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ADVISORY

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Investment Outlook

Has Globalisation Peaked?

When Margaret Thatcher gained power in May 1979, one of her first actions was to remove all foreign exchange controls, and allow British investors to make investments all over the world, almost for the first time since 1914. The subsequent deregulation of the City of London, in 1986, was followed by the US repeal of the 'The Glass-Steagall Act'. We have had thirty years of expansion in the financial sector, and a rapid growth in global economies. With the Berlin Wall coming down in 1989, with China and India as well as Russia, and Eastern Europe all opened for trade and investment, and with a massive increase in the global labour force of nearly three billion people. We have also had a deflationary wave, thanks to low Chinese labour costs. The question, which an investor has to ask himself today, is, with the Trump phenomenon in the United States, Boris Johnson leading the 'Brexit' movement in the UK and, as the French president said: "If the Schengen open border scheme is at an end (because of the refugee crisis)" it means, "the end of Europe". Are we witnessing today the beginning of the end of the globalisation trend?

This week China reported a 25% drop in exports: while we must not read too much into one month's statistics, there is no doubt that there is a general slowdown in global trade. The deflation in raw materials such as oil, gas, iron ore and other minerals, and even soft commodities, has impacted the dollar volume of trade, especially in Asia, but also there is weak demand in Europe and developed markets, which is being transmitted to the emerging markets in Asia, Africa and Latin America. We do not believe that the

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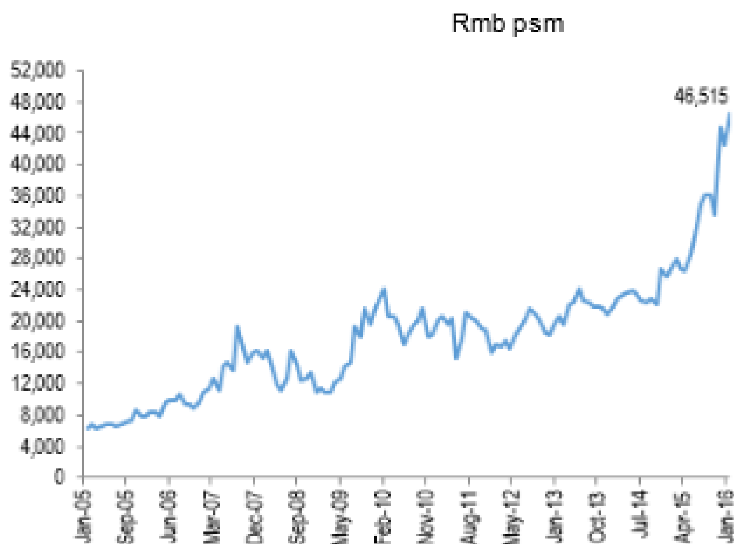
short term bounce in commodities prices will last. There is a long term trend of oversupply in oil and minerals, which will continue to weigh on prices for ten years or more. Our view on China, is that it became oversold in the first two months of the year. Now that the Renminbi has stabilised, capital outflows have slowed down, and Beijing has emphasised their 6.5% growth target, we expect that this will put a floor under the Asian share markets. It is remarkable how close the correlation has been between the Renminbi and global equities, last summer and again in January.

However, we continue to believe that by 2017, there will be a more serious slump developing in property values in major Chinese cities, and especially in Hong Kong, where property transactions are already down 70% from a year ago, and prices have fallen about 10%, so far in a thinly traded market. We see neighbouring cities such as Shenzhen also being in a bubble situation, where residential prices have risen eight times in ten years, whereas average household incomes have only increased two times. The risks to the banking sector as well as to economic growth with perhaps 20% of annual output related to construction are growing. In two years – 2011/2012 – China produced more cement than the US did in the entire 20th century.

Shenzhen—Primary residential price

Sources: www.szfdc.gov.cn, J.P. Morgan estimates.



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Two weeks ago, Mr Modi's government came out with his second budget. India still looks to achieve at least 7% GDP growth and 16/18% corporate earnings growth, over the next two years. They are making a substantial investment in the power sector and pursuing further privatisation of state companies. They are addressing the non-performing loan issue of the public sector banks, and restructuring the coal industry: both road and railway building, and electrification are priorities for New Delhi today. We expect that this background will be favourable for Indian share prices, given the pro-business stance of Modi's administration, the stable Indian rupee, and consistent monetary policies. On my visit to Mumbai earlier in the year, I saw a number of start-up internet businesses: e-commerce is growing rapidly. There is a vibrant entrepreneurial sector in the consumer space in India, and we are focused on finding the best companies. Modi has tried to include the large rural population (over 50%) in the economy's growth by introducing over 1 billion "AADHAAR" (national identity cards) for direct benefits and "JAN DHAN" scheme with over 200 million new bank accounts.

I also visited Australia last week: surprisingly the real estate sector in Australia is now a bigger contributor to GNP than the mining sector, which has fallen by almost 70% in two years. The Australian dollar has also corrected by 30% and it appears to be bottoming out. Shipments of iron ore and coal are continuing at a steady pace to China, and other Asian trading partners. One sector which we have studied in Australia is healthcare, where there are some very fine companies with innovative products, taking advantage of the changing demographics in Asia. There will be a billion people over 65 years old, in the world within the next decade, a large number of them in China. Such companies as Ramsay Healthcare, Cochlear and Blackmores have pioneered Australian sales into this market with trusted brands and products.

Last week, I visited Nanosonics, which is a A$500 million company with a growing global footprint in sales to hospitals of their 'Trophons' ultrasound equipment for desanitising devices. This is another of our "10 best stock" ideas in our Bamboo portfolio, which is focused on China, India and the region with several companies under US$2 billion in size.

Although there is at last a return to stock picking rather than passive indexing, a critical factor in portfolio management is valuation, and it is clear that something of a "technology bubble" has developed in the last year in the USA as well as Asia, with the leadership of the markets being led by the "FANGs" (Facebook, Amazon, Netflix and Google) and likewise in China and India, so we are reviewing all our internet businesses in these two markets to see whether the valuations are reasonable with "a margin of safety" as Benjamin Graham recommended.

We are also becoming more cautious on bank and insurance stocks, as the impact of negative interest rates (which may reach -1% in Japan) is more apparent. The disappointing performance of many of the premier brand banks such as HSBC and Standard Chartered, is teaching investors that there is no 'Moat' around these long established businesses - online banking, lending, wealth management and broking services are increasingly available from local and regional players with strong roots in their communities. The international banks have no "lock" on this business.

As I travel around the world, I see more and more retail spaces close down, or struggling to break even. It is as if the internet, was a kind of "Neutron bomb" which leaves all the buildings standing, but empty of their human traffic and commerce. This is clearly a concern for property investors, in the medium term, that space in shopping malls and retail outlets will be less valuable, and rents will fall in the years to come. We continue, therefore, to avoid the property sector on principle and see that by next year, there could be a global downturn developing in high end residential as well as commercial space.

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(one of my Hong Kong colleagues remarks that shopping malls in Asia have in fact, become a cultural and social experience with families camping out for the weekend at IKEA: particularly in the hot countries of South East Asia – but does this really boost sales?)

10th March 2016

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