

JUSTIN'S COMMENTARY

SEVEN 
Investment Management

Justin Urquhart Stewart is one of the most recognisable and trusted market commentators on television, radio and in the press. Originally trained as a lawyer he has observed the retail market industry for 30 years whilst in corporate banking and stockbroking, and has developed a unique understanding of the market's roles and benefits for the private investor.



INFLATION: NO SMOKE WITHOUT FIRE – EVENTUALLY?

Anyone remember inflation?

Those of a certain age may recall those dreadful days of flared trousers, kipper ties and double digit inflation. Today speaking of such numbers just encourages a certain level of derision and disbelief from younger members of the population. Many of them of course have not really known any significant scale of inflation, and also have lived in a period of exceedingly low interest rates for a record period of time. Some have never seen a rate rise in their working career. Thus to suggest that this 'status quo' might be coming to an end is greeted with astonishment.

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Now, however, is the time that we should be taking some notice of this 'financial acid' of inflation, which if not carefully watched, has the capacity of insidiously dissolving investment and savings values without anyone really noticing. Of course, some less responsible politicians are happy to encourage inflation, as its corrosive effect will effectively devalue the government debts built up over the past few years. Inflation can become a very important devaluer of the debts incurred by especially irresponsible governments who have run up too many debts in their good times. For private investors though, it will start to

erode the value of their investments, as many saw in the 1960s and 1970s. With high national debt levels around the globe, it is going to take many years of higher inflation to bring down this international pile of debt poo.

So where is this inflation coming from? It seems all the more astonishing as most of the headlines recently have been about little or no inflation, or even deflation. The reality is that some of the headline numbers are somewhat misleading. The key figures to look at are the core numbers where you have to strip out as many of the variables as possible. So what does this show us? It gives us a bare number which we then can subdivide into its economic constituents. Thus the current number in the UK can be divided into the manufacturing and service sector inflation numbers. Upon closer inspection it shows that the manufacturing side is still seeing some deflationary pressures, especially from commodity prices. However the service sector, which in the case of the UK is far larger, has more inflationary pressures, not least of which are rising pay levels. This in fact could be closer to 2% in some areas.

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Now let's take this a stage further. When oil was at US\$110 a barrel, a US\$10 rise was of marginal interest, and not very inflationary. However, when the crude price was recently at US\$30 per barrel and we saw a US\$10 rise, that is a very significant rise - and inflationary. So commodity prices (of oil, iron and copper ores) rising from low levels will eventually lead the inflation dragon to start to twitch its tail. It may not be breathing fire as yet, but beware of the smoke from its nostrils (no smoke without fire) in due course. Time for investment managers to consider this in portfolios.

Some Budget issues. Good news & bad news

1 - Lifetime ISAs- all good news? Well, let's get past the enthusiasm from the ISA sellers and look at the strategic issues around this. It is good news as a tax encouragement for youngsters to take out an ISA and hold it for longer - so what is not to like? How about that the Chancellor has gone a long way to discourage, take apart, or even kill off key areas of the pensions industry?

If I may explain. The ISA is a valuable savings box of chocolates which you can add into and take out again as you wish. Good for disciplined savers (and just how many of them are there?), but bad for normal humans who will raid the chocolates when they feel a little peckish. The pension is an incentivised lock box designed to put money away in order to provide an income for the future, when you are no longer earning an income.

This to me looks like some clever thinking by bright people who don't understand the longer term savings market and who certainly don't appreciate that pensions have to be developed over time. Therefore, unlike Treasury civil servants, who have pensions provided to them by a money tree offering golden final salary pension fruit, it does not work like that for employees in the real world. They have to put money aside each month to build up that future value. This is what should be encouraged from birth, and thus a combination of both a pension and an ISA would be the perfect blend. Unfortunately in this form it could seriously damage the take up of pensions, especially at a time when the 'workplace pension' is just getting going.

2 - Small Companies- good news. Generally I think, yes, this budget has a range of initiatives for smaller businesses. Given that this is the driving area of our economy with over half a million businesses established each year, then quite rightly this area needs careful nurturing.

3 - Regional devolution and regional 'powerhouses'. Personally I have never seen the clear logic of just voting for a mayor and encouraging significant economic devolution. It sounds good in a speech, but in financial reality very little will be achieved without capital. So where is the local capital for local development? Well, it is not going to come from government, so a key issue the Treasury is missing here is the need to encourage and develop regional fundraising for regional companies and investment. It is an old issue to me, but still a vital one.

4 - Productivity data? A lot of the productivity data I see seems to compare the UK with other nations somewhat unfavourably. However, much of this comparison is with countries who have far higher manufacturing bases than the UK. Now manufacturing is relatively easy to measure - how many widgets did you make in an hour? A lot more difficult to measure and where the majority of our value lies, is the service sector. It is far more subjective. So the comments about our 'productivity gap' seem to me to be rather unreliable. Perhaps some more careful research into our productivity would be far more enlightening.

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And finally... Roosters running rampant in an Australian city were rounded up on Saturday in a campaign to curb the crowing cocks. The Tasmanian state capital of Hobart, and its southern fringe in particular, has for the past few years been plagued by feral fowls.

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"They're crowing and carrying on" said a local, Mr Baldock. People who have been keeping chickens for their eggs often have abandoned roosters, which for obvious reasons, do not produce eggs. "We've got people dumping them on the side of the road," Baldock said. "They're particularly a traffic hazard. It's also an animal welfare issue, because they're suffering predation by dogs and cats and not being fed properly."

A recent 'amnesty' organised by the Bantam Club and the Royal Tasmanian Agricultural Society has encouraged people to hand in unwanted birds, no questions asked, and this has resulted in more than 150 fowls being brought in. Some would be re-homed with breeders, while the rest would be quietly euthanized. Sounds like a marketing opportunity for Nando's to me.

Have a good week.

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