Investment Committee Report

July 2023

Introduction

It has been interesting to see over recent months investment commentary that we follow – and have a high regard for – continuing to highlight and reference issues that go far beyond investment markets.

To me the message seems clear; whilst it is easy to get preoccupied with the latest view on stock market direction and/or the economy it it is just as, if not more, important to understand society and human behaviour. How we all interact and respond to different scenarios drives the direction of travel for our lives.

It seems society is in its greatest state of flux in decades with an increasing polarisation (in politics in particular), distrust of institutions and what feels like an inability by different parties to engage in reasonable debate to reach a common ground.

One theme that continues to dominate is the concept of the large cycle that humanity tends to follow of 75-85 years; Mauldin Economics[1] summarises this extremely well and makes the key point that "…our choices reflect the era we live in."

1. The first turning is a high and everyone pulls together for the greater good.
2. The second turning is awakening of resistance and conflict.
3. The third turning there is an unravelling as people lose trust in institutions and embrace individualism.
4. The fourth turning is a crisis with a threat to core institutions and public behaviour.

The end of World War Two was the start of the first turning and we may now be heading into the fourth turning and the most dangerous period.

This is accentuated by the financial gap between the wealthy and the young who continue to find it hard to establish themselves – whether this is buying a property, renting a first home, or simply becoming financially independent. In the US Hedgeye[2] highlighted the increasing percentage of of Millennials (born 1983-2004) and Gen-Z (born 2004 onwards) who are now living pay check to pay check is continuing to increase.

Understanding history and these patterns will be crucial to navigating the coming years not just from an investment perspective but socially as well – if we can all do our bit to make a difficult period less painful that there is undoubtedly a case for optimism, and hopefully prosperity, in the time that follows.

---

[1] "Turning Time" Mauldin Economic 28th July 2023
[2] "As The World Turns" Hedgeye Market Edges 24th July 2023

FINANCIAL PLANNING WALES

Investment Committee Report

Key Factors to Watch

The indicators that we look at help build a picture of the investment and economic landscape; understanding history is also crucial to identifying the trends and risks that are created.

Economic Conditions

Whist inflation may appear to be slowing, we should think of it as rising but just not as fast as it was! Prices remain elevated in comparison to recent history and inflation will not truly slow until wage growth starts to fall.

Countries also remain vulnerable to spikes in energy cost; the fall in the price of oil from $119 in June 2022 to $74 in June 2023 (-37%) has helped reduce the pressure but that quickly change direction.

At the same time the structural pressures that make costs rise still exist:

1. Demographics – ageing population and declining workforce.
2. Deglobalisation – moving production closer to home.
3. Government spending – financed by large budget deficits.
4. Energy transition – how will this be financed?

This means that as in the 1970's we could see inflation fall before rising again with vengeance to new highs.

As always it is not clear cut! The risk in the near term of recession remains with consumer spending continued to be squeezed by higher costs and rising interest rates; it may some time before we see this filter through to published economic data. Recession, inflation, stagflation, muddle through – all are still on the table.

Market Conditions

Global Stock Markets continue to show mixed performance since February this year.

- FTSE-100 -9.24% United Kingdom
- S&P 500 +5.79% United States
- Nikkei +14.43% Japan

This can perhaps be explained as much by the sentiment of investors rather than underlying fundamentals. The US may be a little ahead of the UK in coming to the end of their current interest rates rises but they face similar challenges – the difference with the US market is that they have been driven by the Technology and AI narrative. In Japan despite huge levels of debt to GDP the Government continues to throw money at keeping interest rates low – a move that was great for stocks in the US and investors have latched on to in Japan.

Interesting Articles

In their latest investment review Ruffer elaborated much more eloquently than I can about a strategy that is like our own.

To the crux of this Investment Review – why have we inconvenienced ourselves and others by clambering onto the high ground to avoid a tsunami? Put differently: 'You've been waiting at the bus-stop (with our money) for a fair while; perhaps no bus will come…' In our view, it would already have happened but for two unrelated phenomena which provided providential liquidity. The first was a wave of animal-spirited confidence in the old favourites of yesteryear (the FAANGs) joined by a new cadre of the jam factories of tomorrow, namely the beneficiaries of artificial intelligence. There was – is – nothing unreal about this dynamic; it is, however, temporary – a spate river filling up with a violent thunderstorm's offering during a period of chronic drought.[3]

This was echoed by GMO's James Montier.

The late, great Rudi Dornbusch once opined, "The crisis takes a much longer time in coming than you think, and then it happens much faster than you would have thought." My own experience of premature bubble spotting certainly speaks to the first part of Dornbusch's quote. And as we all know far too well, when looking through the lens of the short term there is no difference between being early and being wrong.[4]

My main purpose here is not to justify my approach or seek comfort from others who share similar views, but to provide evidence from other sources that have a strong track record of successfully managing capital across different business cycles of how important it is to read the warning signs and not get distracted.

Changing the subject entirely an article from the Felder Report[5] caught my eye this month; large Tech firms are transitioning from a business model where they didn't need many fixed assets to one where they need to spend huge amounts on buildings for the servers in their data farms. Recently Meta spent $88 billion on data centres, to put this into context there are only 75 countries in the World with GDP over this figure! One of the impacts of these data centres though is on the environment and local communities, the Felder Report states:

What I do know, though, is that in the past decade or so, one of the most farming-dependent economies in the region decided to become ground zero for the boom in data centers. Meta and Apple have both opened multiple new data centers in Prineville, Oregon in recent years even though they are massive consumers of resources like water and electricity.

[3] Ruffer Investment Review July 2023
[4] "Slow Burning Minsky Moments" GMO White Paper James Montier July 2023
[5] "The High Cost of Literally Becoming Big Tech" The Felder Report 28th July 2023

So now we have a situation in which these data centers simply take more and more groundwater, however much they need (which is literally millions of liters per day), and farmers have their water access shut off earlier and earlier in the growing season due to the worsening drought. And people have only begun to pay attention to the dichotomy here.

It's an issue that is not just relegated to Central Oregon but is now affecting communities around the world. That this hasn't come up for discussion among the ESG community is strange, to say the least. However, because the cloud and AI (both build upon massive data centers) are now the primary growth engines for Big Tech companies today, it is a topic that is bound to come up at some point.

Investment Strategy

I have been continuing to make plans for the implementation of a "Bulletproof" core to investment portfolios that are created to help prevent missteps and human bias that can lead to missed opportunities in both potential gains and protecting capital.

For clients within the Working Partnership Service the coming months will also see an introduction of some more active components that I hope will enhance returns.