So, even though THEY ARE MORE EXPENSIVE, they are treated as not so. 🤷
Look it up. This is just one of the many ways they fraudulently calculate inflation nowadays.

Regular readers will know I have been writing / forecasting big inflation for a long time. We took action in our investing. Did you? If not, why not???

Having said that, it seems to us that inflation is actually peaking here, for the next year or two. In fact, we would not be surprised to see April 2022 (or perhaps May 2022, to be published June 2022) setting the peak in annual, year-on-year inflation for the coming perhaps two years. In other words, we expect the annual increase in costs to fall from 11% to around 4% by Spring 2024. This does not mean we see falling prices, overall. (There will be some actual falls in prices^.) Overall, the rate at which prices have been soaring will fall.

^ We can see oil and gas falling. So, it may be prudent to hold off locking in long term energy supply contracts. The price at the pump should fall.
Second hand car prices should fall.
House prices should fall.
Collectables eg watches, fine art, wines, furniture, classic cars etc should fall.

Why?

There is an adage in the commodities markets:

The cure for high prices is high prices.

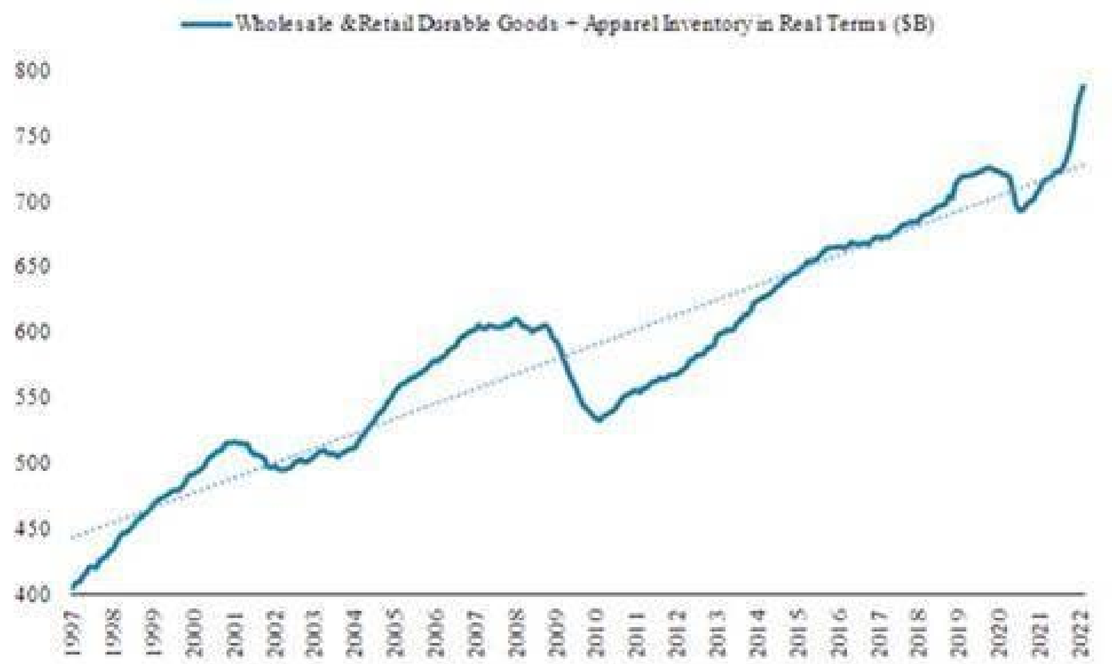
Simply put, there comes a point when the price just becomes too high and demand has to fall. It's not like food and water - which must be consumed daily.

One can holiday / travel less (less fuel), buy fewer clothes and 'stuff' etc. The same goes for farmers and manufacturers. If their input costs go sky high - and they have done - they cut back.

So, demand falls and prices normally fall back, as inventories rise. And it seems to us that inventories are going to rise in "nice things", as an economic recession, stock prices collapse and higher unemployment unfold.
To start with, inventories at major retailers are soaring:
Abercrombie +45%
Target +43%
Kohl's +40%
Walmart +24%

US Inventories

Exhibit 6: Real Inventory Levels for Consumer Goods Are on the Rise



Source: Haver Analytics, Morgan Stanley Research.

To us, there are strong signs that we are in a very similar position as Dotcom Bust #1, perhaps worse, which took place between March 2000 and October 2002 or March 2003, depending on the stocks' indices analysed.

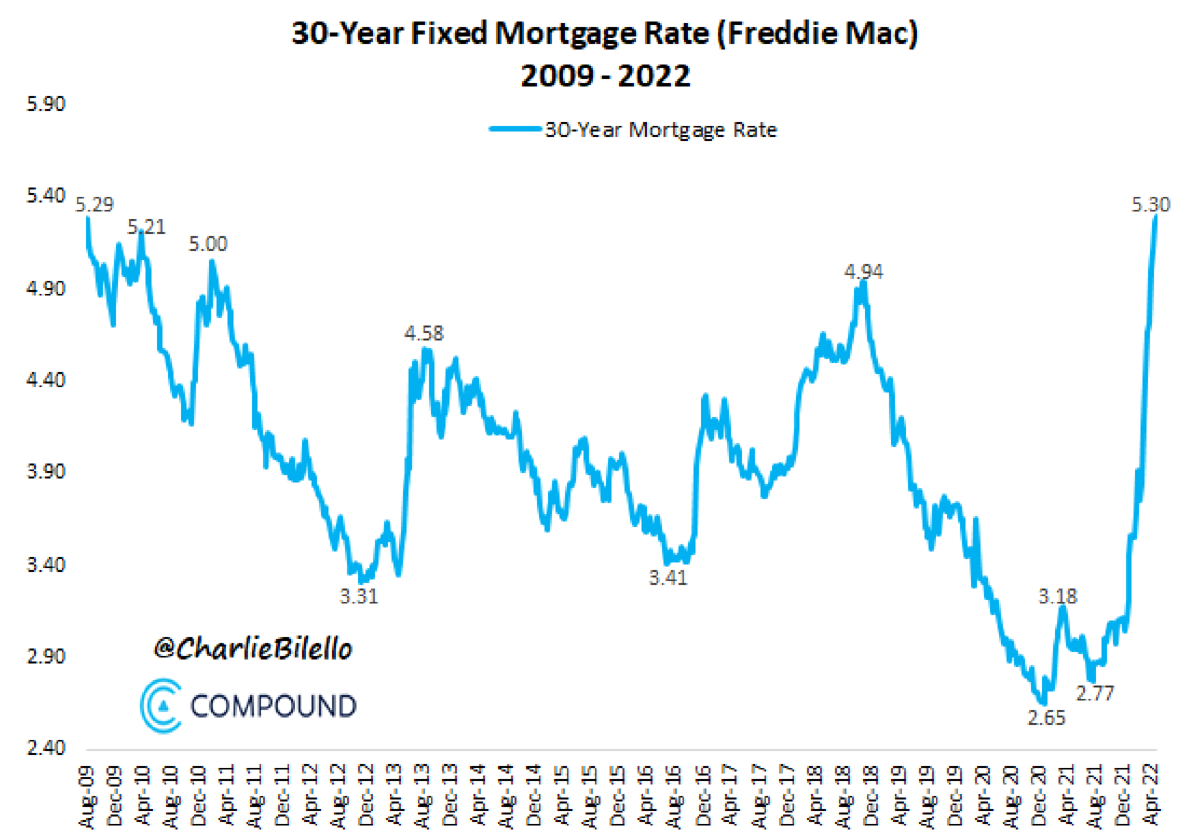
Also, note that the fabled US consumer accounts for some 70% of the US economy. The US economy pretty well determines the rest of the world's economy.

Unlike small countries (by land mass) like the UK and other European countries, Americans drive EVERYWHERE. Ask an American how do you walk to somewhere and he'll look at you as if you're from outer space. NOBODY WALKS in the USA.

In 2018, when we visited Florida (when we had free movement), we were actually shocked it only cost us $25 to fill our 2.0 litre engine hire car's tank. We put $40 on the credit card payment machine, expecting no change. 😂

No longer. As the oil price has soared, it has gone directly to the US consumer's back pockets. It is now some $150 to fill a tank. And they have to fill it at least weekly, just to get to work. That is a huge chunk of, what was, disposable income. Then, add on the much higher costs of heating and lighting their homes, the rising costs of food and so on. Mr and Mrs Apple Pie are, increasingly, tapped out.

30 Year Fixed Mortgage rates



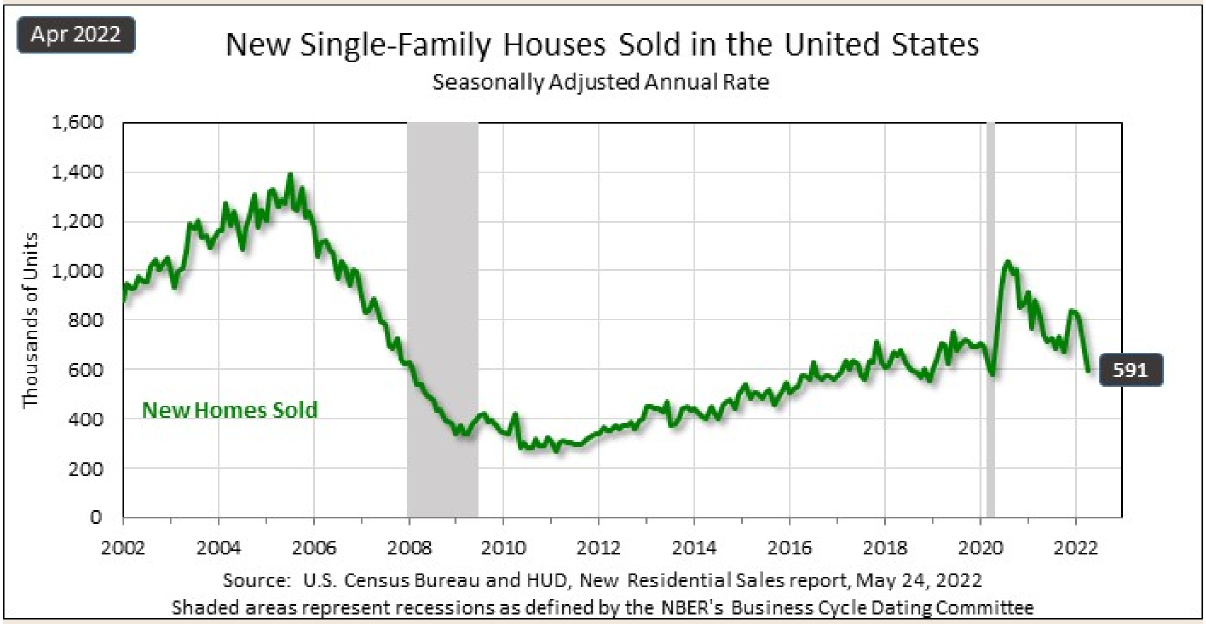
In America, most folk take out very long term fixed rate mortgages, WITHOUT a switching penalty.

So, as mortgage rates fell, for decades, borrowers would simply move to a new, lower rate, without exit penalty (for the old mortgage) and pay less, monthly. An easy uplift to disposable income. Helped keep the economy plates spinning for decades.

But look at 30 year mortgage rates, in recent months. They have skyrocketed to the highest level since... the last recession. For the last six months, US mortgage holders could not just remortgage to a lower rate and reduce their monthly bills. Of course, they didn't remortgage to a higher rate. They will still hold the low rate they obtained 2019 to 2021. However, NEW borrowers ie First Time Buyers or those wishing to trade up, found that rates were much higher than previously. Inevitably, this hurts house buying demand.

From April 2021 to April 2022, US new housing sales fell 9.5%.

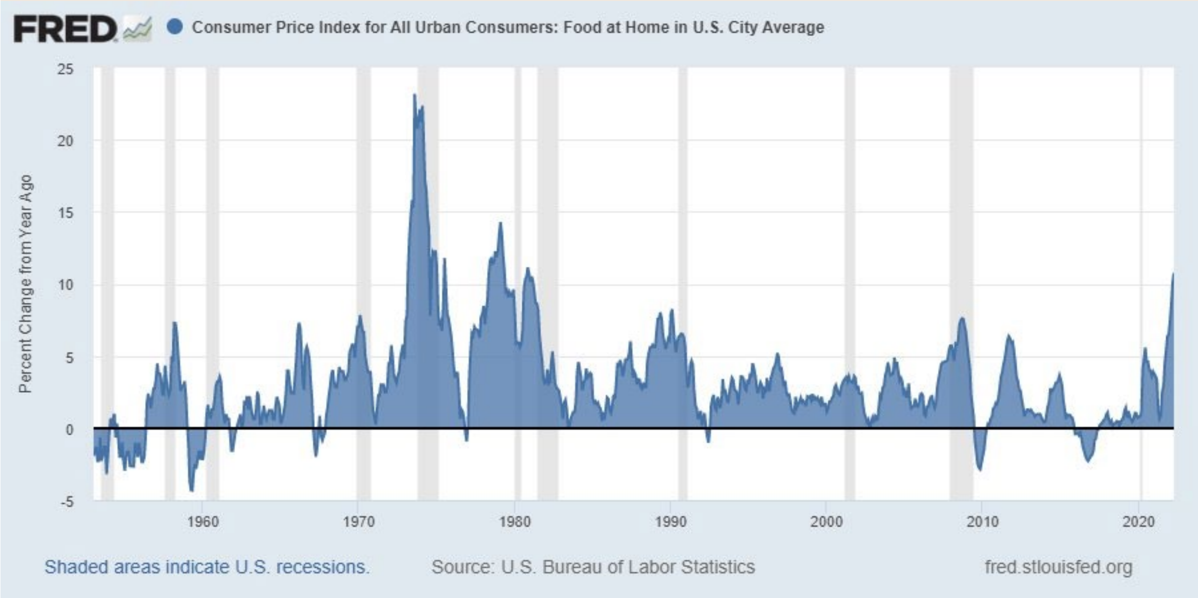
New Home Sales



US new home sales are plummeting, and have been since mid 2020. 591k sales, suggested for the year at 24 May 2022. Compared to 1.4m in 2005. (The grey shaded vertical areas are when the US (Globe) had economic recession.) We are now at levels indicating general economic recession.

It also means that household disposable income will not be bailed out as car fuel and home energy and food costs soar.

US Food inflation (Urban)



So, 'everything' is soaring in price. This is all having an effect on consumer spending. They are reining it in.

This is recessionary.

Note the following fact of economic history:
Every time the US had inflation above 4% - which it is - and unemployment was below 4% - which it is - the US went into recession within two years.

Now look at the stock market.

S&P 500

The S&P 500, the biggest public companies in the US (Global companies), after having soared, from the March 2020 low, has crashed since the end of 2021.

After housing, the US consumer holds most wealth in the stock markets and, especially, the S&P 500. Some 65-85% of Americans' pensions is in stocks and Corporate Bonds. The other 15-35% is in Government Bonds.

Stocks are down 20-25%.
Corporate Bonds are down 10-15%.
Government Bonds, since early 2020, are down around 20%.

Over the last six months, investment wealth is down around 20% from the peak. For the average American Consumer.

... WHILE, IN THE LAST 1-2 YEARS, THE COSTS OF LIVING HAVE SOARED.

Is the American consumer feeling good right now? Are they spending freely?
No and No.

On top, they are worried that unemployment will rise, as interest rates rise.

Total quarterly Real consumer spending growth has collapsed from 17.1% (Q3 20 - Q2 21) to just 2.5% (Q3 21 to Q1 22). It won't take much for quarterly consumer spending to go negative. Less spending = lower GDP ie recession.

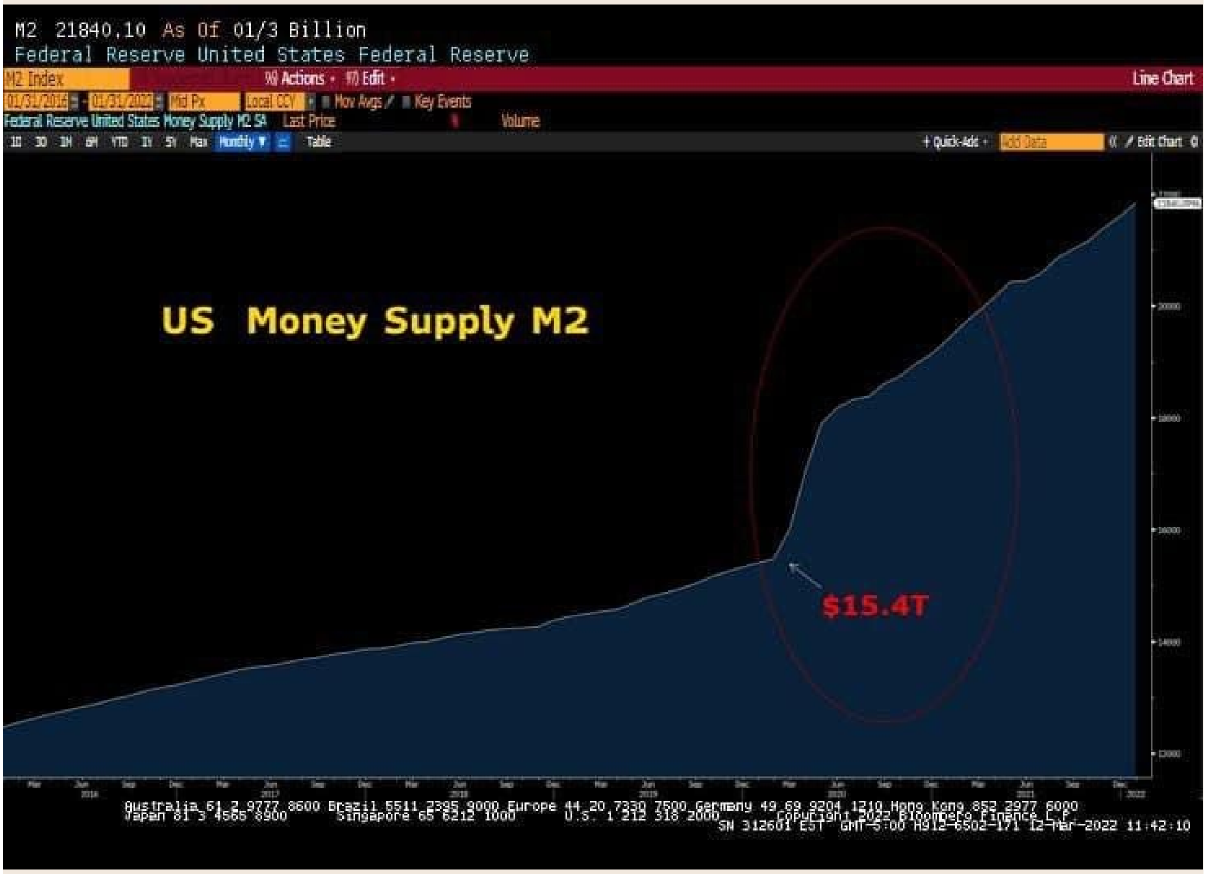
Real GDP from Q4 2021 to Q1 2022 was lower by 1.5%.

The Global central banks are doing what they think they ought to and raising rates. Of course, THEY and the politicians created the huge inflation (YOU MUST NOT INVEST IN OIL AND GAS AND PRODUCE MORE. YOU MUST HAVE HUGELY EXPENSIVE ENERGIES, when the sun shines and the wind blows... You must not have nuclear power - thee most efficient energy source on the plant, by a million miles. 🤦) They kept interest rates FAR TOO LOW for FAR TOO LONG, pushing inflation up and up. On top, the politicians started "MMT" in earnest - Modern Monetary Theory (what a crock of garbage.)

MMT says the politicians can helicopter money to the people and keep everyone fed, housed and prosperous. And intelligent people actually buy this???!!!
One does not need to be a rocket scientist to realise that if you hand people money for doing nothing - like 2020 and 2021 - then you get inflation and the people are then EVEN WORSE OFF, after the initial excitement. Do they also not realise this is Marxism/Communism/Fascism - all sides of the same coin? It's blindingly obvious. And yet...
(The MMT con artists say all will be well unless we get inflation. This is troubling as there is no way you won't get inflation!)

In the US, over 40% of ALL US DOLLARS ever created were printed in 2020 and 2021.

MMT



Even now, the US Real Interest Rate (rate less Inflation), after rate hikes, is -7.4%. To combat inflation, rates will need to be much less lower than inflation.
In the UK the Real Rate is -8%.
In the Eurozone: -7.9%.

(You notice they are all similar. Independent central banks? Oh please.)

(Brazil, notably, is +0.6%. Now, there is a country serious about combating inflation - which helps the people, not the City and politicians.)

There isn't an example in history of a successful economy sustaining high inflation. It's great for the billionaires, bankers, bureaucrats (Fully Index-Linked pensions...), academics, politicians et al. Terrible for everyone else.
High inflation is recessionary.

Look at Germany.   A half of its largest exporters have announced they will sell less to China, Germany's third largest export market.
Daimler-Benz has announced it will cut 10% of its dealers, globally. (Why would they do that?)

Germany is probably in recession now.

Thus, the entire EU is.

The UK probably is in recession. Manufacturing costs have risen THE MOST ON RECORD year-on-year. Companies cannot bear that for long.
Supermarket prices have risen the fastest in 13 years. And, of course, for a long time we have had the insidious Shrinkflation. No one has cared while it affected chocolate bars. It's now affecting meats and vegetables.

Add all that to what has been happening to the stock market, it seems likely we are in or just about to be in a US-led, Global recession.
Batten down the hatches. It could well be the first major recession for 20 years (ie since Dotcom Bust #1*). It could be Dotcom Bust #2. (The NASDAQ 100 index was down 30% at the recent lows.)

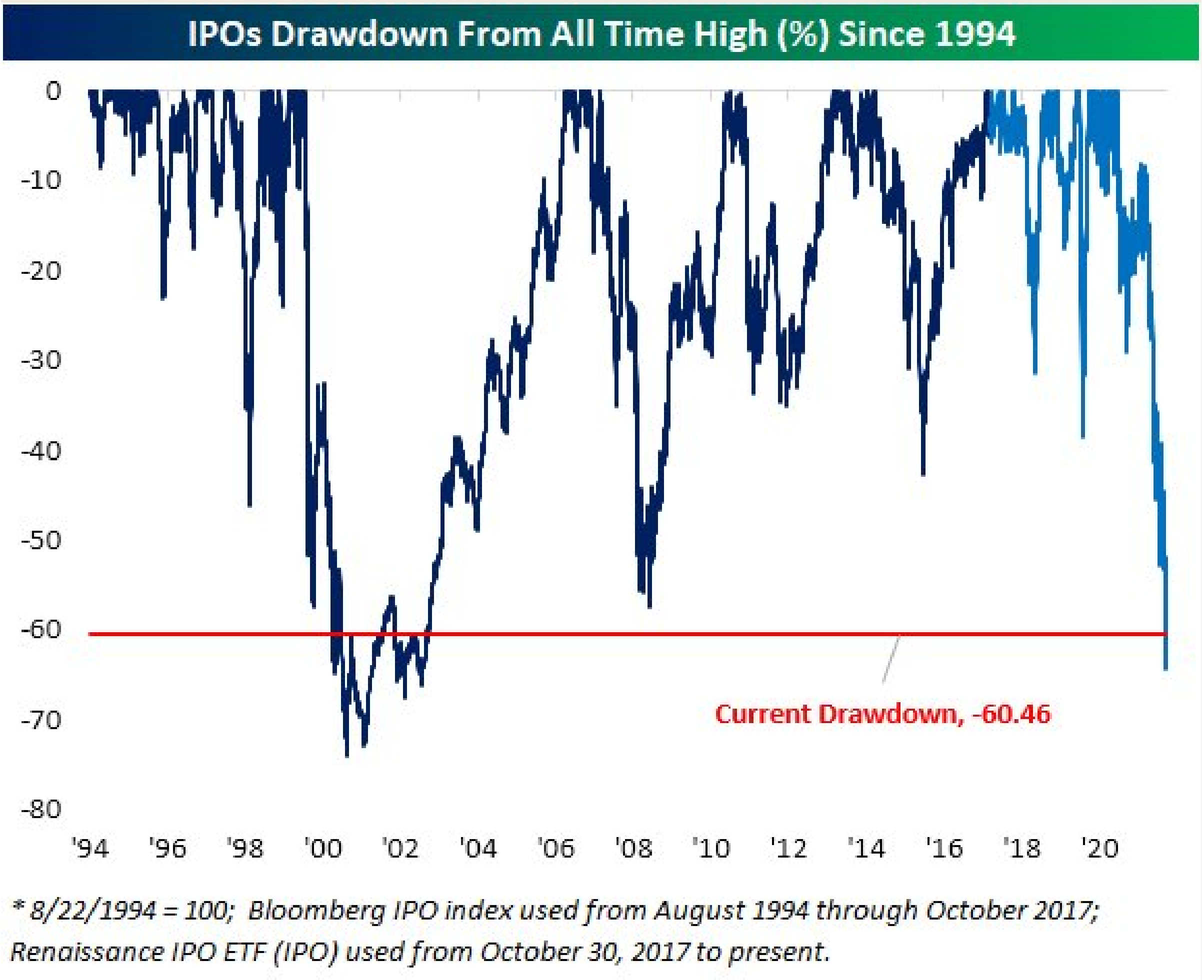
*   No. 2008 was not a major recession. They call it The Great Financial Crisis. It surely was. It wasn't a major economic recession.

In October 2002, we bought a 2 year old car, which had been £25k, new, in December 2000. It had just 11k miles on the clock. We paid £10,000. It was a major recession. Companies were desperate for Cash to come in. You didn't see that kind of thing in 2008.

Even so, UK house prices fell 20% in 2008. Then they slashed interest rates.
This time, they can't slash interest rates. I've said so, in advance, for the last 10+ years.

(Those folk, who showed me property funds had achieved 8% pa for several years, will have me asking them what have they done now, and in two years' time... And in 10 years' time...)

IPO Bust. Same as 2000



The collapse in the share prices of recently brought-to-market companies, is as high as the Dotcom Bust from 2000. (An average collapse of 60% in their prices.) This is likely due to much less liquidity in the system.

This is the 4th worst start to a year, in history, for the S&P 500. Down 20% in around 100 trading days.
The worst years were:

1932 Great Depression, 1940 WW11 and 1970 (Vietnam War).

The S&P chart shows a bounce happening, since 20 May 2022. To us, until we see more / different data, we see this as a "Dead Cat Bounce" *. We will be surprised to see anything higher than 4400/4500 in this short-lived bounce, before the collapse resumes. At this point, we expect a two year bust in stocks, just like 2000-2002/3. And our clients are taking appropriate risk-reducing actions.

ARE YOU?

* No animals were hurt in the making of this Booms & Busts Report... 🤣 (It's just a markets' phrase.)

You will have read me ranting on about 60/40 portfolios, and how awful they will be for many years, if not decades. (If you haven't, go back in previous Reports.) On average, such portfolios are down 15% **so far this year**. This is just the start, as we see it.
The next year or two will see major falls in 60/40 portfolios, that will, likely, never fully recover, certainly against the costs of living.

Collectables
It seems to us, normally, we see a major crash in prices of these when we go into recession and when there is a stock markets crash.

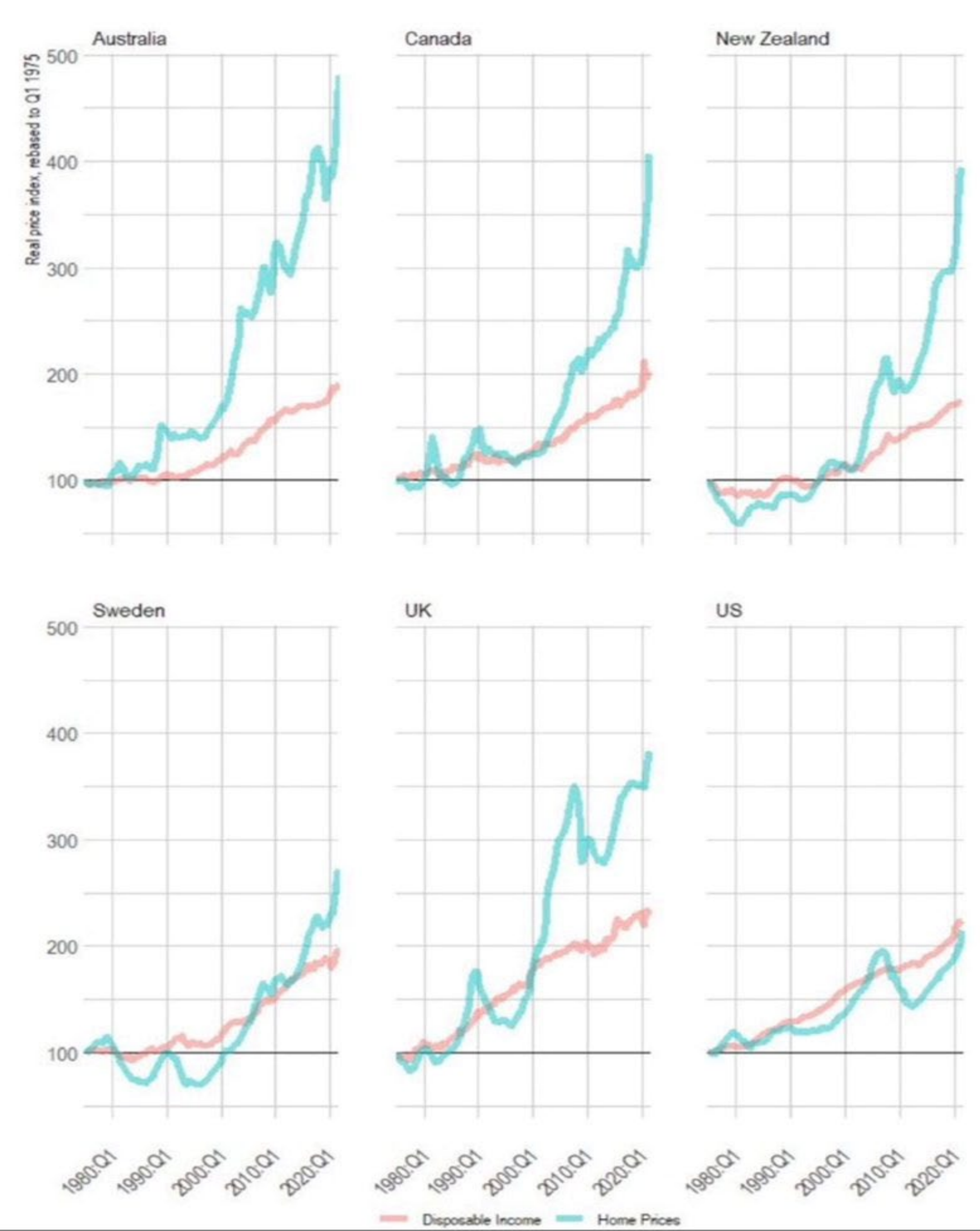
They are flashy of course and when the City isn't getting huge bonuses and when people are tight with scarce funds these items are the first not to be bought and almost the first to be sold, as Cash is needed, quickly.
Demand should fall and Supply should rise, over the next year or two. The time to buy a Rolex is Spring 2024 is our estimation.
Also, a classic Mercedes / Porsche etc.

Not H1 2022. Or 2022. Nor, probably, 2023.

For the long term, expect collectables NOT to have the breath taking rise they have had for decades. The World has changed. Buy to enjoy, not to make money.

Let's move on to house prices.

HPs Vs Disposable Incomes



A selection of 40 year histories of Average House Prices compared to Average Disposable Incomes.

What do we know of the last 40 or so years?

Investments have achieved some 6% pa growth, compound... while inflation has been falling.
Interest rates have plummeted to effectively nothing.
Prices of goods have fallen (China / online business).
Inheritances have soared.
Household formation has been consistently high.

So, house prices have soared against incomes. Look at Australia. Uh oh. 🤦‍♀️
Canada, New Zealand and UK. Uh oh. 🤦‍♀️

What do I expect over the next 10-20 years?

Investments will fall vis-a-vis inflation. They may not make any money at all, even nominally. (Like mid 1960s to 1982, as I have previously presented.)
Interest rates will not fall. At BEST they will stay around where they are, over the long term. At WORST they will rise for many years.
Inflation is here to stay (not the next year or two).
Inheritances will soar.
Household formation will not rise further.

Are you a long term house price bull? I'd love to know your thesis. I can't see it myself.

I wouldn't, yet, go so far to say house prices will fall, into the 2030s. I can yet see a little growth for several years, net. Falls next couple of years. Then rises, then falls and so on. Net, perhaps 20% up over the next 10 years. Maybe.

While incomes probably double.

Thus, what I do expect is the Average Price to Average Earnings to fall, materially.

The South East of England average income is around £35k, and that includes The City. The average house price is around £700k. 20:1.

I see no economic growth, net, over the next 10 years. (Recession then growth then recession. Rinse. Repeat.) I see unemployment rise, sustainably.

If average earnings double and average prices rise 20%, by 2032, the ratio will fall to 12:1. That wouldn't surprise me, at all. And similar in Oz, Canada, NZ.

Probably similar long term outlook for the US.

In a world where hard assets will make fortunes ie Oil and Gas, Base Metals (Copper etc), agricultural produce, and precious metals, the world will be a very different place in the next 10-20 years than the last 40+.

Incidentally, if you read recent Booms & Busts Reports, what should you hold during recessions, falling prices' periods?

Business School and Academics

I saw someone tweet, last week, that in 1997, the brightest of the brightest, students at Harvard Business School, told a young Jeff Bezos that his business idea of Amazon (stupid name, means nothing...) would fail. They told him "You seem a really nice guy. So, don't take this the wrong way but you really need to sell your [fledgling company] to Barnes & Noble [for non US: think huge national book sellers. Unsurpassable...] and get out now." The oh so clever lecturers and professors agreed.
Since 1997, the share price peaked at 100,000 x the 1997 price...

I promised my Twitter followers that I would recount a tale of when I was an MBA student at Cranfield Business School.

It was also, coincidentally, Summer 1997. The group project was to analyse Japan Inc and report on its outlook, given it had had a few years of a downturn.

Recall that Japan had 'taken over the exporting world'. It was a sight to behold and everyone wanted some of the Japanese magic, since You Only Live Twice in 1964.

Our group wrote Japan was going to come back and again rise far above the highs that it had seen in the late 80s. We should all copy the Japanese. There was only one way for global business and manufacturing and it was Japanese.

Remember the hit song "Turning Japanese" by The Vapors (1980), as Japan was soaring.

As it turns out, Japan and Japan Inc had peaked in the late 80s, and then went into a 30+ year DEPRESSION! It was a debt-deflation depression.

The level of debt the Japanese had taken on was literally astronomical (in numbers). Eventually, it all crashed under the sheer weight of debt. Only now, 35 years after the peak period, can Japan look at coming out of the malaise.

I can still remember one of my group calling "Jonathan! We got the paper back" and he was smiling from ear to ear.

Needless to say the professor and lecturer who marked our pathetic paper gave us 86% and an A+. 🤣

The moral is: Recency Bias can be damaging to your wealth. Look forward, not back. Look at debt, not output.

What was that?
Did someone mention China?

For us, China is very much Turning Japanese. I won't be touching China or Hong Kong, for investing, even with a barge pole, for a long time. A very long time.
If you want to know more, you know where I am.

Follow me on Twitter @j0nathandavis where I frequently comment on markets and economics and where you will see day-to-day thinking, and sometimes big picture.
Some folk may wish to follow on twitter but do not have and do not want a Twitter account.
Just go to nitter.net/j0nathandavis and bookmark the URL
You do not need a Twitter account to follow my tweets.

We advise private clients, exclusively, nationally and internationally (ex-UK residents). Some international folk, non-UK, subscribe to our Client-Only Updates.

I have limited space for new clients.
I have unlimited space for subscribers to our Client-Only Updates.

"We advise you based on what we would do, were we in your shoes, given what we know."
Call me personally to see how we can help you.

I think most folk do not realise the growing problems in investment markets.
They will. But will they have lost out or benefitted from the correct actions taken?

If you have any queries over any of the issues raised call me or email by clicking ***here***.

With kind regards

Jonathan Davis BA MBA FCII FPFS EFP
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