►On Target

Martin Spring's private newsletter on global strategy

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A European Success Story

Greece has been the focus of attention for months as its difficult relationship with creditors switched abruptly from resentful compliance to adolescent rebellion, and finally to surrendered acceptance as the status of a "German protectorate," as one anonymous Eurozone official described it.

But this month I want to write mainly about a much happier story, about a small nation the other side of Europe with half as many people, living standards nearly three times greater, and consistent ratings as one of the world's leading nations for the happiness of its people, and the quality of its personal freedom, business administration and governance – Denmark.

Not surprisingly, it's also highly rated by investors:

► In the first half of this year it had the strongest stock market in Europe apart from Hungary, with a rise of 24 per cent in terms of its own currency (the krone, closely linked to the euro) and 13 per cent in dollar terms.

► Its government bonds are so highly prized that its ten-year securities trade on yields below 1 per cent – not much above Germany's, and far below those of the US (about 2.3 per cent) and the UK (2.2 per cent).

In the June general election Denmark shifted to the Right as voters opted for tougher controls on immigration, but the new coalition government is not expected to make significant changes in economic policy, which is a cautious combination of fiscal restraint, pro-growth measures, and active management of the currency and money supply.

Its central bank was the first in Europe to experiment seriously with negative interest rates. In July 2012 it began charging lenders 0.2 per cent for some of the cash they parked in it, as the krone came under pressure from funds seeking a European alternative to the euro.

After the European Central Bank launched its programme of quantitative easing, Denmark boosted its negative rate of 0.75 per cent on banks' excess reserves. The policy seems to have worked. Its central bank is expected to be able to "normalize" interest rates before the end of the year.

In some ways the nation's success story may seem surprising in terms of conservative values. Its taxes are high, as is usual in Scandinavia, with income taxed at rates of up to 57 per cent and capital gains at rates up to 42 per cent. Welfare spending by the state is generous, even lavish. Danes have a great deal of

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personal debt (3.2 times their incomes), as a consequence of a pre-2008 residential property boom.

Yet these burdens are not crippling, because of the dynamism produced by a business-friendly environment.

Denmark offers:

► One of the world's best ratings for economic freedoms – to do business, to invest, to finance. Entrepreneurial activity is encouraged. There's strong support for free trade. Regulation is transparent and efficient. Importantly, in contrast with conditions prevalent elsewhere in Europe, labour-market regulation is flexible – firing is easy… which encourages hiring.

► There is strong protection for property rights through an independent, corruption-free judiciary.

► Government spending, although high, is properly financed through appropriate policies and an efficient tax collection system. Public debt is relatively low.

► While maintaining impressive welfare systems, some of which boost prosperity such as generous childcare that allows so many women to work, socialist-inclined Danish politicians see the benefits of using private business to raise the efficiency of public services – operating fire engines and ambulances are examples.

► Denmark has managed to combine a high degree of integration with its European neighbours while maintaining an important measure of independence from them. For example, it remains outside the Eurozone (with its increasingly nasty infighting over policies such as austerity and aid to Greece), yet its currency is managed to track the euro.

The best Danish companies have become leaders in their fields, despite the lack of a huge domestic market enjoyed by rivals in the US, Germany, China and Japan, exploiting their edge in traditional industries such as agriculture, shipping and healthcare.

Novo Nordisk, for example, is a global champion that controls half the world's supply of insulin to some 350 million people suffering from diabetes. It's the Copenhagen anchor of a cluster of enterprises operating on the frontiers of biotechnology.

Denmark is also a leader in fields such as shipping (Maersk), wind turbines (Vestas), hearing aids (Oticon), toys (Lego) and beverages (Carlsberg).

Passion for progress in the chilly North

The Economist says Nordic companies owe their success to four qualities – relentless innovation, balancing passion for the new with ability to take the long view, a consensus-based approach to management, and an intense interest in replacing labour with machines.

"Tiny Denmark remains the world's eighth-biggest food exporter thanks to its obsession with productivity. Danish farmers use implanted chips to monitor their cows to maximize their milk yield."

Maersk Line, the world's largest transporter of sea freight, has an "ability to make money while its rivals cannot" that has been "almost embarrassing," Richard Milne

reports. In each of the past three years, in an industry largely stuck in the doldrums since the global financial crisis, Maersk has made profits when its average competitor ran at a loss.

If you are encouraged to follow investors who powered the up-trend in Copenhagen in the first half of the year, iShares does have a country ETF. If you prefer direct stakes in individual companies, here is my own short list of shares that merit further investigation…

Ambu is a small-cap company in the healthcare sector. It develops, manufactures and markets diagnostic and life-supporting devices for hospitals and rescue services. Its price has been soaring since mid-2013, so it's now rather expensive on a price/earnings ratio of around 46 times.

Chr. Hansen is a mid-sized bioscience firm that develops natural ingredients such as enzymes for the food, pharmaceutical and agricultural industries. Its share has been rising consistently for years and earnings have been growing strongly, but it's also expensive on a PE of about 43x.

DSV is another mid-cap, this time in the transportation sector. It provides freight and logistics services around the world, and is active in 70 countries. The share has been rising strongly for four years. It currently trades on a P/E of about 22x.

Jeudan is a real-estate specialist in acquisition, development, management and rental of commercial and residential properties, mainly in the Copenhagen area. Despite highly volatile earnings, this small-cap has also been rising strongly for four years.

Novo Nordisk is the giant of the Scandinavian bourses, with a market cap. of some $120 billion. Some 24 million people depend on its insulin to ward off early painful death from diabetes. Its research and development budget for seeking new, more easily-administered treatments, runs at $2 billion a year. With a very strong and consistent record of earnings growth, averaging 23 per cent a year over the past five, the share is understandably highly rated on a PE of about 35x.

Novozymes, an offshoot of Novo Nordisk, supplies half the world's enzymes used in the pharmaceutical, household care, food processing and textile industries, and is a major player in biotech. This is another highly-rated stock (PE about 43x) with an excellent and consistent earnings growth record.

Royal Unibrew is a small-cap play play on European consumers, making and distributing branded beers, soft drinks and fruit juices. Strong in Denmark, it also operates in Poland and the Baltic states. It has been delivering excellent and consistent earnings growth, and is good value on a PE of 19x.

Schouw & Co. is another interesting small-cap, with a diversified portfolio of industrial holdings – in feed for fish farms, personal care products, agricultural spares, hydraulic components, biogas plants, even lighting and smoke machines for the entertainment business. Its share, which has been rising strongly for three years, is still moderately priced on a PE of 17x.

Simcorp is a small-cap that develops and markets software for the finance industry. It operates worldwide and has an excellent and consistent earnings growth record. A bit pricey on a PE of 36x.

Tryg sells insurance products throughout the Nordic countries. It's a mid-cap with an outstanding earnings growth record, which is why the stock looks really good value on a PE of 18x, after going through a big correction in recent months that has made it cheaper.

I haven't mentioned some big stocks like Danske, Denmark's largest bank (too expensive), or Vestas Wind Systems, the world's biggest producer of turbines for onshore and offshore wind farms (much too volatile for my taste). The shares I've picked have combined strong growth with consistency.

Why Global Economic Growth Is Sluggish

There's bullish talk about a coming pick-up in global economic growth, but for the moment, the signals are negative. Trends in the global economy look increasingly ominous.

Global trade is sluggish. In the first four months of the year, it rose only 2 per cent in volume terms, fell 12 per cent in dollar terms, year-on-year. Exports of Asian countries that are particularly sensitive indicators are looking awful.

Investment in expanding productive capacity is weak. The gap between new orders and stocks held by manufacturers is the poorest in three years.

Inflation is trending downwards in the US, Europe, China and Japan, with the rise in consumer prices in purchasing-power terms down over the past two years from 3 per cent to 1.2 per cent.

The OECD – the think-tank of mature economies – has cut its forecast for growth this year from 3.7 per cent to 3.1. The US is only expected to grow 1.1 per cent according to the Atlanta Fed's latest GDPNow model. Europe and Japan are forecast to deliver minimal growth, while the most dynamic constituent of the world economy, China, is losing momentum.

Of course, there are some positive factors to counter the gloom. The fall in oil prices, by improving users' spending power, is adding 0.25 percentage points to economic growth. Central banks show no sign of retreating from their extreme money and credit creation policies to stimulate growth. In the US unemployment continues to fall, wage gains have started to gain traction, the housing market is looking better.

But nevertheless, the world economy, on balance, remains stuck in what the OECD calls "low-level equilibrium." Two years ago in *On Target,* I forecast: "Global economic growth is going to remain weak for many years to come."

My friend, London analyst David Fuller, counters this view, arguing that what we're experiencing "is no more than a typically slow recovery following a credit-crisis recession more severe than any seen since the 1930s."

Deflation isn't necessarily a bad thing if it's produced by accelerating technological innovation; the American economy has not lost growth momentum despite the cessation of quantitative easing; the dollar has been strong; several other central banks have now followed the US with QE policies; Treasury bond yields have had their strongest rally since 2013.

I hope his optimism will be rewarded. But I remain unconvinced. Falling economic growth rates and worsening disinflation are not encouraging signs.

Why has global recovery been so sluggish?

The most important reasons are…

► **Poor growth in demand**.

Consumers aren't able to deliver the buoyant spending that has been a key driver of economic growth in the past because they're not earning more, nor are they able or willing to go deeper into personal debt.

There is little or no growth in the incomes of most of the workers in the mature economies because of a combination of adverse factors such as competition from cheap foreign labour, job destruction by infotech, labour laws that discourage job creation, a shift in demand towards higher-level skills and attitudes, and an abundance of unemployed available for the lower-level jobs.

Governments no longer have the fire-power to boost demand by spending more because they are already spending too much (often on the wrong things), thanks to decades of expanding state entitlements without responsible financing. Poor economic growth has boosted the burden of those entitlements while depressing tax revenues. High and still-rising levels of public debt increase voter hostility to greater borrowing to finance stimulus measures.

Businesses lack the confidence to invest in aggressive expansion as they have in the past. The credit crisis has shocked managements into much more cautious policies. They require less uncertainty about the future when considering new projects. Greater priority is given to hoarding cash, distributing immediate rewards through buybacks and dividends, strengthening balance sheets, and seeking growth through mergers and acquisitions rather than building new plants or creating new businesses.

Greater caution, foolish policies

Many of those nevertheless willing to risk expansion are unable to do so because banks, too, have been shocked into greater caution and driven by a flood of regulation into being much more restrictive about lending, intensifying their preference for lowest-risk and least dynamic borrowers. That includes the foolish officially-promoted policy of facilitating banks' borrowing from one government agency to lend to another at a marginally higher rate of interest.

In the past, the credit system was a major stimulant for growth. Now it is a major depressant.

► **Globalization is losing its positive impact**.

The low-hanging fruit has been harvested, most spectacularly with the completion of massive industrial complexes in Asia.

International competition is intensifying because there is over-supply of goods, even of some internationally-traded services, and of commodities, against a background of sluggish demand. There are few promising growth markets in the US, Europe, the oil producers, even many of the emerging economies.

Adding to the disruptive effect of the supply/demand imbalance is a currencies war, led by Japan, with the yen falling 30 per cent in dollar terms in 30 months.

Protectionism is creeping back.

► **Asia, the world's greatest growth engine, is losing momentum**.

China is still growing fast, but not as fast as before.

Lower growth is accepted by the government as the price to be paid for addressing major fundamental problems such as over-investment in fixed capital, poor public services, a real estate bubble, badly-structured local government finance, corruption, pollution and energy resources.

India, Indonesia and other Asian economies, both emerging and already-developed, face similar or different but equally taxing problems.

Although Asian nations will continue to deliver high growth, and an increasing proportion of global growth, that won't happen at the levels of the glory days.

What are going to be the consequences of relatively sluggish economic activity for the world as a whole, for years to come?

Firstly, it's going to continue to be what I've dubbed a Noflation World… neither inflation nor deflation will be significant.

There will be no general inflation because there will be no buoyant demand for goods and services pressing on limited supply. Some stagflation in individual countries produced by weakness in their currencies, nothing more.

For several years the world has been experiencing DISinflation. According to the Bank of England, 40 countries are now experiencing deflation.

We're even seeing this where I live, in Thailand, where the official consumer price index has been falling this year.

However, the world is not likely to experience serious deflation.

Why? Because, unlike in the past, the state accounts for such a large share of all economic activity in advanced nations – in Europe, roughly half. Governments aren't going to cut back on their spending, no matter how much taxpaying voters would like that. Central banks have made it clear that there is no limit to their capacity and willingness to "print" money to prevent deflation.

As investors, we should plan on the basis that easy-money policies are likely to continue indefinitely. Official interest rates will remain ultra-low to encourage economic activity, contain political pressures, and reflect central bankers' well-grounded fears of the risks of normalization (that is, reverting to normal interest rates).

What a Shambles!

So Grexit didn't happen, although it was a close-run thing. In the end the French won the battle to maintain the political integrity of the Eurozone at the cost of yet another bail-out; the Germans won the battle to force through administrative reforms and even greater austerity as the price of the bail-out; the Greeks lost on all fronts after an amazing display of incompetence by its new government.

Unfortunately it was yet another example of "kicking the can down the road," of Eurozone leadership refusing to face up to realities and make the radical policy changes that cannot be avoided indefinitely.

Greece is to remain stuck in a system where its government cannot manipulate the exchange rate of its currency, the most effective weapon governments have to shield and stimulate their economies.

It is to remain saddled with foreign debt so massive – and now growing even larger – that it has no hope of ever repaying. The main purpose of refusing to recognize that is to save the face of the politicians and officials who foolishly lent vast sums to the Greeks in the first place, by maintaining the fiction that Greek debts are "assets". And to provide them with the cover to send even more to Athens!

Greece is being forced to impose even more austerity when current levels are already crushingly painful for most of the population, and negative for desperately-needed economic recovery.

While many of the reforms demanded by the foreign creditors such liberalizing labour and business markets are much-needed, their benefits will only come through long-term. Other reforms such as higher taxes are designed to balance the books of government, but will do nothing in the short term to boost economic growth.

The Greek government has passed many laws to implement reforms, but is already backsliding on its commitments by delaying the politically most difficult ones – new rules on early retirement, scrapping concessions to farmers that are a major source of tax evasion.

Much of the plan imposed on Greece by Eurozone hardliners is obvious nonsense.

► Even if it produces honest tax collection (the hope of dreamers in Berlin and Brussels), how much tax is going to be collectible from a devastated economy, reported to have contracted by a quarter this year?

► Who is going to buy the €50 billion worth of state assets that it's planned to sell off, and at what prices?

► How is it going to be possible to implement the laws forced through by Eurozone leaders providing for reforms, in the face of a resentful bureaucracy and a population bitterly hostile to foreign dictates?

Recycling debt to save creditors' face

There is so much dishonesty about all this that it's mind-boggling.

One example is the way that, with Greece's capitulation to its creditors, it was announced as a reward there would be up to €86 billion in fresh bail-out loans. You might have got the impression that all that extra money is to give a boost to the stricken economy. Not so. €30 billion will just be recycled into paying off old debts. Most of the rest will be hoovered up by the banks… and we know from what's happening elsewhere, that financing business growth and creating jobs is low on all banks' priorities.

Bail-out Plan 3 for Greece looks no more likely to succeed than its two predecessors that left the country with €320 billion of foreign debt, plus nearly €90 billion of repayable "liquidity assistance" to banks from the European Central Bank.

Loading austerity on to a shattered economy, whose population is experiencing a humanitarian crisis, greatly increases the risk of civil unrest, rising political extremism, perhaps even seizure of power by the military.

You think that's an extreme view? Donald Tusk, the former premier of Poland who heads the European Council, recently said in an interview that in Greece he feels "something revolutionary" is in the air; the "most probable scenario" of the *FT*'s commentator on Eurozone affairs, Wolfgang Münchau, is that Grexit is going to happen "through insurrection."

Two final thoughts…

► How would you like to be sent to Athens as one of inspectors tasked with the job of enforcing Eurozone reforms? Not my idea of a dream posting.

► As Greek politicians and officials are clearly incompetent, and those making policy elsewhere in the Eurozone clearly prefer bureaucratic "solutions" to free-market, growth-creating ones, why not put in charge in Athens those Greeks with a world-class record of efficient management – the shipping magnates?

The Yellow Metal Takes a Fall

Why did the gold price break down so suddenly?

The *FT* reported that the "sharp sell-off" was triggered by "the strengthening dollar and the prospect of a rise in US interest rates."

Nonsense.

The dollar's trade-weighted value rose steadily from July last year to March this. Over that period the gold price went all over the place, but actually rose sharply in tandem with the dollar from early November to late January. As for the prospect of rising interest rates… judging by the market in Treasury bonds, that was no more likely when the gold price plunged than it was a month before.

The yellow metal has been in a bear market for nearly four years since it became clear that the avalanche of "money printing" by the central banks would not trigger an outburst of inflation. Since then the world has been experiencing DISinflation, leading to deflation in dozens of countries. That is the worst environment for gold as an investment.

Two things produced the sharp sell-off:

► China's central bank revealed its gold holdings after years of secrecy. Gold market analysts long believed that it was buying lots. Ronald-Peter Stoeferle of the Incrementum consultancy reported a year ago: "It is realistic to assume that China currently holds 4,000 to 6,000 tons of gold." Instead, Beijing announced it has just 1,658. It accumulated only 600 tons over six years, or just a quarter to a third of what the experts expected.

Aurophiles were shocked, as the revelation demolished one of the pillars of the bullish case for gold, that China wants far bigger bullion reserves to back its renminbi currency as a challenger to the dollar's global dominance. {The US has reserves of 8,133 tons).

► Massive sales suggest a raid by bearish speculators, probably mainly Chinese. On July 17, the equivalent of $1.7 billion worth of gold was sold in just three to four minutes on American and Chinese securities markets. The same day gold-tracking exchange-traded funds suffered their worst daily outflow in almost two years.

Since then, gold prices have continued to fall, and are now below $1,100. What next?

Since 2011 all commodities have suffered from what Incrementum calls a “disinflationary earthquake.” The after-shocks continue, with commodities as a whole testing their lowest levels in 13 years.

Majority opinion predicts that global disinflation is coming to an end as economic growth picks up. But we’ve heard that for years, and the optimists have been consistently wrong. For the moment, the trend is for prices generally to continue falling. That means the outlook for gold remains gloomy.

However, the complete lack of bullish speculative interest and pronounced negative sentiment suggests to me that we are probably at or close to the bottom of the down-trend.

Incrementum rightly warns: “A final sell-off is possible… A reversal following such a test would be a reliable indication of a primary trend change.”

Gold should always be one component of any balanced portfolio as the ultimate insurance against financial catastrophe, but for the moment it’s a deadbeat investment.

China’s Burst Bubble

The extraordinary China stock-market events of recent weeks have stunned investors, with the Beijing government taking extreme measures to stem a meltdown which saw the benchmark Shanghai A-Shares index fall by a third and trading temporarily suspended in half of all the nation’s listed companies.

The biggest banks were ordered to provide the equivalent of $200 billion to buy shares, with an additional $500 billion earmarked for use if necessary. There was a temporary ban on sales by major shareholders, indeed some 300 corporate bosses were told they had to buy back their own companies’ shares. Police were ordered to hunt down those guilty of “malicious” short selling.

This impressive use of state power worked. The downward spiral was halted, the markets bounced back (by 17 per cent for Shanghai A shares at time of writing), and trading was resumed for hundreds of companies.

There has been a barrage of jeering by foreign commentators always ready to believe the worst about China. And undoubtedly the foolish way Beijing encouraged a bubble in stock-market speculation, then panicked and acted brutally to limit the fallout when it burst, has done some serious damage to China’s reputation for sound financial governance.

However, it’s important to keep a sense of perspective.

Analyst Eoin Treacy of FullerTreacyMoney rightly points out: “China is certainly not the only country to offer assistance to its stock-market in times of stress. The Fed has its Plunge Protection Team, and Europe banned short positions during its sovereign debt crisis.

“China might now be supporting the market, but it is also worth highlighting that it was instrumental in creating the preceding rally.”

Even after the bursting of the speculative bubble, China's A shares have stabilized at levels more than double those just a year ago. And many of them can be bought in Hong Kong on valuations that are very attractive compared to those of blue chips in New York and London.

The Lucky Few Grow Richer

Most Americans continue to be left out of the joys of economic growth, which is why inequality is becoming a bigger issue in the nation's political life.

According to a new report by the Swiss Re insurance company, US savers as a whole profited from a doubling in the value of their equity holdings over the 2009-2013 period. But the wealthiest 1 per cent of households made an average gain of $3.7 million from the stock-market boom, equivalent to 50 per cent of their total financial wealth, while the bottom 90 per cent of households registered an average gain of only $7,300, or 12 per cent of their financial wealth.

There's a similar disparity in earnings from employment.

For six years earnings growth in the private sector, for those who do have jobs, has been averaging just 2 per cent a year. Highly-skilled workers are doing much better. That's because there's a shortage of them. Most of the job creation which captures the headlines is in the unskilled, low-wage sectors such as retailing, leisure and hospitality – 816,000 extra jobs in the past 12 months.

"The reality," argues CLSA strategist Christopher Wood, "is that, despite the fancy oratory of American President Barack Obama, there is no longer a 'middle class' in the US.

"There is an affluent upper class – who probably account for 20 per cent of consumers – who have the skills demanded by the labour market, and who have been geared into the QE-driven asset inflation of recent years. And then there are the rest, most of whom are living month-to-month, paycheck-to-paycheck.

"That is to assume they have a job at all, with the labour participation rate still running at a 37-year low of 62.7 per cent, while 'disability' payments have grown by 35 per cent over the past two years to an average $1,017/month."

For many Americans, there has not really been an economic recovery. Over the past ten years economic output per person in real terms has only risen at an average annual rate of 0.7 per cent, compared to 2.2 per cent over the preceding decade. Too many people lacking the skills to compete for jobs that pay well is one major reason.

Investment Strategies Now

If economic growth is going to remain weak, and the Fed makes no more than a nominal gesture towards raising interest rates, where should one invest?

This environment favours two options, says the *FT*'s James Mackintosh:

► Buy companies that can expand in any economic environment – growth stocks; or

► Buy boring companies able to generate steady returns even in a slow economy -- high-quality defensives.

Both categories are more expensive than the wider market. Biotech, for example, “seems to have discovered the hope gene.” Shares in the Nasdaq biotech index are trading on average at nine times their book value and 50 times cash flow.

When investors take the view that such valuations are too much even for a fast-growing sector, value stocks, which have been outperforming since 2009 but especially this year, will bounce back.

Value investors are heavily overweight in shares that are most sensitive to economic conditions, such as cheaper financial and energy stocks.

Tailpieces

Risk in bonds: Government securities continue to defy consensus predictions of an end to their bull market, which has lasted for 30 years in the case of US Treasuries.

The reason is that monetary policy has been a complete failure. Although US central bank, the Federal Reserve, has created vast amounts of extra money, it’s circulating less effectively. Since 2000 annual velocity of money (defined as nominal GDP divided by M2 quantity of money) has plunged from 2.2 times to 1.5 times.

It has boosted the prices of investment assets such as bonds rather than stimulating economic growth.

However, recent severe turbulence in the markets points to a much higher level of risk in bonds. Ultra-low interest rates have driven a dangerous “search for yield.” Technical factors have brought about a sharp decline in liquidity, which means the “rush for the exits,” when it comes, will be potentially severe, especially for higher-risk and less-liquid securities.

Already the spread between rates on lowest-risk sovereign bonds and higher-risk securities such as high-yield corporate and emerging-market credits is increasing.

Britain’s armed forces: Although the UK still continues to meet the NATO target of spending 2 per cent of national income on defence, and has now “ring-fenced” that commitment, the way it’s spending the money seems crazy.

The army is being cut back so savagely that it’s soon expected to number as few as 50,000 men, the smallest it’s been in more than two centuries. The air force has been so neglected that it struggles to find more than a handful of operational aircraft when they are needed to meet international commitments. The UK is no longer able to conduct maritime surveillance because it has scrapped its Nimrod early-warning aircraft.

On the other hand, the UK is spending billions on nuclear-armed submarines and building two new aircraft carriers. Only one flattop will be equipped to operate, and will be so short of aircraft and escorts that it will have limited military value.

Soaring burden of healthcare: The reason American families aren’t rushing out to spend the unexpected boost to their purchasing power from the halving of oil prices is that it’s being neutralized by the higher costs of medical services and related insurance.

In May those costs accounted for an amazing 24 per cent of their personal consumption expenditure, and were running more than 6 per cent higher than 12 months before. They accounted for 39 per cent of the $431 billion increase in PCE.

Companies are making employees pay more towards their healthcare coverage, and insurance premiums are much higher as a consequence of Obamacare.

Asian shares: Although Chinese stock markets "may amount to 'here be dragons' land," it would be "unfair to tar all of Asia with the same brush," says PFP Wealth Management's Tim Price.

Two markets look especially attractive:

► Japan. Almost half the bourse trades on price-to-book ratios of less than one. Only 15 per cent of the US trades at a comparable multiple.

► Vietnam. It looks set to benefit from the removal of limits on foreign ownership of listed businesses. "Having been the worst-performing market in Asia for the last five years," it "has the potential to be one of the best over the next five years."

US rate rise: Two reasons why pressure is mounting for- US Federal Reserve chairman Janet Yellen soon to start raising the cost of credit after six years of easy-money policies…

► Without higher rates, the central bank lacks its most powerful traditional weapon for combating the next recession – cheapening credit.

► Growing recognition that quantitative easing and zero rates have inflated a bubble in asset prices and driven related rising wealth inequality, yet failed to boost economic growth.

Risk: The assumption that market returns follow a "normal distribution" – the well-known "bell curve" -- is "false," says the *FT*'s James Mackintosh, even though it's "still relied upon by lots of financial models." Of those, the two most important are the model used by investors for asset allocation, and the model used to work out financial institutions' regulatory capital requirements.

False signals: Price/earnings ratios are notoriously poor guides to year-ahead outcomes, and therefore tell us nothing useful about whether the global bull market will be over soon, says well-respected commentator Jonathan Davis.

Wise words: *The way to crush the bourgeoisie is to grind them between the millstones of taxation and inflation.* Vladimir Lenin.

Martin

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