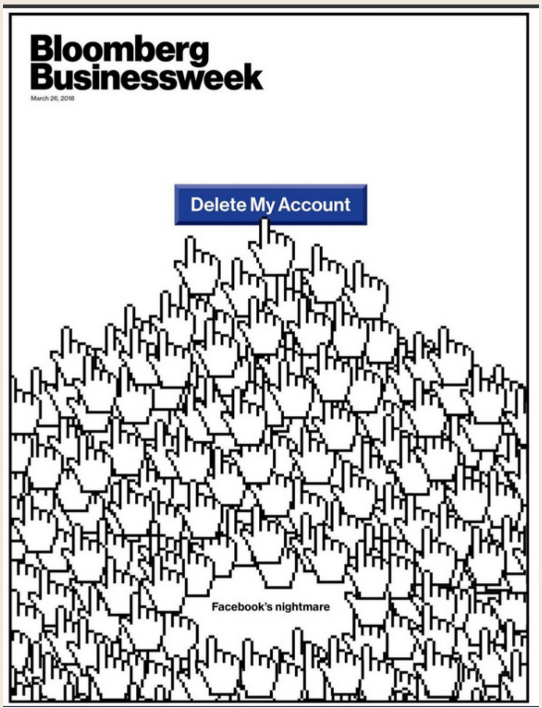
JONATHAN DAVIS WM

Leaders in Wealth Management

Chartered Financial Planners

Economics and Wealth Advice Update

I produce these economics and markets reports every two months. We produce, more frequently, more in-depth reports, for clients.



Whatever the rights and (almost entirely) wrongs of Facebook selling users' private data to all and sundry - it's being going on for years* - the cartoon on the left is the best analysis/conclusion I could find of the fallout of the scandal. Personally, I have NEVER opened a Facebook page in my life. Of course, I have never had an account.

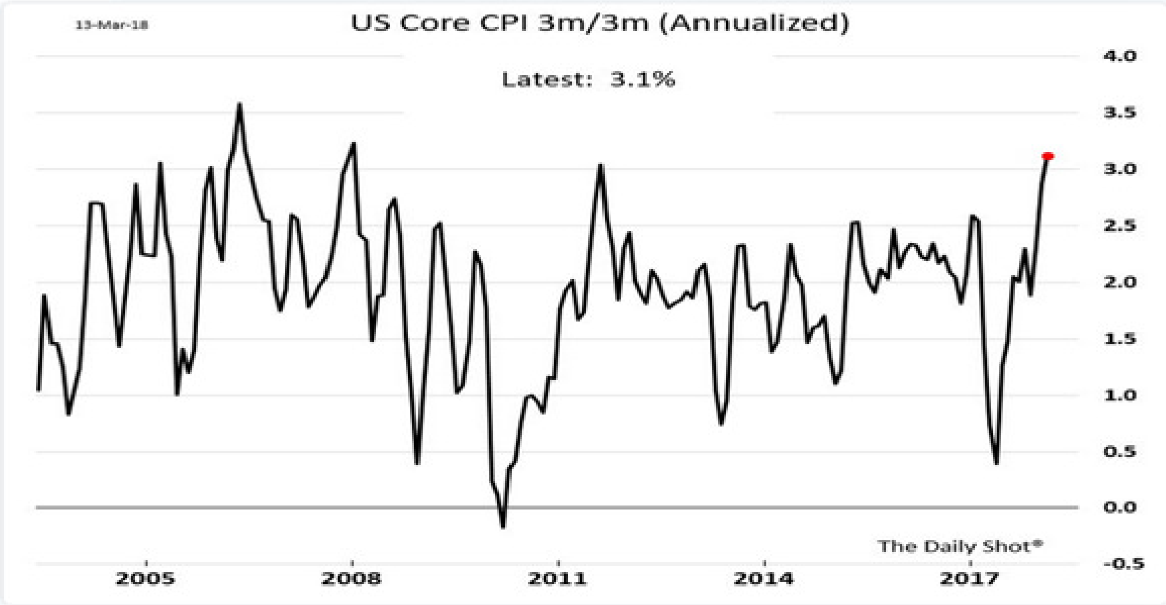
I have zero intention of handing my private details to those who will greedily sell it to corporations, governments and politicians. They already have quite enough data on me (and everyone else).

Those who use Facebook agreed to their data being sold. If you don't like, delete your account.

I use Twitter a great deal but anything on there anyone could find out anyway by reading The Booms and Busts Reports, for example.

*   Barack Obama and Hillary Clinton spent fortunes on such data. Clinton expended many times more than Trump.

On a 3-month basis, US core CPI growth hit the highest level in over a decade



Inflation

It creeps up on you and it grows imperceptibly.

In the US, CPI has been under 2.5% (and, at times, below 1%) since 2011.

However, as I have been saying for nigh on 2 years now, we appear to have moved from disinflation to inflation. On the face of it, it did not seem so, if you had only been looking at official CPI stats, as above.

But when we looked at rising oil prices and many other commodities, rising market interest rates, falling government bond prices, rising manufacturing input costs, soaring unsecured borrowing (car finance, credit cards, overdrafts), the tightness of labour markets etc we saw inflation building, sustainably, in the system.

And BOOM! Since just last year, US CPI has soared from 0.4% to 3.1%.

None of the above statistics suggest a reversal any time soon. Indeed, the likelihood is that inflation continues to build, globally.

Thus, we see the US Federal Reserve raising the Fed Funds Rate (like the UK Base Rate) this week to 1.5%. It was 0.25% in December 2016.

The FED tells us they are likely to raise a further 0.5% this year.

The FED tells us they are likely to raise a further 0.75% next year.

The FED tells us they are likely to raise a further 0.75% in 2020, taking the rate to over 3%.

It seems to me the only situation that will slow or halt the rises is if we happen to enter a Recession. I am not calling for one for this year. In fact, I am the most bullish for stocks and commodities than I have been since 2009/10.

[I am the most bearish for government bonds as I have been in years.]

In fact, the global economy is, shall we say, OK. There is nothing suggesting a Recession at this time.

Back in late 2006 when I started making big bearish calls, I could see the bubble in US housing. In the next year, Iceland 'blew up'. Later in 2017, Northern Rock. Early in 2018, Bear Stearns on Wall St. Then, of course, Lehmans and AIG in October 2008.

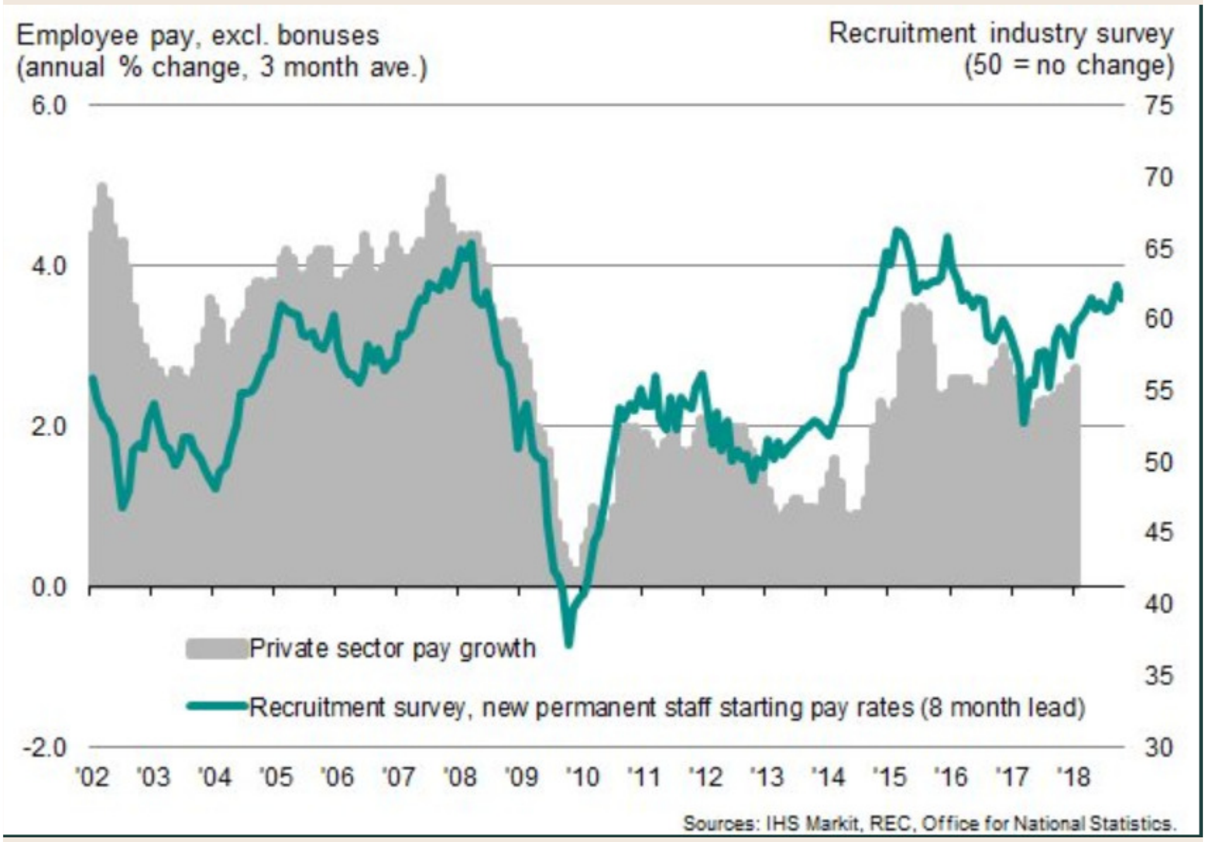
The point is, I see no such similar issues at this time. Going into 2016, our clients were heavily invested in government bonds as disinflation was strong and global trade was falling (2nd worst year-on-year change since 1958!). Bonds rose materially in 2015 and 2016. Stocks fell materially.

During 2016, as inflation started to take hold, we moved out of bonds into (cheaper) stocks and more commodities.

Oil bottomed at $26 per barrel in early 2016. It is now c $64. The trend suggests it's heading to the high $70s and maybe even $80s (irrespective of short term corrections). Inflationary.

The FED is, by far, the most important central bank in the developed world.

Looking at the UK, the markets expect the (insignificant) Bank of England to raise the Base Rate 1 or 2 times this year, thus expecting to take us to a 1.0% rate. If so, we would be a full 1.0% behind the US. And yet, we have rising inflation too.



Pay rates, for new employees, are rising strongly (green line, above 50 is expansionary). Earnings, excluding bankers' bonuses, are also rising and materially higher than in the first half of this decade.

It's almost as if Mark Carney, the Bank Governor, is averse to raising rates. (As the head of the Bank of England, and as head of the Bank of Canada, before, he has only raised the rate once. And that was only because he cut it after the Brexit referendum, before which he had said we'd go to Hell in a handcart if we voted to Leave. He had to save his face. He quickly reversed the cut.)

With central banks, all over, raising or saying they will raise, Carney will have to raise once or twice this year. (He should have raised again and again by now to stave off inflation. But he hates doing what is needed.)

That should be £ positive. And, indeed, the £ is back over $1.40 and this week touched €1.15 and appears heading higher against both major currencies. This general rise is fuelled by the markets expecting Base Rate rises. See how that works?

Even the uber dovish European Central Bank is getting in on the act. They are not yet raising but they have changed their mantra.

ECB guidance	Previous (January 2018)	New (March 2018)
Broad stance	"An ample degree of monetary stimulus remains necessary."	unchanged
Policy rates	Policy rates "to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases."	unchanged
QE guidance	QE to continue "in any case until the Governing Council sees a sustained adjustment in the path of inflation".	unchanged
QE bias	"The Governing Council stands ready to increase the APP in terms of size and/or duration."	REMOVED
Balance of risks: growth	"Risks surrounding the euro area growth outlook remain broadly balanced."	"The risks surrounding the growth outlook are assessed as broadly balanced."
Balance of risks: inflation	no explicit balance of risks	unchanged

Source: Pictet WM – AA&MR, ECB

In their guidance to the markets they have removed the statement that they will increase the amount of QE they have been doing.

This is less dovish than previously. Thus, it is ever-so-slightly more hawkish. That should be € positive vs the US$.

So, if currencies are rising vs the US$, that is - obviously - negative for the US$.

If the US$ falls, that is inflationary, as commodities - for example, oil - rise.

So, this is a little something of how global finance moves.

Our clients are fully invested (some more fully than others) in commodity-related financial assets.

Are you? In your pension and ISAs and in other parts of your portfolio?

Are you still holding a load of cash because the papers, pundits, your financial advisers and Uncle Tom Cobley tell you there is crash, recession and/or deflation on the way?

Remember, if you are making 0.7% on cash (after tax) and inflation is 2.7%, you lose 2% purchasing power, annually.

NB Historically, in rising inflation environments, inflation rises faster than interest rates. Thus, the losses increase.

Long-time readers of The Booms and Busts Report might be surprised that I am 'inflationary'. They shouldn't be.

I was 'deflationary' going into 2008, correctly.

I was 'inflationary' in 2009, 10 and 11, correctly.

I was neither in 2012.

I was 'deflationary', again, from 2013 to 2015. Oil peaked mid 2014 and had been flat from 2011.

And I was moving towards being 'inflationary' from early 2016.
Fully 'inflationary' by end 2016.

The economics and markets' conditions change. As investors, we must move with them. Not fight them.

So, inflation and market rates are rising and central banks are, to a greater or lesser degree, raising rates but slower. THAT should make inflation (and market rates) rise even further. Central banks are most unlikely to get in front (they never do!):

a) They created the inflation by
1. Having rates too low for too long and
2. MASSIVE money printing

b) They're still stoking inflation by behind behind

We have also seen a dramatic fall, over recent years, in the number of global free trade deals. Also, to counter EU and Chinese tariffs the USA has started to increase tariffs.

Thus, we have rising global protectionism. The result would be higher prices for goods and services, globally.

Thus, when you put it all together, we have to expect rising inflation and interest rates for a long period.

And this will hurt.

With higher and higher prices, without Real wage rises (above inflation), the volume of goods and services sold will likely slow.

Higher market rates (not central bank rates which are rising slowly) lead to higher loan interest rates e.g. mortgages. We have seen and continue to see material falls in residential and commercial property activity. Thus, prices for sale and rent are falling in the South East of the UK and this is likely to spread nationwide.

The US Federal Reserve has guided that it is looking at over 3% Funds (Base) Rate by 2020.

The UK could be looking at over 2% Base by 2020. That suggests mortgage rates of 4 or 5%, compared to 1-3% from 2011 to 2016.

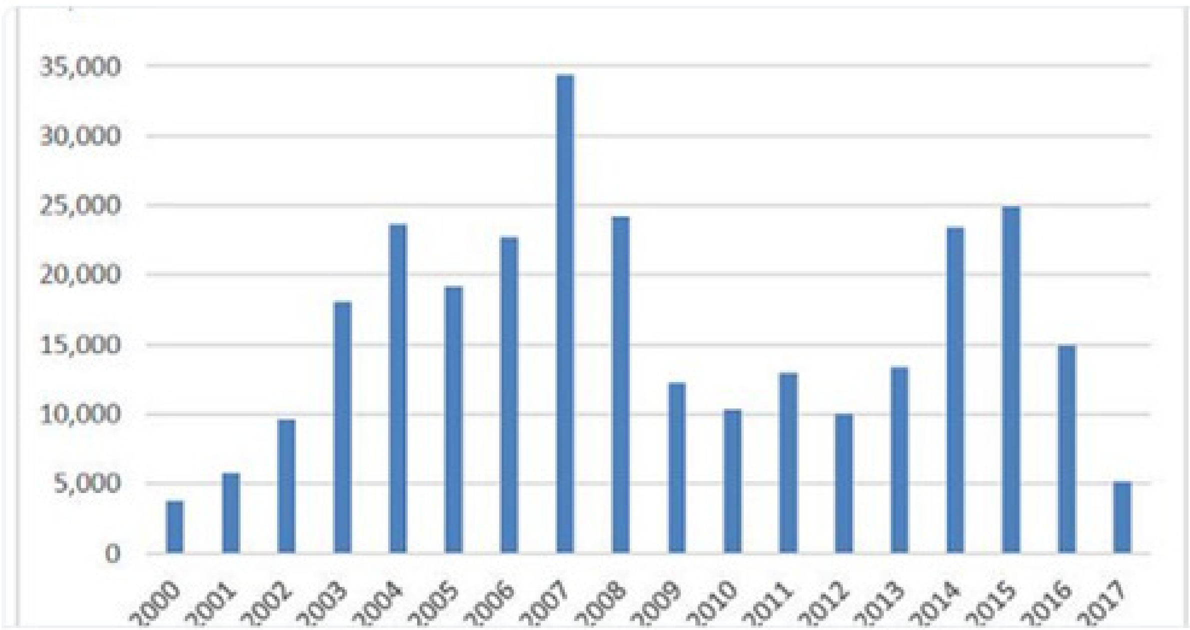
Add that folk who 'bought' using Help To Buy will have to pay interest on HTB loans, whereas for the first 5 years they didn't (amazing but true!). Many mortgagees, of the last few years, could see monthly mortgage payments rise by 50% from 2017 to 2020. With earnings rising perhaps 15%. Yet another headwind to the property market.

I have told clients and others - see ***Daily Reckoning 14 February 2018*** for example - that the outlook has a rising probability of price falls for a generation.

Shall I repeat that?

Recent figures show that Buy-to-Let imploded 80% from 2015 to 2017, from £25Bns to just £5Bns.

Buy-to-let investment plummets 80% in two years



Source:

Intermediary Mortgage Lenders Association

I have written, from time to time, about huge, building (sic!) downward pressures to the residential property markets. They continue to build.

49 out of 50 folk CANNOT EVEN IMAGINE house prices falling **sustainably**.

As I often say about markets, when the consensus is so strong in its belief, the consensus is usually wrong. Facts are facts and the pressures are large and building. If you or friends/relatives are highly exposed to property, if you didn't do so already, strongly, I suggest you read the linked-to article wot I wrote (HT Morecambe and Wise).

LIBOR is the rates' index that most large-scale corporate borrowing is set to. 3-month LIBOR, at over 2.0%, is the highest in nearly a decade. For years, corporates were borrowing at under 0.5%. Monthly / annual loan payments vary directly with LIBOR. This is and will hurt large companies, who have loaded up their balance sheets with debt, to sustain (unsustainable) dividends and keep stock prices up. It's possible we are going to see darlings of the stock market of recent years reverse and prior duds re-emerge.

The darling stocks have included technology stocks (eg Facebook ...) and the duds have included energy shares (did someone mention the oil price doubling and possibly trebling...?).

There is another, not widely-known, issue that should concern investors about the US stock market (and other markets but to a lesser degree) and the 'prior darlings'.

Vanguard is a simply huge investment fund manager. It manages some $4 Trillions (with a T), of which some $3Trns are in passive funds. In other words, $3Trns are invested in 'the market' and moves with the market. While the market has been rising that has been great and more and more have piled into the 'easy money'.

Only 8 years ago Vanguard 'owned' 3.3% of the S&P 500. Now it 'owns' 7.9%.

Can you see the problem?
Passive investing (and there are other passive firms) works when markets rise. And more buying begets higher prices.
But...if the owners of these funds decided to sell, this would create a huge downward pressure on the market and ... this would create a huge downward pressure on the market... and so on.

Getting back to prior darlings and hated shares, what have (hated) global energy shares (commodity companies) been doing?

They've been soaring since... early 2016. Pulled back somewhat in February but they look as if they are about to fly again. It seems to me they will do so for years. The index halved from mid 2014 to early 2016. Since then, up just over 50%. A lot more to come.

Yes, well it's very volatile Jonathan.

Hmmm... Since when did we distrust BP, Shell, Exxon etc for our portfolios? Especially when bought cheaply.

In 2011, energy shares made up 12% of the S&P 500. Now, it's 6%. Technology is now 21%.

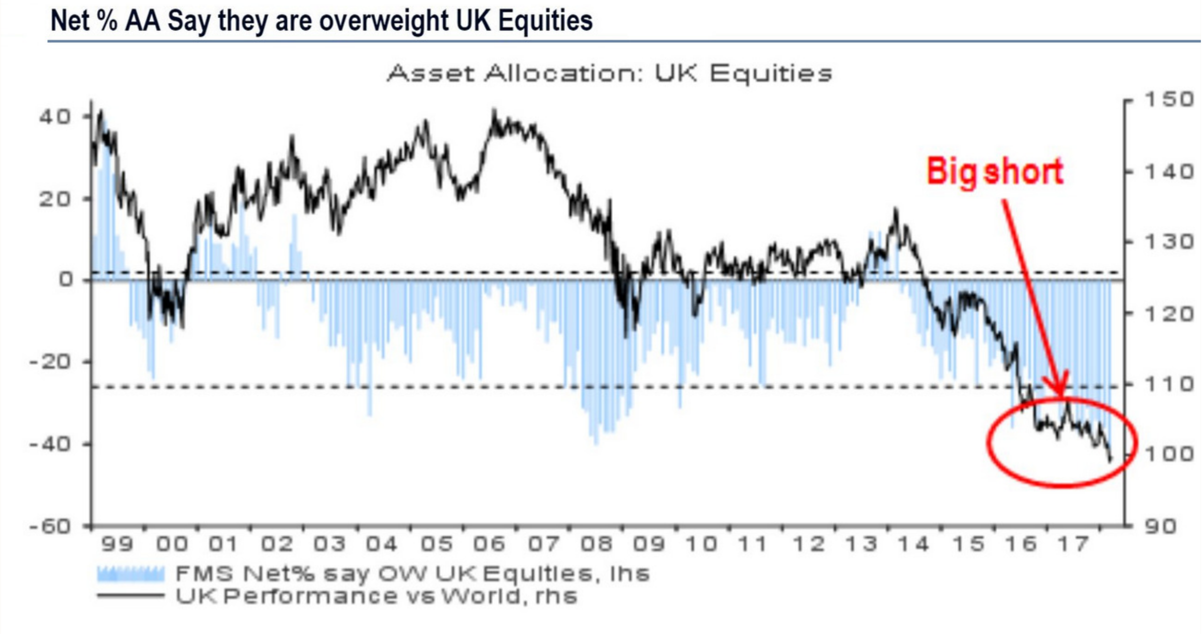
What could be in the works is, as I say, pressure downwards on prior darling stocks and markets and a renaissance in prior hated stocks and markets. That suggests the US market may not do as well, relative to other markets, as it has done for years. This is not to suggest I expect sustained falls in US stocks. What I am seeing, however, are signs that markets, outside of the darling US, are building strength. Thus, if they both rise - which is likely - non-US will rise faster. And, incidentally, Emerging Markets (there's that oil again...) will rise faster than Developed Markets.

See how the US hugely outperformed non-US for years.

Notice though too the outperformance all but stopped in late 2016 - just at the point our clients increased materially their portfolio exposure to Global Equities.

It seems to me there is a rising probability US stocks will now underperform non-US stocks.

Indeed, the UK market, to zoom in on one non-US market, is somewhat 'hated'.



Source: BofA Merrill Lynch Global Fund Manager Survey

What you see there is how much fund managers are invested in UK shares, or not as the case may be. A net NEGATIVE 45% i.e. managers are severely underweight the UK. This is hilarious.

1. As you see, relative to Global (World) equities, the UK has severely underperformed since 2006 and, particularly, since 2014. Thus, the UK market is relatively cheap! Watch it outperform over the next few years, led by prior hated stocks and sectors...

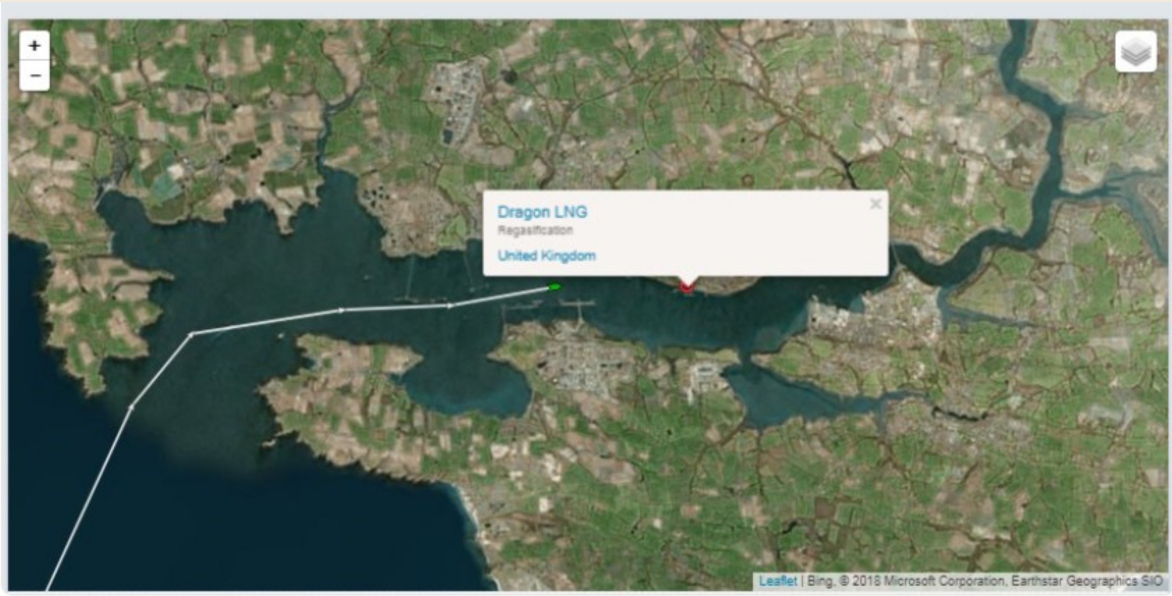
2. The two largest sectors in the FTSE 100 are Oil and Gas companies (!) and Banks. I think it's obvious by now what I'm thinking about the former.

As to the latter, banks tend to do really well in inflationary environments. And these two make up some 30% of the FTSE 100 (and some 25% of the FT-All Share).

And 'professional' fund managers are severely underweight the UK stock market.

So, that would be YOUR portfolio advisers/managers then...

I want to mention a little bit of history that took place this week.



9:26 AM - 21 Mar 2018

Dragon LNG says this on its website:

" The Dragon terminal is a Liquefied **Natural Gas** (LNG) receiving, storing and regasifying facility based in Waterston, Milford Haven, Pembrokeshire, which has two shareholders, Shell and Petronas. One of just three such terminals in the UK, Dragon forms a critical part of the nation’s energy infrastructure, providing a link between the UK and its overseas gas suppliers for a vital source of clean and reliable energy.

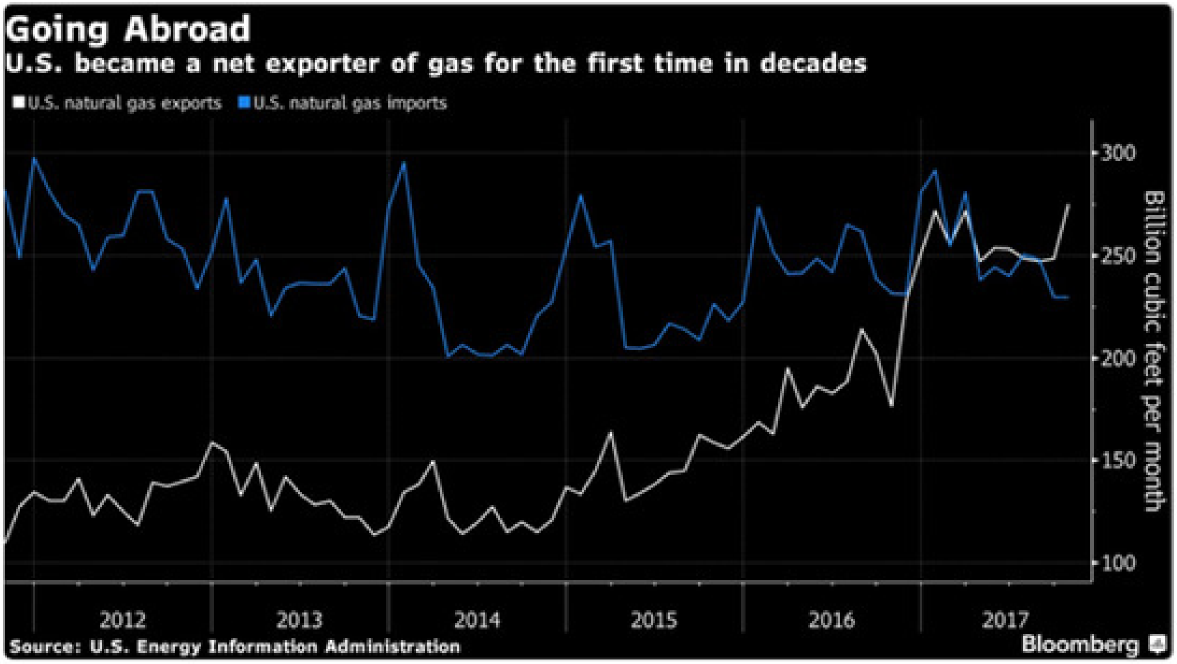
Over 85% of homes in the UK use natural gas and a significant proportion of UK electric power is generated from this. The demand for energy and natural gas is increasing at a time when the UK’s domestic production from the North Sea is declining. Dragon can supply up to 10% of the UK’s energy needs, allowing diversity of supply from 19* producing countries around the World.

*Source GIIGNL 2014"

The photo is dated 21 March. This is the date of the arrival of the first ever cargo of gas from the Dominion Cove Point facility on the east coast of America.

Dominion Energy’s Cove Point facility is the second such facility to ship US shale gas overseas.

Shell’s Gemmata LNG tanker transported this first Cove Point cargo.



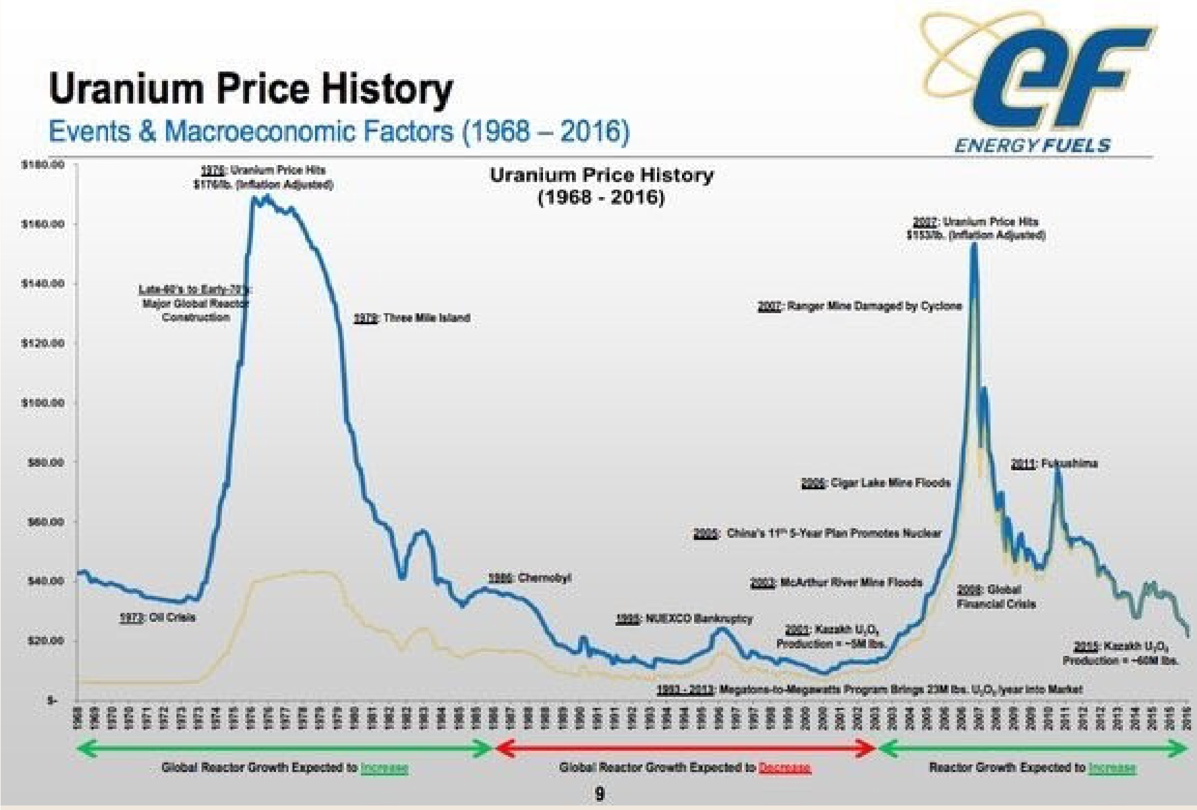
So what?

Well, the US has just become a net exporter of Natural Gas, for the first time in decades. You'll note that imports have been steady these last 5 years. Exports, however, have soared and now exceed imports.

This has the potential to raise the price of Natural Gas, sustainably. This would be normal, given Gas funds and companies have had massive falls in prices in recent years.

Finally, an energy that doesn't get much talk is **nuclear and uranium**, to fuel the power.

The following shows the price of uranium over the last 50 years.



You will see there have been two massive bull markets and bear markets. The chart goes up to 2016 and the price has been steady these last 2 years and is currently around $22/lb.

In other words, uranium is dirt cheap.

And yet, production, globally, has fallen sharply due to economic decisions by the biggest players.

And yet, demand is rising as more nuclear reactors open (and are reopened in Japan).

If supply is flat or falling and demand is rising ... Economics 101 says the price of the commodity should rise.

Uranium miners' share prices are generally at about 10% or less of where they were several years ago...

So, I ask again, as I do every Booms and Busts Report:

What should **YOU** do to secure and grow your wealth and purchasing power?

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

Can you benefit potentially from our advice?
We work for wealthy families and/or high earners.
We work for clients all over the UK and indeed on three continents.

We now have an association with an excellent financial planning firm who can advise interested parties with portfolios materially under £500k. Contact me for details.

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:

I believe most folk do not realise, in big picture, the changes happening right now in our economy and markets (major stock markets, corporate and government bonds and property).

They will.

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

They will. But will they benefit?

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 or emailing me at ***jdavis@jonathandaviswm.com***.

On Twitter, follow me ***@J0nathanDavis*** where I frequently comment and link to important commentaries on markets and economics.

Kind Regards

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Please note that investments can fall as well as rise. And they do!

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