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**Monthly Commentary – June 2013**

I have spent the last 2 weeks in Washington, DC and had a number of interesting talks with political and economic commentators as well as 'think tanks'. My impression is that the Americans are retreating, as they do at regular intervals, into a new isolationism. The background behind this is their feeling that, after Iraq and Afghanistan, they want to have no more to do with the Middle East, or foreign military entanglements generally, and that with the change in the global energy balance, they can now ignore OPEC and the Arab world.

All my informants tell me that President Obama, who is now in his second term and not under any pressure to be re-elected, will not intervene in Syria and can make some controversial decisions, such as giving the green light to the Keystone Pipeline, which will bring Canadian oil and gas from the Alberta Tar Sands down to the main hub in Texas.

At the same time, we keep hearing well informed rumours that the new Mexican President, Piña Nieto, will change the Mexican constitution to allow foreign investors and oil companies to participate in his country's oil and gas sector. This has been monopolised by Pemex for the last 80 years and the result has been declining efficiency in production and corruption.

When we look beyond the NAFTA Nations, and consider Venezuela, which has very large reserves, and even Argentina, which has the world's largest gas reserves (as big as Qatar's), we can understand that for the major American investors, a new focus on their own hemisphere, and especially on Latin America, makes sense. In a long interview with one of Canada's largest pension funds, I learned that their focus is now on investing in consumer sectors, such as shopping malls in Brazil, and stable infrastructure projects with a guaranteed rate of return.

Since 2008, aversion to risk, both economic and political, has risen considerably, and trustees everywhere are more conscious of their obligations and liabilities to retirees. The difficulty of finding income has again come to the centre of debate, as a person retiring at the age of 65 with US$1m can barely make US$20,000 from fixed income investments today. There is a broad consensus that the best place to be is in growing consumer franchises with global market reach, such as Coca Cola, McDonald's, Colgate, some of the pharmaceutical and agricultural companies, IBM and other major brand names which have dividend yields of 3%, and are growing their dividends at a steady pace.

If however U.S. government bond yields rise again to their historical level of 3-4%, there will be some competition for this asset class. In the long term it is impossible to solve a debt crisis by issuing more debt, unless that produces real growth in the economy. Also, as this risk aversion increases, there is a flight out of Emerging Market currencies and bond markets and back into the U.S. Dollar.

We have seen the Indian Rupee fall sharply to a new low, as well as the South African Rand, the Brazilian Real and more recently the Turkish Lira. The spread of the so called 'Arab Spring' to a middle class, developed, secular economy such as Turkey's, with 80m population, is indeed a worrying phenomenon.

We remain convinced that investing in strong companies with good capital management and good corporate governance will be rewarding, even in countries which appear, from the headlines, to be unstable. One example is Egypt, where we have had a successful investment in Eastern Tobacco, which has continued to grow through the political turbulence of the last two years. One of our largest Frontier market investments is in Vinamilk, a leading dairy producer in Vietnam, otherwise a country about which we have had political and economic doubts.

We are continuing our steady research and growth of corporate network of contacts in Myanmar, which we see as a long term growth opportunity. McKinsey estimates that the economy can more than quadruple from US $45bn in 2010 to US$300bn in 2030, with the quadrupling of incomes and a growth rate of 8% per annum, mirroring the experience of China since 1990.

Once again, if we look at it geopolitically, Myanmar's energy and mineral resources will put it front and centre within China's hemisphere of influence, but will also attract investment from India, ASEAN, as well from Western countries.

In the meantime, the figures coming from China confirm every month the continued slowdown in consumer spending, as well as infrastructure investment and foreign trade (Europe is the largest market for Chinese exporters). There is no doubt in our minds that we are looking, within a year or two, at 5% (and perhaps less) GDP growth. It is likely to cause turbulence in the stock market in the coming months and recent reports of a new property tax could cause a 10% drop in housing demand, and reduce China's economic growth by a further 1-2%.

On the other hand, we do not see this as a collapse, but as a normal and natural evolution from a high growth era to a slower growth era, where Chinese consumers will continue to have a very vital influence on global markets and products. Successful consumer brands in China will be world beaters and, as we have done in our Frontier market approach in Africa, we focus on the basic consumer products, such as instant noodles, beer, and edible oil and foreign companies such as Proctor and Gamble, Unilever and L'Oreal, which dominate the personal care and cosmetics sector.

In summary, we are expecting a flat or downward trend in commodity prices, except for food, which is very weather dependent. We see a great deal more volatility in the next few months in currencies, especially in the commodity based currencies, such as the Australian and Canadian Dollars and many Emerging Market currencies. Although there could be some recovery in gold, we expect that the oil and gas sector will remain under pressure as new discoveries come on stream, and the world economic slowdown keeps demand sluggish.

We are increasingly focussed on how to invest in water, which is a problem not only in China, but also in many of the drier areas of the Muslim world. More than ever, we think of the famous Chinese proverb 'may you live in interesting times'.

R. Lloyd George

Robert Lloyd George
18th June 2013