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Monthly Investment Commentary – November 2013

The pessimists and doom-mongers in the investment world are usually wrong, and they have been wrong again in 2013, when we have generally seen very good returns for investors in US and some European shares. One lesson we learn is to keep looking in unfashionable areas, to buy when others are fearful and sell when they become greedy. The interesting question in November 2013 is whether we are now into bubble territory in some financial markets and other asset classes and if so, for how long the current liquidity driven market is likely to continue. In Asia and the Emerging markets this is less of an issue because we have not seen the same capital inflows and GEM markets are flat for the year.

The economic reality on the ground continues to be strong: China is maintaining its growth at around 7.5%, which it needs to create 10 million new jobs annually (as the service industry grows in China, each 1% growth in GDP translates into 1.5 million new jobs). We continue to estimate around 5% growth in the South East Asian economies with inflation still quite low. We have also commented in the last three months on the robust economies of Africa, and of the Andean region in Latin America. There is a very clear division between those countries pursuing free market, investor-friendly policies and those which continue to exercise a heavy degree of state intervention. State-owned enterprises, whether in China, Brazil, Russia or other countries, continue to be disappointing investments. One aspect of the recently-announced Chinese reforms is that the monopoly of the state banks and telecoms, as well as the oil companies (which are being investigated for corruption), will be opened up more to the private sector.

Last week, we visited both clients and superannuation funds in Australia. The Australian economy and dollar continues to surprise the pessimists and to maintain steady growth based on China's continued demand for Australian minerals; the country also has US$2 trillion of superannuation funds, growing at 10% per annum. This is a powerful support for the Australian stock market. Even though Australian banks now yield 5% to 6%, and are valued at 2.5 times book value, they remain sound long term investments. We notice the same phenomenon in Sydney as in Toronto: the large inflow of Chinese investors buying mainly residential and commercial property which is at an all time high. This is another example of bubbles forming in different areas of the world, as a result of high global liquidity.

In China itself, property continues to rise about 15% this year in the major urban centres and this influences the way that the mainland Chinese investors see property elsewhere in the world, as relatively inexpensive. In Hong Kong, the government has taken some draconian measures to reduce speculation at the higher end of the property market. In the last two months, we have seen a 24% rebound (in US$ terms) in the Indian stock market, which had become very oversold in early September, when the Rupee fell as low as 70 to the dollar. With the arrival of Mr. Rajan as the new governor of the Reserve Bank of India, interest rates have been raised and over US$6 billion of foreign capital has flowed into Indian shares and deposits in two months. Gold imports have also fallen by 50%. We have maintained a positive stance on the Indian market, and the political outlook is also becoming more propitious. The probability of victory for Mr. Modi and the BJP in the election of May 2014 is now being discounted in the stock market, and earnings growth among Indian-listed stocks is still around 15%. Our Indian team feels that the market has become overbought in the short term, as CPI inflation is still running at 10%, and interest rates will probably have to be raised again.

Elsewhere, in Japan and in Europe, the concern remains deflation, rather than inflation. It will be important to see which way the oil price moves in the next 6 to 12 months. Our expectation is for slower growth and falling commodity prices in 2014.

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We may move into the 'bubble' territory in both shares and property (we are already there in the art market): in this scenario, a sharp correction many intervene in the spring of 2014 when the new chairman of the Fed comes in.

Robert Lloyd George
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