



After the Summer Doldrums

A good global review from Hong Kong. The focus for leadership continues to be the U.S., with its volatile (shall be unnamed) President.

Corporate America is healthy and we continue to believe that 'Georgian' dividend-growing equities provide the most assured offense / defense.

Enjoy the read. Comments or questions always welcome.

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Investment Outlook

After the Summer Doldrums

This summer has been a volatile period in the US market, as well as in the Chinese world, because of the uncertainty about the US/China Trade War and the continuing unrest in Hong Kong, for which we cannot forecast a clear resolution. At the time of writing, the G7 meeting has just concluded in Biarritz, and President Trump's remarks on trade have, again, increased market volatility, with high frequency trading algorithms responding to key words in his tweets and press conference.

Nevertheless, the US economy continues to be strong. Corporate earnings have exceeded expectations, consumer confidence is high, retailers have reported very strong results and interest rates remain at all-time historic lows. Despite the briefly inverted earnings yield on treasury bonds, most market forecasters are not yet predicting a recession, perhaps not until 2021.

However, anxiety in Europe and Asia remains high, and the level of caution in the global markets means that we are not approaching bubble levels. Value stocks are trading at 44-year lows compared to growth stocks. The pound is at a 35-year low to the dollar. US share prices are at a 50-year high, relative to US GDP. Bond yields are at all-time lows, and there are now over US\$16 trillion worth of bonds in Europe and Japan with negative interest rates.

The question of when the US recession begins, is critically important to the outcome of the November 2020 election. Until recently, the market had comfortably assumed that President Trump would be re-elected; but if that certainty begins to deteriorate, and a more leftwing Democratic candidate is selected, then the risk to the market will correspondingly increase. If



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US growth continues at around 2% and inflation and interest rates remain low, Trump is likely to be re-elected, but not if we are in a recession.

To a seasoned observer, it appears that there is, therefore, no alternative to high yield dividend paying stocks for the retired investors, or pensioners, or even large insurance company funds. The Norwegian Fund, for example, has over 70% in stocks now. Gold is making a comeback in the world financial system. China, Russia, and other emerging nations are buying gold for their central bank reserves at a rapid pace. Worldwide debt has reached almost US\$250 trillion, or 320% of world GDP, up by 20% since 2012. This is the biggest danger to global markets and, if inflation should rebound in 2020/2021, then the impact on interest rates and markets would be very fast and very severe.

China's economy has held up well in the face of the US trade tariffs; GDP is still above 6%. Latest retail sales numbers are growing at 7.6%, and on-line sales at 16.8%, although auto sales have fallen 4%. We have a two-track market in China, with the domestic consumer continuing to demonstrate robust confidence, and industrial output, exports and infrastructure all slowing down. The areas where we see high growth are cosmetics, skincare, sportswear, sports shoes, dairy products and yogurt, Moutai, or spirits and beer and wine, which are all growing almost 50% year-on-year.

Even the property market in China is holding up, showing 9% annual appreciation in sales, although new supply is diminishing and developers are holding back inventory. Mortgage rates are above 5%, against an inflation rate of 2.8%. With Alibaba announcing 40% year-on-year revenue growth, we cannot be completely negative about China's outlook. It is, in any case, a very large continental economy, like the USA, where different regions and sectors have very different growth rates.

When we turn to Southeast Asia, we see the broad ASEAN economy growing around 5%, with higher growth in Vietnam and more sluggish growth in Singapore. Again, the consumer is the key in this region's growth, with particularly strong earnings in Thailand and Vietnam. The



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Indonesian government has announced a US\$33 billion project to build a new capitol in Kalimantan (Borneo) because of the growing flooding problem in Jakarta. We continue to favour the consumer and IT sectors in Vietnam, which, with a young population of 100 million, has a large inflow of foreign direct investment.

The renminbi has weakened to almost 7.2 to the dollar, and this has a regional impact with other currencies also depreciating, such as the Australian dollar and the Korean won, notably. The two strongest currencies in Asia are the Japanese yen and the Thai baht, and these may emerge as safe haven currencies for investors just as the Swiss franc and, perhaps, the Norwegian krone, are in Europe. There is no doubt that Asian demand for gold is also growing (and much of the demand for cryptocurrencies is also coming from the East).

The European outlook continues to be clouded by the unknown impact of Brexit, whether “no deal” or with a new agreement on the Irish back stop, by October 31st. We have barely two months to go, and the German economy, meanwhile, is already in recession with a pronounced slowdown across the whole Eurozone. Some of this is due to the slowdown in Chinese demand (German exports to China are down 7.5%), since China has become Germany’s leading trade partner. In addition, the fall in oil prices has curtailed some of the demand from the Middle East for capital and consumer goods. There is an outside risk, however, that we see a showdown with Iran approaching in September, and causing a spike in oil prices, which would negatively affect Europe and Asia. (The US is in the fortunate situation of having raised its oil production now to over 10 million barrels a day since fracking came in a few years ago, and is, therefore, much less dependent on imports than it used to be.)

The Indian economy is in a sharp slowdown, and the next two quarters of corporate earnings will disappoint. The banking sector is suffering from high levels of nonperforming loans and questionable accounting practices, by the major international auditors which have led to their being banned from major Indian banks. The Reserve Bank of India has become much more vigilant, and a crisis of confidence has resulted from the Modi government’s reform measures in goods and services tax, a new bankruptcy code, and new real estate regulations, which have



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choked off growth in the short-term. Banks are scared to lend, and corporates are being starved of cash. The slowdown in auto and real estate sales has led to unemployment, and severely hurt domestic consumption.

We expect a strong pickup early in 2020, when the forecast is still for earnings growth of 20% and nominal GDP of 10%; but these forecasts can be downgraded, and the monsoon season in India has been very uneven with severe flooding in two or three states in western India. One of the few bright spots is Reliance Industries, which is doing well in all three segments of their business: oil refining (with a big injection of capital from Saudi Arabia), retailing, and telecoms (both of these last divisions will be spun off in separate listings over the next two or three years). Despite the US downgrading India's status as a trading partner, we continue to see big opportunities in the IT sector for Tata Consulting and Infosys.

At the end of August, the government announced a US\$10 billion injection into state banks and other stimulus measures, including the withdrawal of the foreign portfolio investor tax and some incentives for the automobile sector.

Conclusion:

The investment outlook has never been more difficult to forecast but with very low interest rates and a general atmosphere of investor caution and pessimism, the odds are that stock markets will surprise on the upside, particularly where dividend yields are high and sustainable. There is still plenty of excess savings and capital available, as we see from the bubble in private equity. Our worries are about what happens when the current inflated debt bubble meets a real slowdown or recession in 2020 or 2021; but our immediate focus is on corporate earnings, in the first half of 2020, and the political outlook, both in the USA as well as Europe.

Writing from our Asian HQ in Hong Kong, we are hoping that the autumn will bring a calmer period to the city and an easing of tensions with China.



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Hong Kong

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