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A PERSONAL VIEW FROM PETER BENNETT

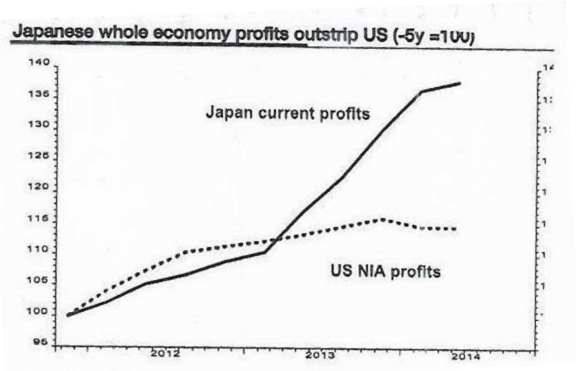
MID-YEAR STRATEGY UPDATE - PART III

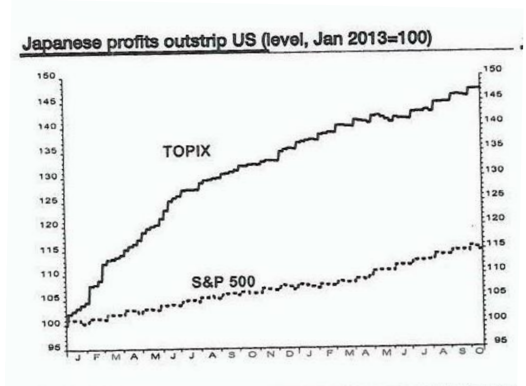
13 July 2015

Japan

I'm still there, though the 'story' is long in the tooth. And far removed from where it started at 7000/8000 on the Nikkei. Whereas Wall Street 'technicals', going back about a year, suggest that topping out **may** slowly, slowly be occurring, this is not the case re Japan technicals (yet anyway). Yet another US amber light: per John Hussman 08/07/15 – over the last six months a record 80% of new issues were loss makers. The previous record: near 80%, at the top of the 2000 tech bubble, then 65% at the top of the recent credit bubble – 2007.

Relative profits performance, shown by the BCA Research graph below (and to which I have previously drawn readers' attention), simply underlines the rationale for the current investment preference.





Source: Datastream

At actual valuation, only on price to cash flow (OK, actually the most important measure) can one use the word 'cheap' now.

A word of caution – profits don't grow to the sky. There has been an explosion recently.

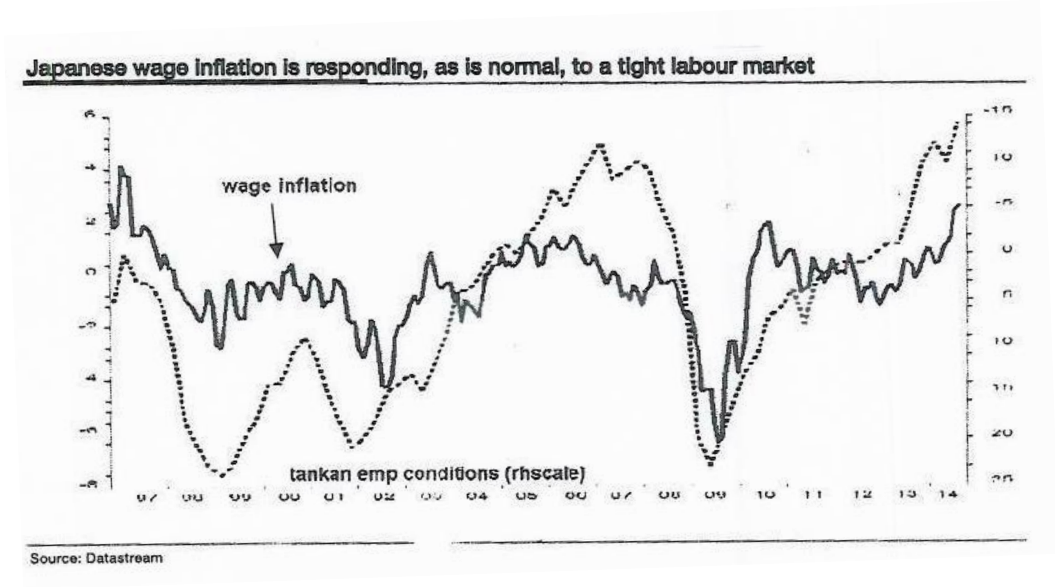
In the poor year, 2008, corporate profits came out at ¥3tn; in 2010 ¥12tn±; and now are running around ¥18tn p.a. *(Source: BCA Research)*

Actually, in the monster bear market there have been six tradable bull runs since the 1989 top. Percentages:

32.8	
55.2	
51.7	
131.6	(2003/06)
46.5	(2009/10)
139.8	2012 to now

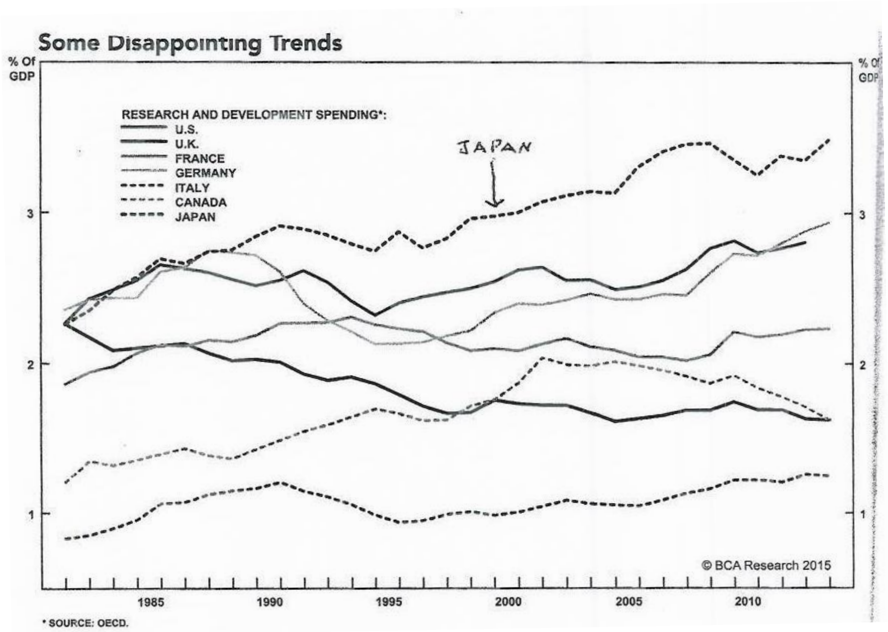
Assisting retained corporate profits has been the decline in (large company) corporation tax from 53% in 1990 to about 36% now. 30% is targeted along with the next VAT rise, supposedly in 2017.

The tight labour market – unemployment about 3½% - should necessarily and at last help wages, but of course these have to be paid by corporates (*inter alia*). Maybe or maybe not tax cuts and productivity can mitigate the effect on profits. Productivity **could** kick in.



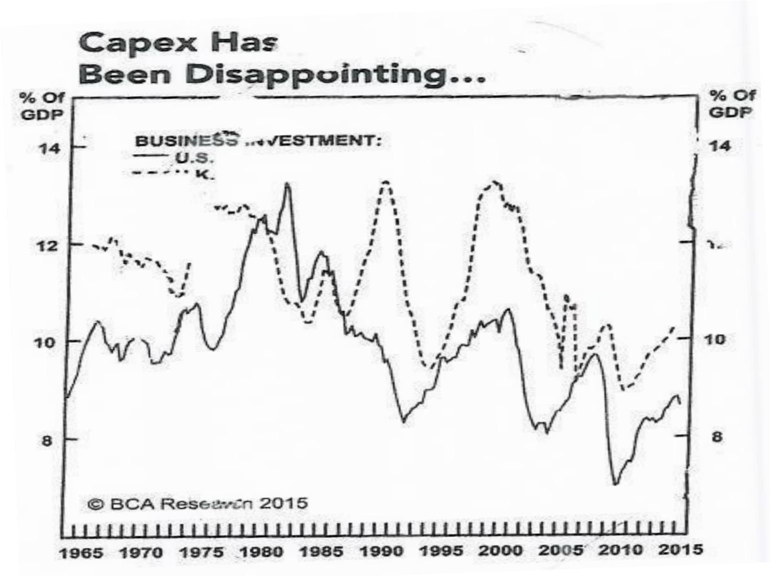
Because unlike US executive stock –optioned blow-hards, at least till now Japanese directors mercifully didn't care a fig about short-term price movements. They did not waste shareholders' money on the buy-back (at hugely expensive valuations currently) nonsense. This time running at record and ludicrous levels in the US as I write.

The Japanese invested (to be fair, until recently, too much) in the future and per the graph below have increased R&D as a percentage of GDP, which is now the highest level in G7.



Lastly – an interesting statistic from BlackRock. Japanese personal financial assets, at $15tn, equal more than German, UK and French GDP added together. More than half in cash. (I should be so lucky.)

The dreary US Capex graph, from BCA Research, is shown below, in no small measure due to the financialisation of the economy - and associated stock price greed. To the haves indeed it shall be given.



The resultant dysfunctional state of the US economy, from the point of view of Ma and Pa Kettle, is again illustrated in incomes. Lombard Street Research shows real median household income at $51,939 p.a. in 2013 vs. $52,432 in 1989. The 'fat cats', of course, are much fatter (and 'GDP' growth is virtually meaningless).

Greece – the deal's stark raving. Even the IMF agree.

Condemned again, worshipping a false God – the euro. Given their appalling history since independence from the Turks – including civil war, the "Colonels" dictatorship, some half a dozen international debt defaults, the world record for hyperinflation (Weimar – eat your heart out), brutal Nazi occupation – it is not surprising the Greeks sought the perceived shelter of the euro. For reasons described here, it didn't work. As a strong Helleno-phile, I am very sad. My personal experience of Greece is positive indeed, including the real joy of studying their ancient history, literature, philosophy – for Classics A Levels. Several wonderful visits – honeymoon included. The warmth of the people; the beauty of the land; the music. All simple stuff – but utterly captivating.

Will they be able to stand by the undertaking arm-twisted from them? Will they want to? I have no idea.

They shouldn't, of course.

What has all this done to "ever closer union"? By financial force? No Panzers this time, but invasion by snoops. Can the tarnished image of the euro be refurbished? Will the chasmic differences in economic cultures of the euro-nations, witnessed in the hours of acrimonious shouting, reported from the finance ministers' marathon meeting, accentuate the euro-drag on European economic prospects? What about future governance? German politics, if the bail-out goes ahead: Merkel desperate to hide from Frau and Herr Schmidt what they're on the hook for. Distrust, dishonesty – the defining characteristics of the euro project. Questions, questions, questions – and answer comes there none. Except a feeling of anger and resignation. And we now ourselves have to reassess our affairs with these people. (I have no views currently on in/out – but the idea we can't hack it on our own I suspect is wet nonsense. We have all our history - during which time 'Europe' has routinely meant trouble.)

The biggest question perhaps of the lot – how does democracy and the will of national economic, at least, sovereignty (which has emphatically not gone away and surrendered, as hoped by the *de haut en bas* brigade) continue to treat with the dictats from the unelected power-brokers at the true 'heart' of Europe? It remains a false construct.

Investment

On a value basis Europe equities are, for the moment, reasonable, though no longer a gimme (as in earlier bulletins).

China

Extraordinarily investors are still advised by many to invest long-term. I must again repeat – what exactly are you buying?

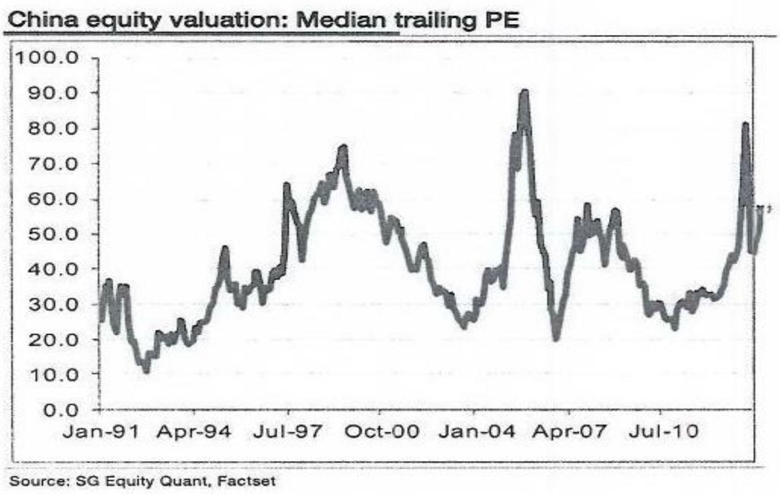
Well, it's certainly proved to be an 'emerging' market. Where you can't 'emerge' in an 'emergency'. If I invest my clients' money I want to be able to get it back when needed, not when a commie big wig says "you may".

Even if you take a gargantuan leap of faith and 'believe' Chinese company accounts and 'believe' that you, as a shareholder, have enforceable rights (I would do neither) – you are still buying over-valued stuff, even after the recent 30%-40% market falls.

Shanghai is supposedly good value at a PER down to 18-19. You can have mine. This is the market stuffed with bank and financial shares (and other likely insolvent SOEs – state owned enterprises). Are the banks solvent – under Western accounting? Do **you** know? (If you don't, forget it.)   Does anyone? It's **your** money they want, not to give money to you. Hence the manufactured bubble to suck punters in.

If one is talking about current PERs (there is not enough history to use well tried metrics like Shiller, Tobin's Q, etc) one should arguably take the median PER of the markets. This removes the downward forcing effects of the huge capitalization SOEs and numerous inefficient behemoths.

The graph from Albert Edwards at SocGen below, says it all.



As I said last bulletin, and despite the lower level now – SELL, if you are a serious investor.

The mantra that China is big; is growing; is opening up its financial markets (when it suits – then it shuts down!) is irrelevant salesmens' flatulence. I've been through 'growth' fantasia a gazillion times before. (In any case growth has slowed. My recent well below consensus estimate in fact may have been too high. Though, actually, it doesn't matter for investment. If you believe today's 7% official figure, you believe in Father Christmas. By and large GDP is a flaky statistic, as you know, and puzzling over every how-many-angels-on-the-head-of-a-pin percent of a percent move is a complete waste of investment time.)

Good luck.

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