► On Target

Martin Spring's private newsletter on global strategy

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Investing in Energy Winners

How embarrassing it all is. As global leaders meet in Glasgow for Boris Johnson's propaganda-fest to encourage governments to commit themselves to absurdly ambitious net zero emission targets – without explaining how they will achieve them -- their energy ministers are frantically scouring the world for millions of tons of extra fossil fuels – especially natural gas and coal.

Yes… the very fossil fuels the powerful activist lobby is fighting to shut down.

Energy shortages have sent prices into orbit. In America natural gas prices have breeched the $6 per thousand cubic feet (Mcf), the highest since 2008; in Europe and Asia they've quadrupled over the past 12 months. Millions of households face savage bills to stay warm as temperatures slide into winter; factories are closing as they can't meet their astronomical gas-supply charges.

After years of pressure by governments and banks to shut down coal mining, the black stuff is now needed desperately. In India the 135 thermal power plants only have an average of four days' fuel. In China, where coal generates three-fifths of all the electricity, prices have doubled; power cuts have forced factory shutdowns making everything from iPhones to Toyota cars.

The "perfect storm" in energy markets stems from an unlikely combination of causes. Short-term factors include the need to rebuild low gas stocks ahead of winter, unusually poor winds driving offshore turbines in the Atlantic, a need to import gas to substitute for lack of water to power hydro-electric stations in Latin America, heavy rainfall in China shutting coal mines.

Foolish government policies driven by climate activism are magnifying the short-term effects. The transition to renewables such as wind and solar has discouraged businesses' and investors' willingness to put their capital into developing supplies of fossil fuels that they're told have no long-term future. Premature closing of "unfashionable" fossil fuel and nuclear plants have reduced dispatchable power and back-up. The move away from coal has encouraged countries to increase dependence on imports of gas, particularly in liquid form, where Asian economies readily outbid their European competitors.

Russia, which provides almost half Europe's gas imports, has been accused of holding back supplies this year to put the European Union under pressure to authorize pumping through the just-completed Russia/Germany Nord Stream 2 gas pipeline. Whatever the facts – which are in dispute – it's unlikely the extra supplies will come through before winter's over.

Europe's largest gas field, Groningen in the Netherlands, is only pumping three-quarters of what it did in 2018 and is heading towards shutdown.

The Brits keep making major bad decisions. They have chosen never to exploit one of the world's biggest undeveloped deposits of shale oil and gas; are shutting down what's left of their once-great coal mining industry; have abandoned the offshore Rough facility, slashing gas storage capacity from 15 days of winter demand to five; and have opted for a dangerous dependence on wind for electricity supplies.

The current energy crisis has awakened consumers and voters to the risks involved in policies seeking to fight production and consumption of fossil fuels and replace them, at enormous cost, with inefficient renewables.

The key inefficiency is intermittency. When winds don't blow and the sun doesn't shine, electricity has to be found elsewhere. In July there was so little wind driving the turbines on which Britain depends for a quarter of its power supplies that they operated at less than 5 per cent of their capacity for 314 hours.

We're told that we'll eventually have battery farms on such a scale storing back-up energy to overcome the intermittency problem with the renewables that will replace fossil fuels. But the figures don't add up. A friend who has analyzed them tells me that, using reasonable assumptions, to replace the 1,400 Terawatthours of electricity used in the European Union each year and currently coming mainly from natural gas and coal will require battery storage back-up of some 273 million tonnes of batteries. Assuming battery prices continue to fall, that will nevertheless cost say $8.2 trillion – double that taking into account necessary peripherals -- and need about 25 years' mining of lithium carbonate. And you'd need to replace the entire stack of batteries every few years as their charge holding capacity erodes. As my friend says: These are "insanely prohibitive costs."

Activists argue that the current energy crisis must be used to intensify the transition to renewables. That is, more of one of the root causes of the crisis. More inefficiency, more malinvestment and more demand for relatively scarce materials such as copper.

The only sensible alternative is atomic power

In practice, fortunately, we are likely to see governments giving lip-service to the ideology of climate change while focusing in practice on boosting supplies of fossil fuels – and the only sensible alternative, which is nuclear energy.

Natural gas will be a clear winner as it's so abundant, efficient, convenient and (normally) inexpensive. Russia can be counted on to increase its gas supplies through new pipelines both to Europe (Nord Stream 2) and to China. Immense investment in liquefaction plants and carriers will deliver great expansion of liquified natural gas shipped from suppliers such as Qatar, Australia, the US.

The current crisis has highlighted the continued importance for developing economies of even the "dirty" and unfashionable fossil fuel, coal. It generates half of China's power, where the government has instructed mining companies to increase production by 100 million tons a year. In the US, despite all the virtue-signalling by the green lobby and the Biden administration, power plants are on course to burn 23 per cent more coal this year.

Nuclear energy is at last making a comeback after decades in the doldrums following the Chernobyl and Fukushima disasters. It has major attractions. Unlike fossil fuels, it generates carbon-free electricity. Unlike renewables, it isn't intermittent and so needs no expensive back-up. Unlike either, its generating stations can be located where the power is needed, requiring no long transmission lines, pipelines or ships.

There are 444 nuclear reactors in operation worldwide, 50 more are under construction. The industry's leader is China, which plans to increase its nuclear generating capacity by 46 per cent, from 48 gigawatts in 2020 to 70 GW by 2025.

Mounting opposition to renewables

For a long time atomic energy was anathema to the green lobby, but opinion there is now divided. Its nil-carbon characteristic and mounting recognition of the deficiencies of renewables has made nuclear more acceptable. However, safe disposal of the highly-dangerous nuclear waste is a continuing negative issue.

Another problem is high capital cost because of the increasingly robust construction and security systems required by regulators. According to a recent report the average cost to build nuclear power stations is about $8 million per megawatt of generating capacity.

However the industry is expected to move away from what Matt Ridley describes as "the huge behemoths built like Egyptian pyramids" by the Chinese to much smaller and cheaper designs made in modular form on production lines. It's claimed that these are safer, more flexible, and may even address the waste problem as they could use recycled fuel.

An important change in how governments are changing their attitude is that France, the European leader in nuclear power plant construction, has abandoned its plan to reduce its dependence on atomic power, instead focusing on expansion. Announcing his France 2030 investment plan, President Emmanuel Macron said he will begin investing in new nuclear projects such as small modular reactors "very quickly."

The *FT* has reported that nuclear power will be "at the heart" of Britain's net zero carbon emissions policy. Other countries that have announced intentions to move towards nuclear are Germany and Poland.

Investors have started to recognize the potential. The price of uranium, the fuel used in atomic power stations, has doubled over the past 12 months and surged to a six-year high.

A driving force has been Canada's Sprott Physical Uranium Trust, which stockpiles the metal and now holds more than 32 million pounds of it. It's listed in the US and Canada. Other funds also hold stocks of "yellowcake" – uranium concentrate in powder form – or invest in the shares of companies that mine it. The three biggest are Kazakhstan's Kazatomprom, Canada's Cameco and Australia's Olympic Dam.

Experts have advised the European Union that it should designate nuclear as a "sustainable" source of electricity. If it agrees (France is pushing for it) this will open the door for new investment under the EU's gig antic green energy plan. Former hedge fund manager Hugh Hendry has described uranium as "the rockstar of commodities." He's one of the increasing number of analysts who believe that nuclear will be the big winner in the energy sector as it has the right "green" characteristics without the big negatives of renewables.

Why You Need an Offshore Bank

You may have wondered: "What can an offshore bank account give me that I can't get at my local bank?" The answer is… A wide range of benefits.

Nick Giambruno of *International Man* lists these reasons why you should open an account with a bank outside your country of residence if you don't already have one. Without delay.

Reason #1: Dilute Your Political Risk

Today, the biggest threat to your savings isn't market risk. It's your own government.

Governments are sinking hopelessly deeper into debt. They are turning to the same desperate measures to deal with their situation that they've used throughout history.

It's only prudent to expect more bail-ins (as we've seen in Cyprus); bank deposit taxes (as we've seen in Spain): expropriation of retirement savings (as we've seen in Poland, Hungary, Portugal, and Argentina): and capital controls (as we've seen in Cyprus and Iceland). To give a few examples.

If you think these kinds of things can't happen in your country, think again.

As the American judge Andrew Napolitano warns: "People who have more than $100,000 in the bank are targets for any government that's looking for money to shore up its own inability to manage its finances."

A big part of any strategy to reduce your political risk is to place some of your savings outside the immediate reach of your home country. Setting up a foreign bank account in the right jurisdiction is a convenient way to do just that.

That way your home government can't easily confiscate, freeze, or devalue all of your money with a couple of taps on the keyboard. If your home government imposes capital controls, an offshore bank account would help ensure you could access your money when you need it most.

In short, keeping some of your savings in the right foreign bank can largely protect you from madness in your home country.

Reason #2: Sounder Banking Systems and Banks

Almost all of the banking systems in Western countries are fundamentally unsound. They've leveraged themselves to the hilt. The promises of insolvent governments are all that back them. Worse, most of these banks only keep a tiny bit of cash on hand to meet customer withdrawal requests. This means, in the event of another Lehman-style financial shock, you could have trouble accessing your money.

There are banks in stable jurisdictions with low debt that don't gamble with customer deposits (that is, your money). Many of these banks are much better capitalized, keep more cash on hand, and are otherwise much more conservatively run, than those in the US and European countries.

Reason #3: Asset Protection

Maybe you think it's just other people who live on the firing line of law suits. Think again.

The Legal Resource Network reports that in the US 15 million cases are filed every year. That works out to a new lawsuit for one out of every 12 adults each year… year after year. Unless you're exceptionally lucky, sooner or later your turn will come. You're not going to like it.

While there is no such thing as 100 per cent protection, a foreign bank account can help make you a less attractive target. It also protects you from overzealous government agencies armed with the summary power to freeze your assets. That's because their reach doesn't extend beyond your own country.

If you ever find yourself in a wrestling match with a government agency or a frivolous lawsuit, a foreign bank account gives you resources you can count on.

Reason #4: Currency Diversification

Holding foreign currencies is a great way to diversify your portfolio risk, protect your purchasing power, and internationalize some of your savings.

Chances are, though, that your domestic bank offers few, if any, options for holding foreign currencies. Offshore banks, on the other hand, commonly offer convenient on-line platforms for holding foreign currencies.

Reason #5: Higher Interest Rates for Your Deposits

In what amounts to a war on savers, the European Central Bank and the Federal Reserve have manipulated interest rates to historic lows. These artificially low interest rates effectively transfer wealth away from savers, who would otherwise enjoy higher returns on their deposits, to borrowers. In fact, if you live in the West, there's a good chance the interest you're earning on your savings isn't even keeping pace with the real rate of inflation.

If you look abroad, though, you can find banks that pay significantly higher interest rates than what you'd find at home.

Reason #6: Ensure Access to Medical Care Abroad

If you're unable to receive timely treatment in your home country, an increasing possibility in most countries, you may want to access medical care abroad. In Thailand, for example, you can easily get walk-in appointments with consultants qualified in the US and Europe.

Suppose, for whatever reason, you cannot get the medical care you need in your home country and you have to go abroad. You would have to transfer money abroad to pay for it. However, if your home government has already imposed capital controls, it could be difficult or impossible to pay for the medical care you need.

This is where having a foreign bank account, which isn't hostage to capital controls in your home country, can help ensure you can always pay for the medical care you need.

Reason #7: The Ability to Act Quickly

When it comes to international diversification, it's always better to be a year early than a minute too late. Once a government has imposed capital controls or levied bank accounts, it's too late to protect your money.

If you don't already have one, you should open an offshore bank account now, even if it's a small one. Just having one available, regardless of how much money you initially put in it, gives you meaningful benefits. It gives you the option to act quickly and transfer more money abroad in the future, should the situation warrant it.

Reason #8: Maintain Limited Privacy

Americans who have an aggregate of $10,000 or more in foreign financial accounts at any time during the year must report it. However, if the aggregate total of your foreign financial accounts remains under $10,000 for the year, and you are not using a trust, LLC, or other structure, you don't necessarily have to report it.

This is also often true for citizens of other countries.

An offshore bank account is like an insurance policy. It helps protect you from unsound banks and banking systems and the destructive actions of a bankrupt government. It also makes you a hard target for frivolous lawsuits and ensures you can pay for medical care abroad. Knowing that you've taken a big step to protect yourself should give you more peace of mind.

Is Having an Offshore Bank Account Legal?

Despite what you may hear, offshore banking is completely legal. It's not about tax evasion or other illegal activities. It's simply about legally diversifying your political risk by putting your liquid savings in sound, well-capitalized institutions where they are treated best.

It's no secret that it is becoming harder and harder to open a foreign bank account. Soon it could be impossible. This is a strong incentive to act sooner rather than later - even if you don't plan to use the account immediately.

Investment Outlook Risks in America

Are the investment risks "Fire" – tightening financial conditions – or "Ice" – growth disappointment, particularly on the earnings side?

"We think it's increasingly likely these scenarios happen together" and we'll get a fall in stock markets of 10 per cent or so, says investment bank Morgan Stanley.

It expects earnings trouble ahead as a number of companies have flagged serious supply-chain issues in their latest reports. Beyond the current quarter it thinks earnings risk comes more from the inability of companies to pass on rising costs in their prices, margin risk related more to higher wages, and weakness in sales of consumer goods.

The risk of stagflation undermines the rosy stock-market calculus that we can expect strong economic growth underpinned by cheap finance into perpetuity that is currently priced into asset valuations, says Lena Komileva, chief economist at G+ Economics.

There is a growing realization among government officials that economies are nearer to full employment than thought; that supply disruptions will keep inflation higher and for longer than previously expected.

The recent rise in bond-market yields partially reflects concerns that port congestion and the effects of coronavirus variants on workplace participation will mean that cost pressures may prove more intractable than transitory; that higher inflation may become a self-fulfilling prophecy by forcing businesses to prioritize survival over growth, and profits over market share, by passing higher costs on to end-users.

With withdrawal of central bank stimulus, the likelihood is that we are passing the peak of real economic growth and financial liquidity, making it more likely that higher bond yields herald the end of the sweet spot of this economic cycle.

Cheaper credit has provided fiscal space for governments to respond to the enormous social pressures of the pandemic, but has also helped to facilitate corporate restructuring, spur a shift towards green technology, reflate corporate earnings and lower credit costs.

But the resurgence of inflation will raise questions about a key underpinning of the markets that large increases in fiscal support can be financed by monetary expansion with few repercussions. This means not just tampering the sugar rush of current demand and addressing the self-fulfilling prophecy of public inflation fears, but also creating more targeted public investment and private capital incentives towards tackling climate change, ageing populations and the constraints of fragmented supply chains.

The policy revolution of the post-coronavirus era is just starting.

However the highly-regarded Vancouver-based investment advisor Leon Tuey has a very different view. He says: “Forget the black headlines and the doom merchants – the secular bull market remains powerfully bullish.” He offers these reasons…

► Fundamental metrics make poor timing tools. Ratios such as price/earnings tell investors nothing as they don’t drive the market. What drives the market is earnings momentum.

► Consider relative returns. Currently the earnings yield on the S&P index (the inverse of its P/E) is more than 3 per cent whereas ten-year Treasuries are yielding 1.55 per cent. Clearly, stocks provide better returns than fixed income. With inflation near 2 per cent and interest rates near zero, is the market overvalued?

► The best environment for equities is a period of modest growth and stable inflation. The Fed chairman Jerome Powell is committed to policies designed to achieve exactly that.

► Other factors such as demographics, technology and globalization will help to keep inflation at bay.

► The time to fear is when the Fed begins to tighten meaningfully by raising interest rates aggressively and draining liquidity from the system. It will only do so when the economy overheats, inflation surges and speculation is rampant. Until that happens, relax, stay invested and enjoy the bull market.

Why's There Such a Shortage of Labour?

Wage inflation in the US is now up to 4.6 per cent a year, and accelerating. Many believed that the extended unemployment benefits and the need to take care of children out of school were suppressing labour supply. But the termination of those benefits and the return to school have come and gone, yet the labour shortage persists.

Why is this? One theory is that Covid shutdowns sent many undocumented workers back to their countries of origin as their jobs evaporated. Another is that older workers are reluctant to return to work for fear of getting sick; that those receiving benefits were working for cash off the books.

Yet another theory is that some are not joining or returning to the labour force because they don't need to – older citizens have seen their retirement plans swell with the stock market and have chosen not to return to the workforce; some younger ones have made so much money in cryptocurrencies, non-fungible tokens and meme stocks that they can sit at home rather than enter the labour market.

As the economy reopens, the labour shortage is likely to persist. Employers need to compete for labour, which means rising wages. That, combined with the benefits of fiscal stimulus and rising asset prices means healthy demand. It's a recipe for demand-pull and cost-push inflation at the same time.

Europe's Dependence on American Arms

Although the blow to European pride and armaments industries by Australia's switch from France to the US and UK for its new submarine fleet has boosted talk about the need for Europe to achieve military "strategic autonomy," reality is that it has great dependence on the Americans. An example is that France's Operation Burkhane, in its battle against Jihadi terrorists in North Africa, relies on US transport planes for logistical support, its surveillance drones for reconnaissance, its intelligence services for tracking, and its refuelling planes.

A related issue is that Turkey's need to replace its outdated F16 fighter aircraft is expected to lead to another round of tensions with the US, its NATO ally.

The original plan was to buy more than 100 of the latest-generation American F35s. That collapsed when Turkey annoyed the Americans by choosing a Russian ground-to-air defence system, the S-400, rather than its American rival, the Patriot. Some experts argue that the Russian one is far better.

Turkey has now asked, as a substitute for the cancelled F35 deal, that the US agrees to sell 40 of a new version of F16s, plus kits to upgrade its old-version of the fighter. Trouble is, the Turks are planning to buy a second S-400 air-defence system, which will enrage the Americans and again make it harder for them to agree to the F16 request.

Some analysts say that a deadlock on this issue may influence the Turks to buy Russian aircraft instead, such as the Su-57 fifth-generation fighter.

China Heads for Global Dominance

The announcement that China is to stop funding coal-fired power stations abroad is nothing more than absurd tokenism. The Chinese leader Xi Jinping did not say when he would stop this funding, or whether projects in the pipeline will be affected. The gigantic expansion of coal burning in China itself continues. In the first half of this year construction of 24 coal-fired power stations were approved with a combined capacity of 5 gigawatts. Another 105 gigawatts of coal power is in the pipeline. And China is tripling its capacity to make liquid fuels out of coal.

Matt Ridley says China cannot believe its luck (America's climate change minister John Kerry has described its foreign coal funding announcement as a "great contribution") as it watches Britain close down its reliable and affordable fossil fuel power sources to buy from China wind turbines, solar panels and ingredients for batteries for electric cars. China makes two-thirds of the world's supply of solar panels and wind generators.

China is heading for global dominance because of its advances in artificial intelligence, machine learning and cyber capabilities, says Nicolas Chailan. He has just resigned after three years as chief software officer of the US Air Force in protest against the slow pace of technological transformation in the American military.

He argues that emerging technologies are far more critical to the nation's future than hardware such as big-budget fifth-generation fighter jets such as the F-35.

China, he says, is set to dominate the future of the world, controlling everything from media narratives to geopolitics. US cyber defences in some government departments are at "kindergarten level."

He contrasted the reluctance of Google to work with the US defence department on artificial intelligence and extensive debating over AI ethics with the situation in China, where companies are obliged to work with the government and "massive investment" is being made in AI without regard to ethics.

Tailpieces

American taxes: Democrats like to accuse Republicans of advancing policies that favour the wealthy, but currently they have difficulty shaping their own. The Democrats want to scrap the Trump administration's $10,000 cap on the amount of federal tax credit taxpayers can claim against the state and local taxes they pay. This would be a big boost for high-tax liberal states such as New York and California. Trouble is, if they do it, the big individual taxpayers to gain would be the wealthy ones.

A Marxist choice: The US Senate is likely to reject the Biden administration's choice of Saule Omarova as Comptroller of the Currency, which oversees national banks. She was raised in the Soviet Union and wrote a paper on Karl Marx while studying at Moscow State university. Pat Toomey, the most senior Republican on the Senate banking committee, says: "I don't think I've ever seen a more radical choice for any regulatory spot in our federal government."

COP26: 20 Tesla all-electric cars were bought to ferry leaders attending the conference to and from the Gleneagles hotel. Trouble is, this gesture of support for new-energy transportation has turned out to be an expensive joke. The hotel has only two charging stations, so organizers had to rent generators fuelled by diesel to keep the Teslas in operation.

Spending power: New York Fed consumer surveys suggest that so far Americans have spent only 25 to 29 per cent of their three rounds of stimulus cheques they received during the pandemic.

Another driver of inflation potential will be rents. Costs of shelter account for 41 per cent of core consumer price inflation.

Festive fare: A million British Christmas dinners are to be saved by importing turkeys from Poland and France. British farmers decided to rear many fewer birds because of labour shortages.

Gold: Thailand's was the biggest central bank buyer of gold in the first half of this year, purchasing 90 tons, according to the World Gold Council.

Martin

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