Warner Matthews Diaries – Fourth Quarter 2021

Asset Allocation Musings:

As we enter the final quarter of 2021, the noise levels associated with the likely shortages for our Christmas feasts appear to be reaching unprecedented levels. At this rate we may all be looking at the vegan aisle in our local supermarket for our plant based meat-free main course…putting my cynical hat to one side, there are parallels in history to draw from with regards to the types of shortages and the likely knock-on effects pending. For those with a keen memory the labour shortages in the 1970s led to a decade of strife, the 2000 fuel shortage is helpful for a similar historical reference point and perhaps most recently the toilet paper shortage from March 2020. The one constant is the oft used buzzwords associated with the run on a particular item. With this in mind, coming up with a song title that fits the current panic on various shortages unearthed some interesting choices (care of Google search). The Specials *Ghost Town* is a particular favourite, or for any fan of the punk genre Sex Pistols' *Anarchy in the UK* – both of which encapsulated feelings of the unemployed and alienated in the 1970s. But ever the optimist, this scribe has gone with Peggy Lee's *There won't be a shortage of love*. "That's a bit cheesy" I hear you say. "It's almost Christmas" I retort….

Buzzwords that are resonating…

Recent headlines about shortages of fuel, labour, food, autos, chickens, building materials and even Christmas trees all point towards a bleak winter. For the purposes of this newsletter, we will avoid listing the reasons behind it, however they are both far reaching and wide. The one buzzword that has begun to creep into the narrative and the one that we concern ourselves most with is **Stagflation**…So what is it and why should we be concerned I hear you say? Let's start with the definition: a period where economic growth slows at the same time that unemployment and inflation rises. How does it happen? When an economy faces a supply shock – such as a rapid increase in the price of fuel which can in turn impact the rate of economic growth by making production more costly. Alternatively, when a government increases the money supply too quickly it can cause a sharp rise in wages and prices; both sound somewhat familiar to us.

Why should we be concerned? Taking our lead from history, pronounced periods of stagflation are hard to control and difficult to escape. Although every cycle has its own nuances, the 1970s backdrop appears most relevant. In the eyes of the Austrian school of Economics, the creation of new money does not equate to wealth creation, but instead raises the rate of increase of the prices of goods and services. The policy solutions adopted in the 1970s were damaging as interest rates increased sharply to double digit rates which led to a rise in unemployment, thereby creating a short recession in the Western World. Fast forward to today's backdrop, the prospect of higher interest rates is more remote as the debt levels are significantly higher and the servicing element to this debt would be unmanageable. This appears positive, but if prices continue to rise and economic output wanes, there are less levers available to promote growth. The question remains whether this is just a fleeting issue or something that is "stickier"; only time will tell. As always, we are trying to think one step ahead in terms of how to defend your portfolios against this outcome – feel free to speak to us to find out more.

How Minsky became relevant again…

Ever heard of a Minsky moment? I suspect most of you may not, but times are changing and the probability of it occurring appear on the up. Again, lets start with a definition: named after Hyman Minsky, a professor of Economics at Washington University in the mid-twentieth century, it refers to the onset of a market collapse brought on by the reckless speculative activity. The Minsky moment is the point in time where a sudden decline in market sentiment takes hold that can lead to a market correction.

Inevitably each growth cycle is characterised by events that evenutally look and feel like a Minsky moment. This is normally associated with pockets of euphoria where prospects versus reality become disjointed. You may have read in the papers recently about a Chinese conglomerate named Evergrande (somewhat ironic) whose primary activity is property development and whose shares were suspended from trading earlier this month from the Hong Kong stock exchange. I thought it would be interesting to relay a few basic facts about this developer to create context.

Firstly, it was created in 1996 by Hui Ka Yan in southern China. It currently owns more than 1,300 projects across 280 cities in China. It has expanded its range of businesses to wealth management, electric cars, consumer staples and even owning a leading Chinese football club. Following a tried and tested formula of focusing on market share, Evergrande reached its position as China's largest property developer by ratcheting up its debt by over $300bn in order to build more projects. That's equivalent to 2% of China's GDP. Now it is struggling to service this debt pile and consequently its bond rating has fallen to junk levels making it impossible to raise more money to service its existing debts let alone complete the projects it has on its books.

Why does it matter that a domestic Chinese property developer goes under? Firstly, Evergrande follows a similar model to most Asian developers. It raises money via buyer's deposits that then enables the development to get under way. Further staggered payments then ensure the homeowner receives the product they paid for. However, these down payments can be diverted to help other projects or indeed other related activities. So in today's backdrop, there are thousands of disgruntled home buyers with half built (or in some cases unbuilt) homes with no prospect of receiving their dream home. Then there are the knock-on effects of contractors and suppliers in Evergrande's network that are out of pocket. And finally, there is the wider impact from the debt owed to banks and investors around the world. It is reported that Evergrande owes money to around 170 domestic banks and 120 financial firms. Should Evergrande renege on repayment, the knock-on effect could be significant (less overall system lending).

So far the consequences of the fall out from Evergrande have not been far reaching. It is possible that the market regards Evergrande as too big too fail (a moniker dreamt up as a result of the growing debt pile since the start of the Noughties). But if China is to break with the past and create a backdrop of common prosperity, the Chinese Communist Party may wish to make an example of Evergrande.

Cyber Theft – what can you do to beat the criminals

Having been exposed to bank transfer fraud several times over the last decade and hearing similar stories from colleagues more recently, I thought it would be useful to provide a few pointers as to how to prevent it happening to family, friends and colleagues. Did you know that losses to bank fraud increased by 71% during the first half of 2021 with banks reimbursing just 42.4% of those losses (down year-on-year). There were 106,164 reported cases in the first half of 2021. The scammers come in all sorts of guises, posing as your bank, solicitor or the HMRC to name but a few and it usually involves the use of an online platform.

What protection do you have? Most UK banks have signed up to a voluntary code which means they must take steps to protect customers from fraud and reimburse those that are not to blame for falling victim to a scammer. You are protected under the payment services regulations if any money is taken without your consent. A few extra pointers in addition to the logical steps: firstly, if a caller claims to be your legitimate bank provider, ask them to provide their main switchboard number so that you can hang up and call them back. Secondly, when internet banking, visit the bank provider website by browsing for the website yourself, not from a link that has been provided via an email. Thirdly, it is not recommended to access internet banking when connected to a public wifi. Finally, when selecting a password, the more complex the more secure it is.