JONATHAN DAVIS WM

Leaders in Wealth Management

Chartered Financial Planners

Booms and Busts Report

We publish these reports on Economics, Markets and Financial Planning several times a year. We produce in-depth reports, for clients only, with investment recommendations, separately.
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Well the UK General Election result was something of a surprise, given what the pollsters said beforehand. I'd love to know how they remain in business, given they are so wrong so obviously and so frequently.

Of course, just like BREXIT, Trump and the (almost) hung parliament, the pundits, Bank of England, BBC, The Economist, fund managers etc were also yet again quite wrong in their prognostications of if you vote the 'wrong' way.

Here is what I told a reporter 30 minutes after Theresa May announced the GE:

Jonathan Davis Wealth Management managing director Jonathan Davis says: "As soon as I heard the news I took immediate action and did nothing. I will do the same on the day of the election.

"The UK election won't have any effect on equity markets. The Conservatives are going to win and there will be no effect on commodities either, bonds as well as sterling."

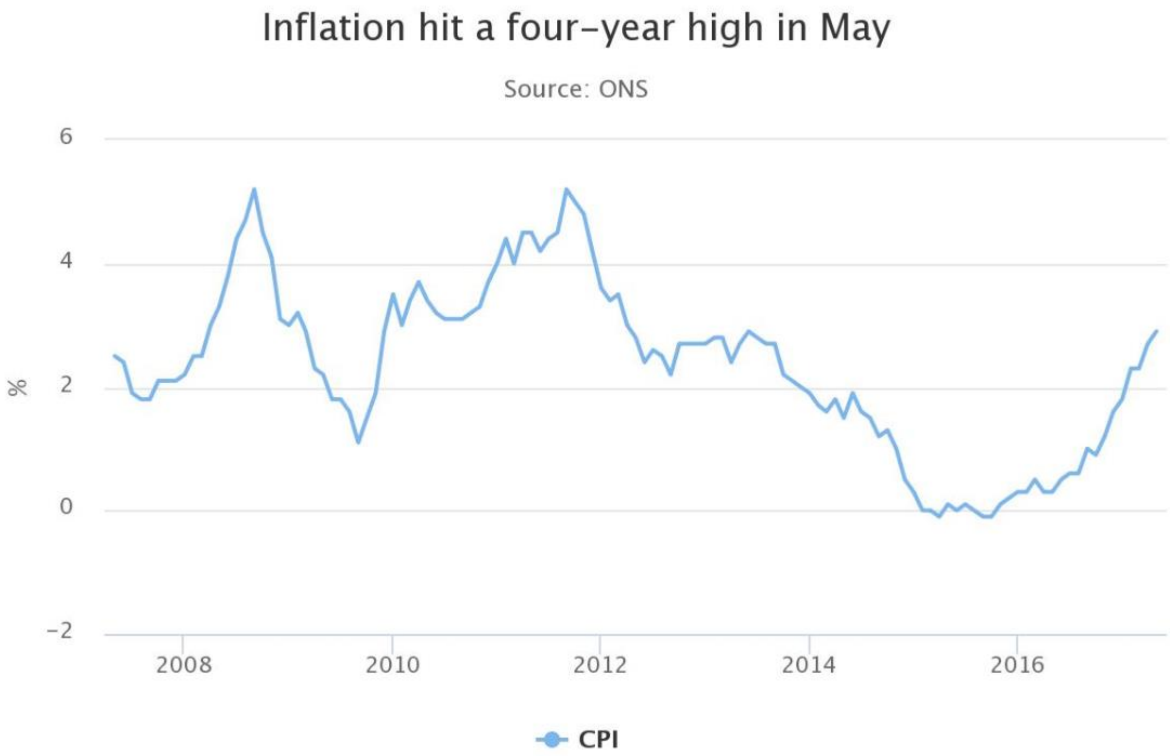
Valentina Romeo

And indeed we changed nothing as a result of the GE.
(We did make a change a few weeks ago but it had nothing to do with the UK GE.)

Nothing in global markets has materially altered since last year, when we re-entered mild global inflation, largely down to rising oil.

When no-one else was discussing inflation, I was. And during last year, our portfolios moved from heavily deflationary-biased to heavily inflationary-biased.

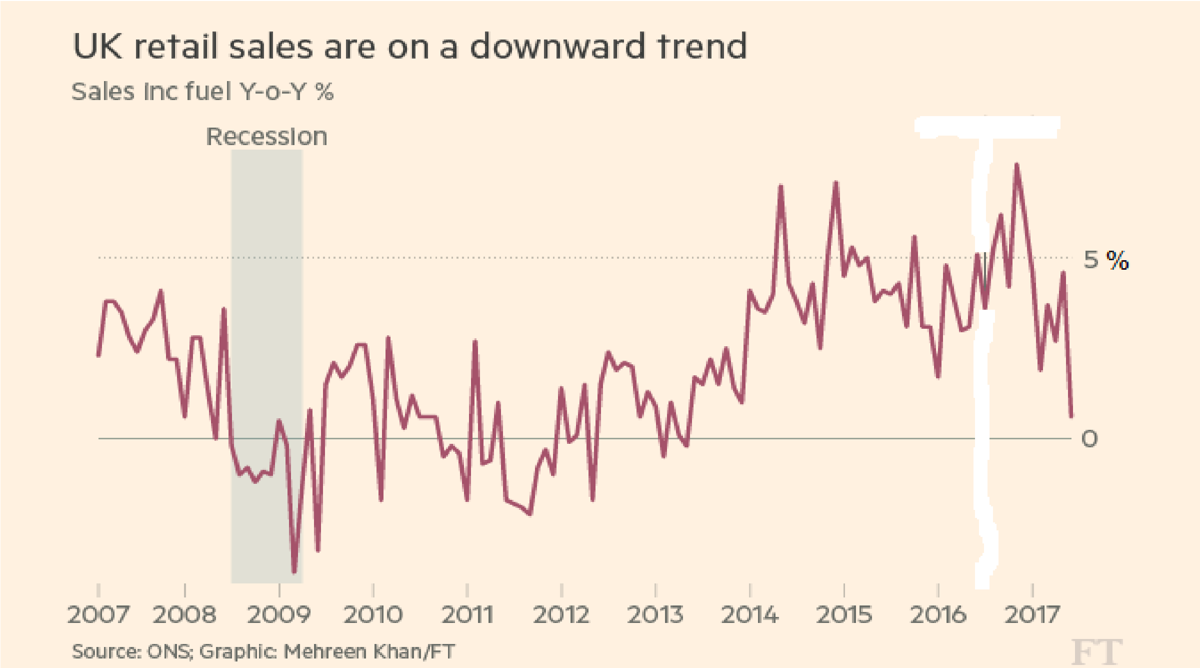
And sure enough, according to the official (pretend) indices we now have around 3% inflation. (In reality it's much much higher but governments don't want you to know that reality.) Bearing in mind, this time last year it was practically NIL%.



However, the rise in oil was February 2016 to February 2017. So, the inflationary pressures should ease now. The index can still rise, to 4% maybe even 5%, but until and unless oil soars again we are likely nearer the top in inflation, than the start of sustained higher inflation.

Add to that the following:

UK retail sales growth fell to merely 0.9% year-on-year to May 2017.



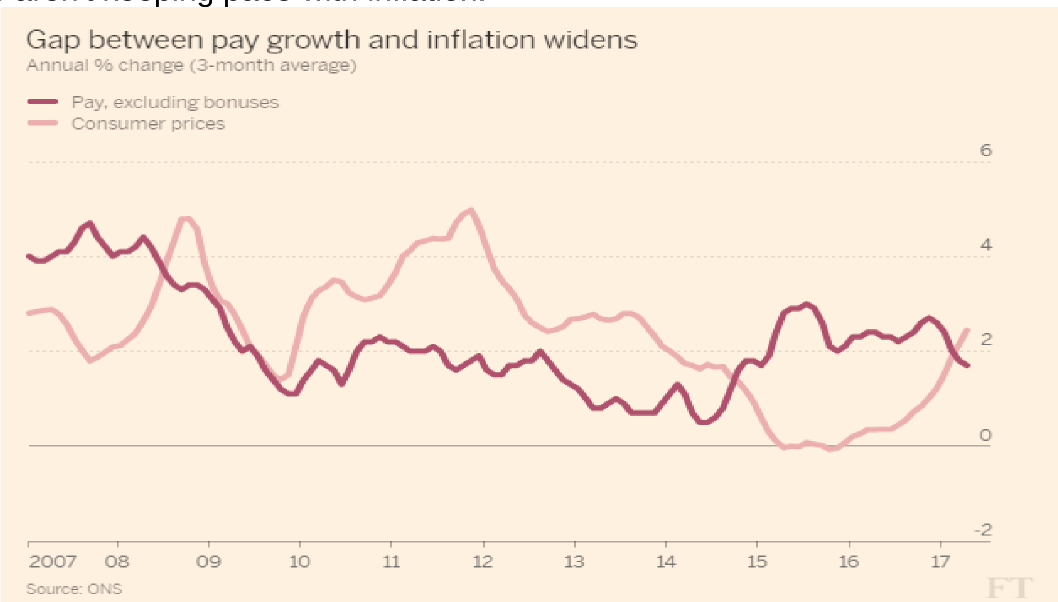
Note that annual retail sales growth was c 8% only last Summer. 8% growth down to sub 1% in less than a year? And heading still down, perhaps going negative year-on-year.

On top, (unfortunately I could not find a chart) when you strip out fuel spending Retail Spending Ex-Fuel was actually **down 1.6%** year-on-year.

THAT is the true state of play on the High St.

What else to note?

Earnings aren't keeping pace with inflation.



The above chart shows April inflation i.e. before the May announcement of 2.9%.
So, we have c 3% inflation (officially) and falling retail sales. We have earnings not keeping pace with the costs of living.

This is not a strong economy. Over the last 10 years we have had c 1% pa growth.
With hundreds of billions of £££ of government borrowing (nb $10s of 000s of Billions globally...), practically no cost to borrow to 'buy' a house and practically no deposit needed (due to Osborne's tragically bad Help To Buy scheme) this is all we have to show for it.

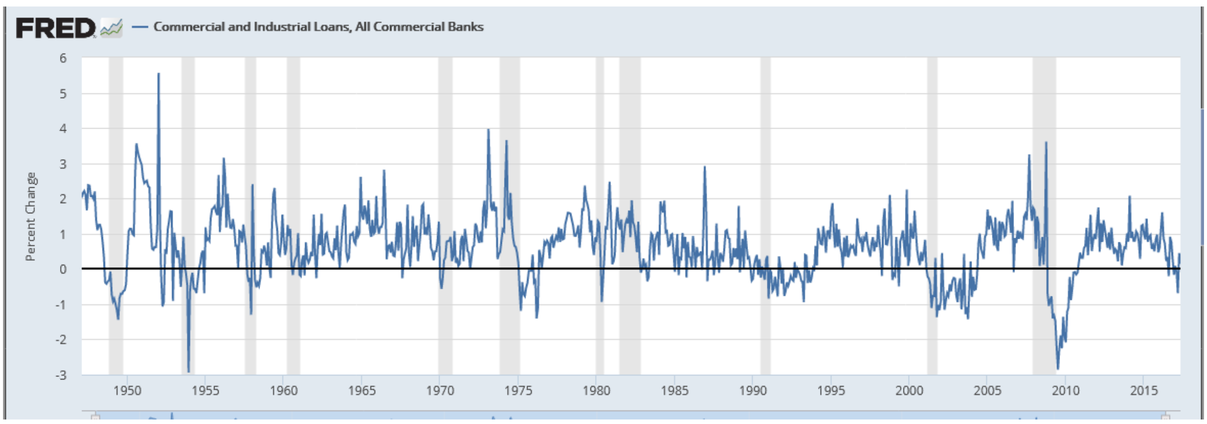
They said that the various and huge stimuli from 2008 onwards would help the economy strengthen so that we could then repay the debt. Interest rates would normalise.

I've said for years it was all nonsense. It was.

New car sales?
In the UK they fell a sizeable 8.5% in the year to May.

In the US the car business is in a dreadful state. Major manufacturers have announced production cutbacks as the stocks at dealers is the highest in living memory. Dealers are slashing prices as they try to sell 2016 stock. Used car prices are plummeting (some 2-3% PER MONTH). I estimate the UK is between just 3 and maybe 6 months behind the US.

Another US economic statistic I keep an eye on is Commercial and Industrial Lending.



The above comes from the Federal Reserve.
The grey vertical bars (in the above and each of the following charts) are when the US (and therefore, more or less, everyone else) was in recession.

You will note there is a high correlation between bank lending to businesses and recessions. When bank lending to companies goes negative we have a recession, pretty well.

Well it's hovering around NIL% growth and has recently been negative. It looks weak and trending down to me.

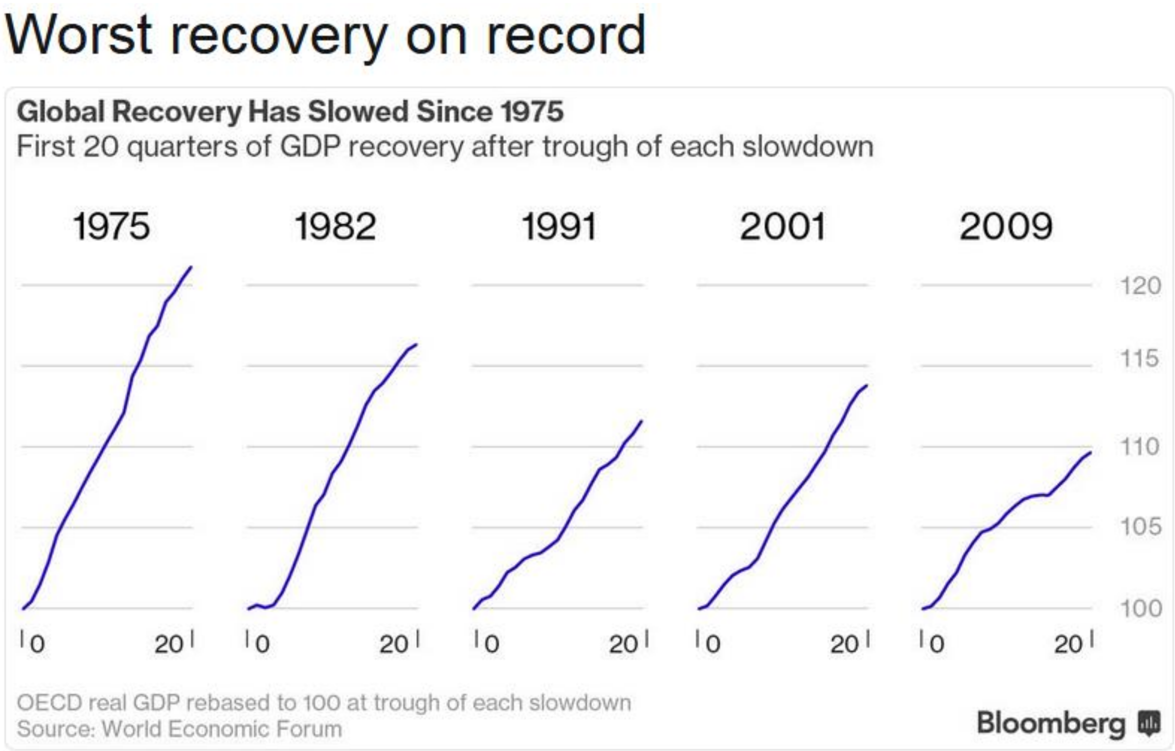
What is also notable is, since 2009, the US has had one of the longest periods, in history, of no recession.

BUT

At the same time, the current expansion in the economy has been the WEAKEST EVER.

After 20 quarters the 2008 recession was succeeded by the lowest GDP rise compared to each of the prior 4 recessions.

If you are in the top 10% this has not been your experience. If you are in the bottom 90% this has been your experience. Voila BREXIT, TRUMP, CORBYN.

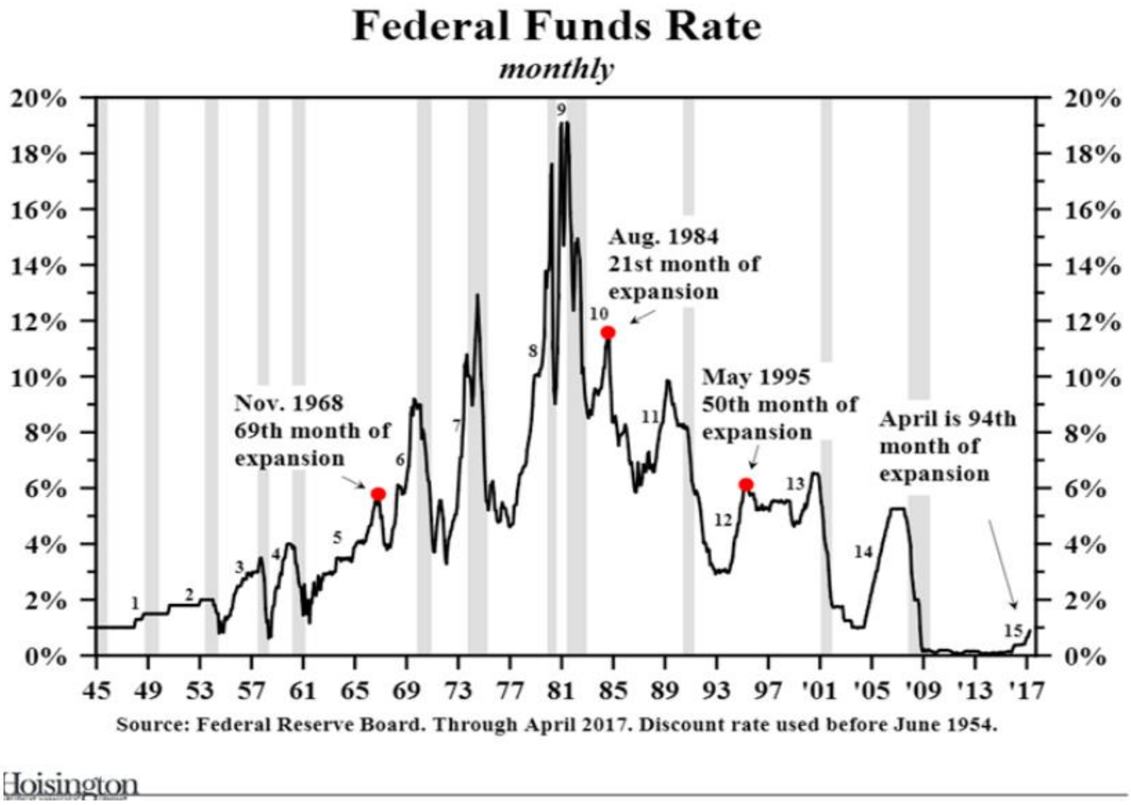


So, with all the 'stimuli', the US has had the weakest expansion in history. And so too the UK.

And, note dear reader, that with the economy fragile, the - oh so obviously political - Federal Reserve (like the Bank of England) (after Trump was elected President) has raised the interest rate 3 times in each of the last 3 quarters (December 16, March and June 17) as well as one in December 2015. So, the US rate has gone from 0% to 1%.

It is estimated that, with the vast amount of business debt around, each 0.25% rise is equivalent - in how it actually affects borrowers - to 0.75%.

Now, please note the following very carefully:
Of the past 19 US Federal Reserve interest rate rise cycles - going back over a century - 16 of them have ended in a recession.



Note the chart was produced prior to last week's latest rise.

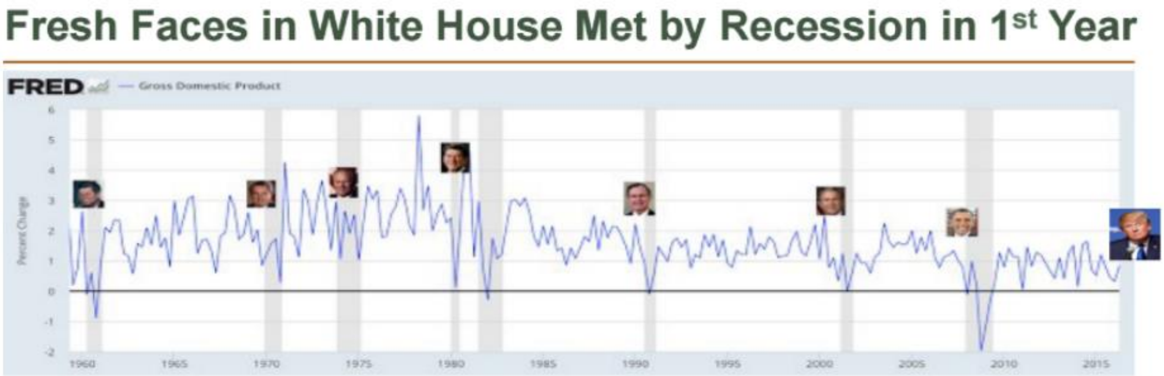
The three occasions, when there was no recession while the FED was raising, were after 69, 21 and 50 months of economic expansion, respectively i.e. mid expansion.

June 2017 is now the 96th month of expansion...

And finally, on this economics round up, I remind you of this (somewhat unsurprising) economic fact of political history.

Over the last 100 years, 8 of the last 11 recessions have coincided with the first year of a new US president. And of the three that it didn't they were either not changing party (Kennedy to Johnson) or it was the end of a 1-term President (Carter and Bush #1).

In the modern era, since the 1950s presidencies, from when Kennedy took over in 1960, the correlation is even more pronounced:



Coincidence? Not at all. The incumbant spends and spends (other people's money) to help his party's candidate. The incoming president then has to deal with the mess which is left. Or, more to the point, the people have to deal with it.

Obama was, of course, the biggest borrower and spender in history. Whomever was coming in would be left with the mess that he left.

So, put it all together, does the end of the economic expansion, which started in 2009, appear likely by early next year or even this year - followed of course by recession? All I can say is there is increasing evidence that the answer is yes. By no means certain or maybe even likely. But there is more evidence than previously.

In times gone by, I would have been able to put a higher certainty on it. But we are in truly extraordinary times of government and central bank recklessness.

Still today, 8 years after the beginning of the expansion, central banks are printing $1,800,000,000,000 ($1.8Trns) per annum and buying financial assets. It is beyond belief. It is what it is. THAT is why a) we haven't yet moved into recession and b) why I cannot be more certain that we will have a recession starting later this year or early next year.

However, there are a number of points you really need to consider.

1. When a recession comes (it will come some time) the central banks cannot slash interest rates. Sure the US will be able to reduce from c 1% or maybe even 2% (by then). But the UK won't be able to do so.

In any case, given the FED will reduce by whatever they can, a 1 or 2% drop is nothing compared to the 6% slashing they did in 2009, given our simply vast debt levels.

What will just a small drop in interest rates do for vastly indebted households, businesses and economies during a recession?

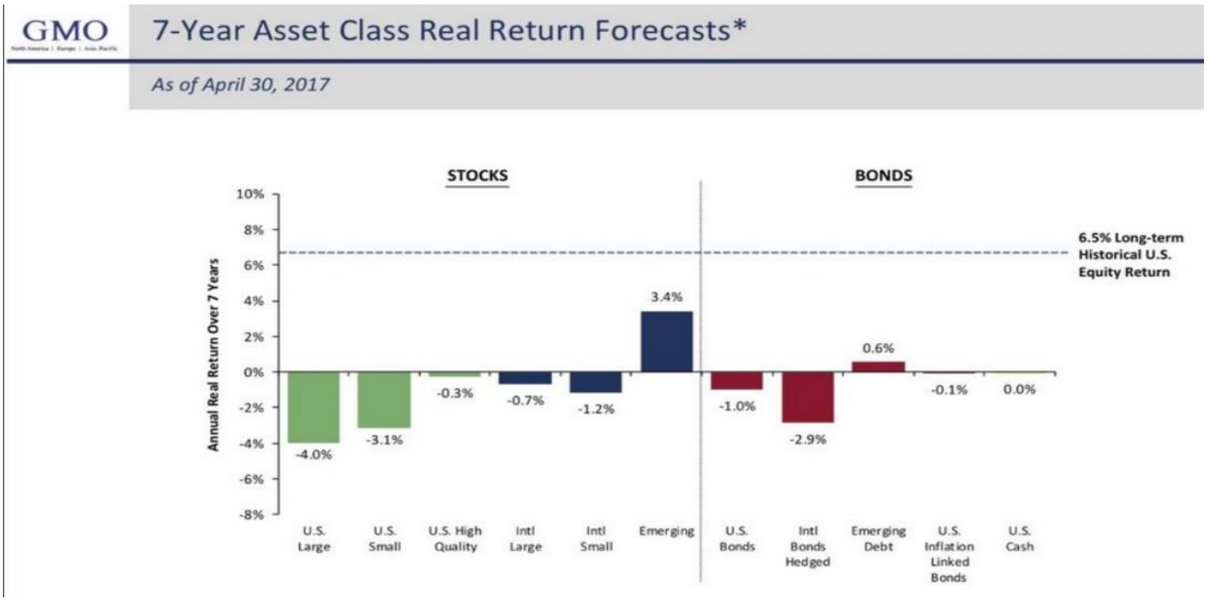
Are you really prepared as you believe?

2. Financial markets are forward looking. What will you look for to tell you if the next recession is approaching? Even if you believe you can see one coming, what will you do about it with regards your investment/pension portfolio?

3. Expect shares and corporate bonds to fall at least 30-50% in the next recession. By all accounts the bulk of investor portfolios is invested in shares and corporate bonds. IF this happens and pulls down your portfolio, consider your annual percentage portfolio growth since 1999 (20 years to 2019). Ask your portfolio manager to calculate your average annual return since 1999 now (i.e. his/her portfolios since 1999) and in 2019. There's a BIG difference between pre and post recession.

4. Ever heard of Jeremy Grantham? He's one of the founders of GMO (he's the G) and is still the CIO, 4 decades later. GMO manage some $80 Bns of private clients and pension etc money.

Every so often he and his team produce an outlook for investment returns and here is the most recent one, as at end April 2017.



So what are they (is he) saying?

Over the next 7 years, expect an **annual** (inflation-adjusted) fall of 4% on US stocks (GMO is a US company), and expect non US Developed market shares to fall 0.7% per annum (after inflation).

How much of your portfolio is the FTSE, EU and US stocks?

Also, expect annual falls in government bonds. How much do you have in Gilts etc?

So, you might be thinking: well, anyone can make a forecast.

Yes, of course. Note, however, his (their) record:
The following shows the forecasts he made at the end of 1999.

Performance of GMO Asset Class Forecasts for the Decade Dec. 31, 1999 to Dec. 31, 2009

Asset Class	Estimated Rank	GMO 10-Yr Forecast Dec-31-99 (% Real Return/Yr)	Actual 10-Yr Return*	Actual Rank
U.S. REITs	1	10.0	7.4	3
Emerging Market Equities	2	7.8	8.1	1
Emerging Country Debt	3	6.1	7.5	2
U.S. TIPS	4	4.3	4.9	4
Barclays Capital U.S. Gov't. Debt	5	3.8	3.5	6
International Small Cap	6	3.4	3.5	7
Foreign Bonds	7	3.0	3.9	5
U.S. Small	8	2.5	2.3	8
U.S. T-Bills	9	2.1	0.3	9
EAFE	10	0.4	-1.4	10
S&P 500	11	-1.9	-3.5	11

He said US shares would fall 1.9% PER ANNUM (inflation-adjusted) **over the next 10 years** (to end 2009).

He was wrong.

They fell 3.5% PER ANNUM (after adjusting for inflation).

Non US developed stocks he forecasted a small rise of 0.4% pa. Actually they fell 1.4% pa.

He forecasted government bonds to rise 3.8% pa. They rose 3.5% pa.

Etc.

An astonishingly accurate record of forecasting.

Remember the context of December 1999. It was Dotcom fever. The internet was transforming our economies. Economies and stocks would never again fall, sustainably.

They peaked 3 months later...

What's the context now? All is well and always will be...

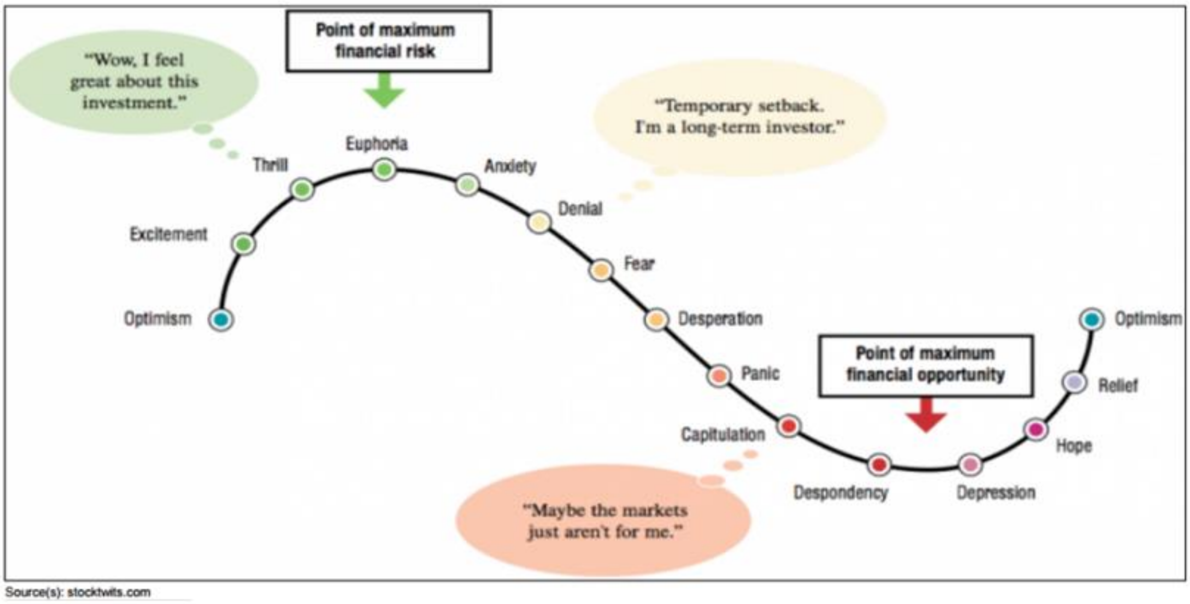
If you don't want to listen to me as I'm some ridiculous doommonger then why not listen to one of thee most successul investors of all time.

Do yourself and your retirement a favour. Review your portfolio and make sure it is sound for what has a good chance of coming, relatively soon.

Or leave it to what always happens in recessions. It's your money.

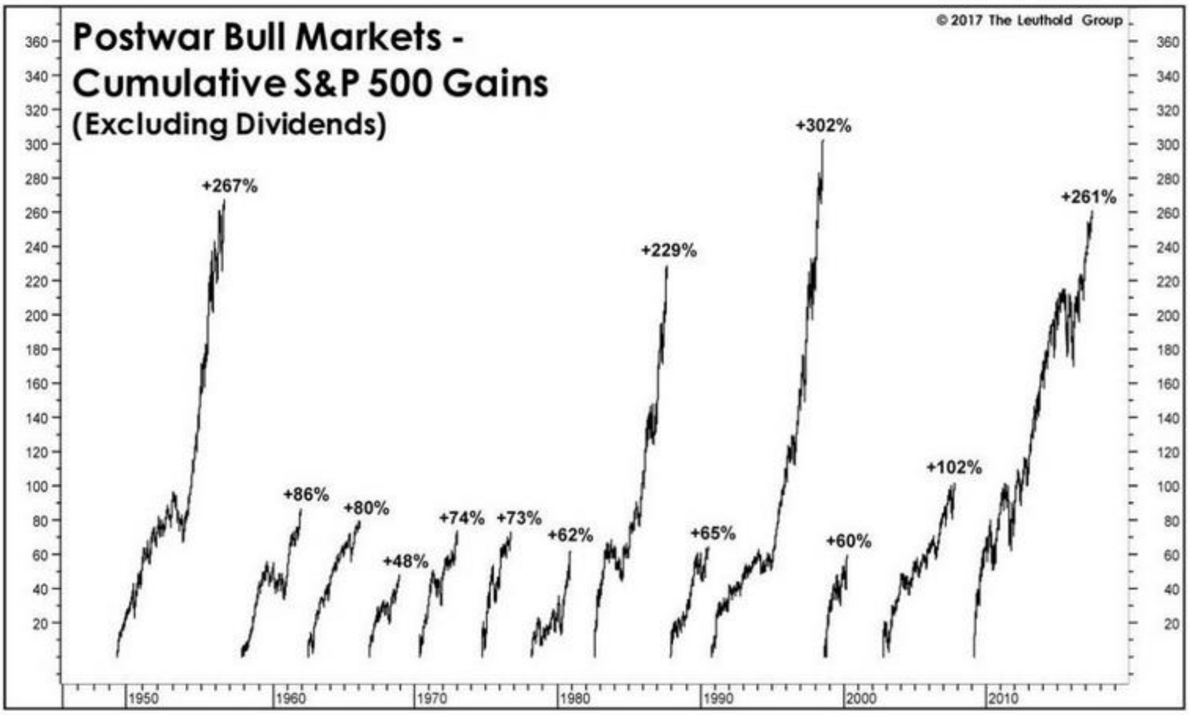
Consider this too. The average investor - as well as professionals - has invested in stocks because there is nothing (per se) to be earned on deposit. Whereas previously many of those 'investors' would have happily stayed in cash. I hope they know what they're doing. I suspect they don't.

Given all you've read just now, and what you read and heard elsewhere, where do you believe we are on the cycle of the psychology of markets?



I would put us between Thrill and Euphoria.
I could of course be totally wrong. We could be at Optimism.

The following shows the growth in the US S&P500, during each bull market since WW2. I remind you that the market is NOT the economy.



While stocks have soared (and your equity biased portfolios have performed very well particularly since last year, as you will see why, next) the economy has grown weakly (see the earlier chart of GDP growth following several recessions).

Having said all that, all of it is for nought if global finance disagrees. I can tell you, they decide what I think.

The above is the last 20 years of the FTSE100, in which much of UK investors' portfolios are invested.

I remind you that, from 2011 to the end of last year, the FTSE grew 900 points. 6 years and merely 15% growth.

It is a fact that though that the FTSE, this year, finally broke up above a level that it hadn't breached even though it tried both at the end of 1999 and in late 2007.

If this is a true break then global finance has decided all is well. Of course, all the time we see 'fake' breaks both above and below previously apparently impregnable levels. Time will tell if this is true or fake.

Global finance was exuberant in 1999 and 2007 and massively fearful in 2003 and 2009. On verra.

One final point, as the economy had great risks in 2007 and early 2008, inflation actually rose, temporarily. It then collapsed as did the economy. And stocks, corporate bonds, property - where the bulk of financial (and overall) assets are held - crashed or collapsed. Inflation has just risen but that does not at all mean all is well.

From late 2007 to early 2009, portfolios, overall, fell some a third over a roughly 18 month period. Around 6 years of normal growth gone.

That was nearly a decade ago. For how long do you believe the expansion will continue? I have stated where I stand on that and my clients know what we are doing and will do.

What are you doing and what will you do?

What should you do to secure your wealth?
Speak to me before something happens, that nobody (else) advised you could happen, and which detrimentally and materially affects your wealth and financial security.

Don't put it off till it's self-evidently too late.

Can you benefit potentially from our advice?
We work for wealthy families (from £500k of financial assets) and/or high earners.
We work for clients all over the UK and indeed on three continents.

Our most important and most often repeated philosophy is (as seen widely on our website):
"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.

Please note carefully the following important messages (and pass them on if you wish):

I believe most folk do not realise, in big picture, **the sheer gravity** of our economics and markets (major stock markets, corporate bonds and property).

They will.

I think most folk also do not realise, in big picture, **the amazing opportunities** in our markets.

They will.

Click ***to forward to a friend*** if you think they could benefit from reading this.

If you have any queries over any of the issues raised do not hesitate to get in touch with me by calling me on 0345 862 2919 or emailing me at ***jdavis@jonathandaviswm.com***.

On Twitter my personal account is [***@J0nathanDavis***] where I frequently comment and link to important commentaries on markets and economics.

Kind Regards

Jonathan Davis **BA MBA FCII FPFS**
Economist and Wealth Adviser
Chartered Financial Planner
Presenter of The Booms and Busts Show on *itunes*