PRICE VALUE PARTNERS

Uncool Britannia

"We know no spectacle so ridiculous as the British public in one of its periodical fits of morality."

- Thomas Babington Macaulay.

"Captain Edward J. Smith: There must be no panic.

Andrews: No.

Captain Edward J. Smith: You'll be careful of what you say to the passengers.

Andrews: Of course... How many people are there on board?

Captain Edward J. Smith: 2,200, or more. And room in the boats for...? How many ?

Andrews: 1,200.

Captain Edward J. Smith: I don't think the Board of Trade regulations ever visualized this situation. Do you ?"

- From the film *A Night To Remember*, screenplay by Eric Ambler.

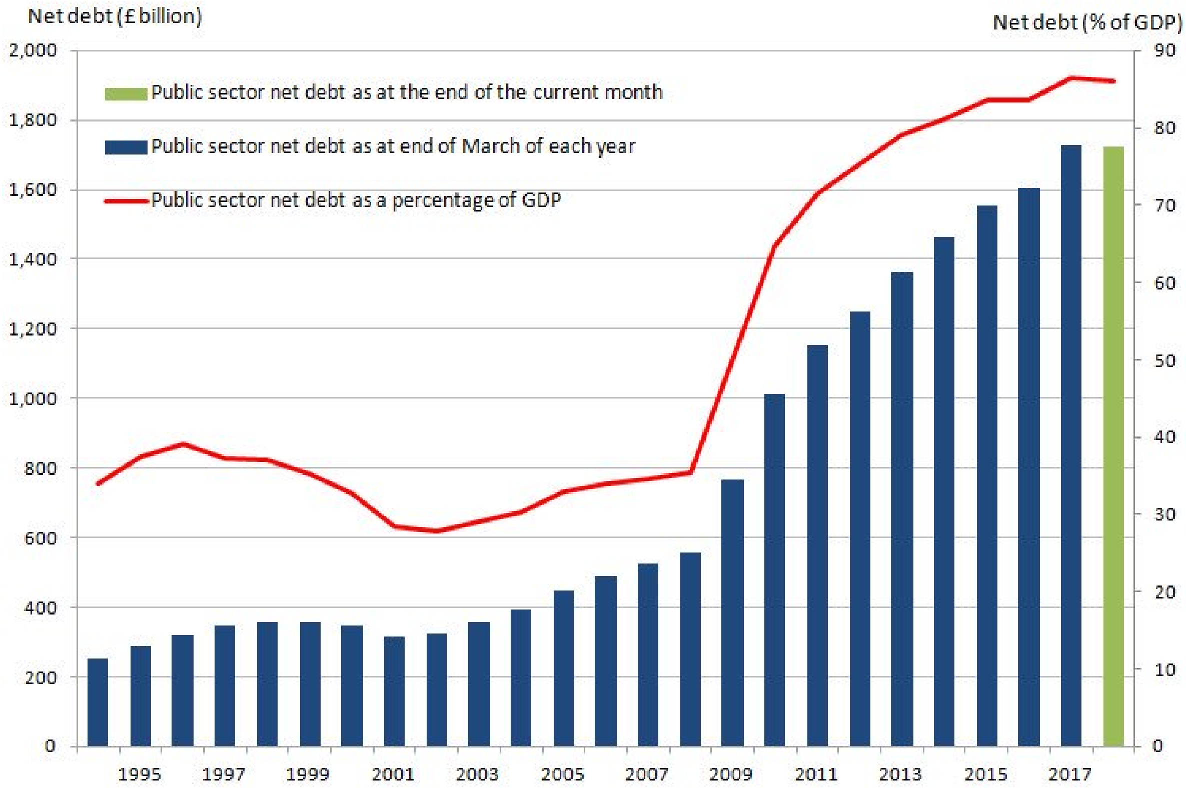
"A newspaper is a device for making the ignorant more ignorant and the crazy crazier."

- H.L. Mencken.

It is going to be a long, hot summer, but the first full-on shiver of the year has already arrived, in the form of Labour's improved showing in the UK General Election – which takes them to within a whisker of Downing Street. Somewhat incredibly, as the Conservative MEP Daniel Hannan points out, two in five Britons voted for a party led by unrepentant Marxists. If there was any thinking being conducted by protest voters (i.e. the young), it was of a rather magical type. Theresa May's outgoing joint chief of staff, Nick Timothy, remarked that "many are tired of austerity"; Jeremy Corbyn, who continues to behave as if he won the election, announced that people “have had quite enough of austerity politics”. What is this ‘austerity’ of which they speak ?

Ireland, for example, genuinely practised some. Between 2010 and 2016 Ireland managed to reduce its gross public debt from 86 per cent to 75 per cent of national income. Over the same period, Britain’s public debt ***rose*** from 76 per cent to 89 per cent.

Spot the austerity

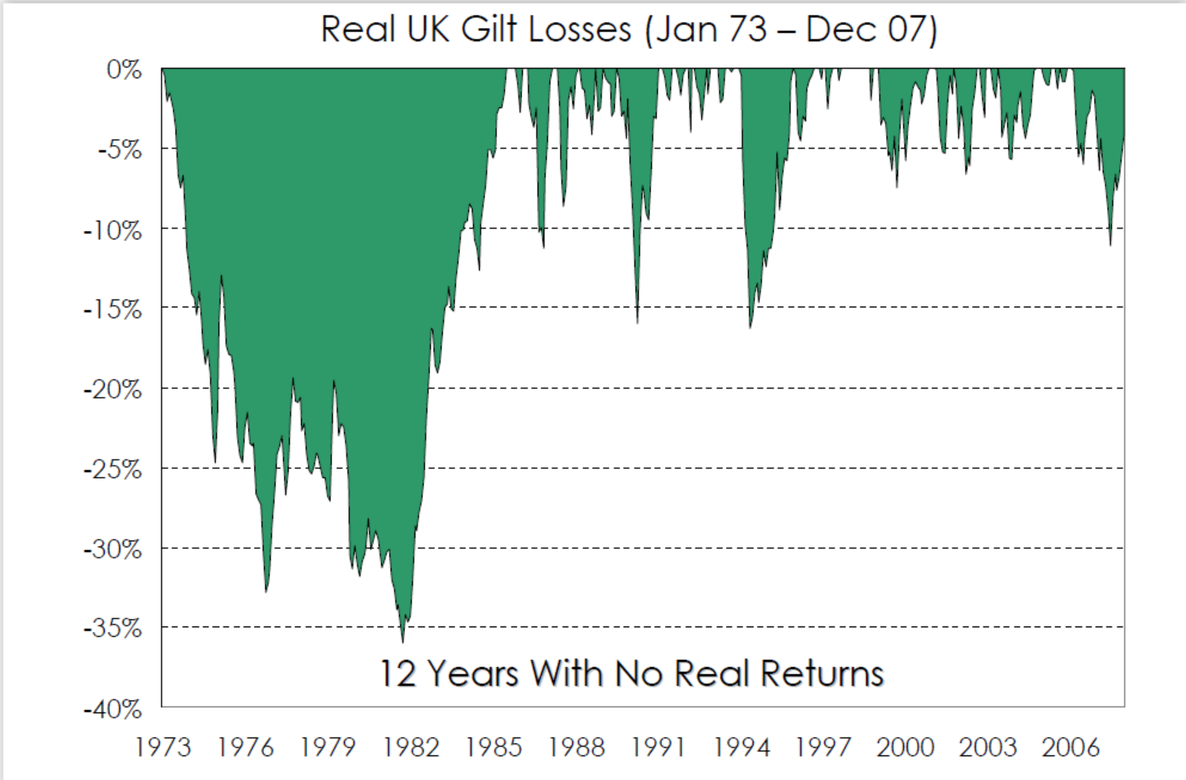


Source: ONS

Now that fauxsterity is apparently dead in the water, investors would be well advised to reconsider what bond exposure they may have. On the back of the election results, 10 year Gilt yields traded below 1 per cent. With inflation at 2.7 per cent and trending higher, as Marcus Ashworth for Bloomberg points out, rather gently,

> Real yields of minus 1.7 per cent offer little value.

With even fauxsterity off the table as the Conservatives U-turn on just about everything, sterling had better hope that foreign investors aren’t paying close attention. The outlook for Gilts gets worse in the event that inflation surprises on the upside. The stagflationary 1970s, for example, was not exactly a good period for bond investors, as the following chart makes clear.



Source: Frontier Investment Management LLP

In real (i.e. after inflation) terms, Gilt investors who bought the market in 1973 had to wait until 1985 before they broke even. This time round, Gilt prices are so elevated and their yields so puny that only a madman – or a Gilt fund manager – would be comfortable buying them. The backdrop for Gilts and for the inflationary outlook is thrown into sharper relief by the chronic inability of Mark Carney at the Bank of England to do anything except cut rates.

While the hard left were busily and cynically making political capital out of the Grenfell Tower disaster last week, the real Public Enemy Number One behind social and economic inequality – the Bank of England itself – was, effectively, skulking away invisibly. As Louise Cooper points out, QE and ZIRP have huge political consequences:

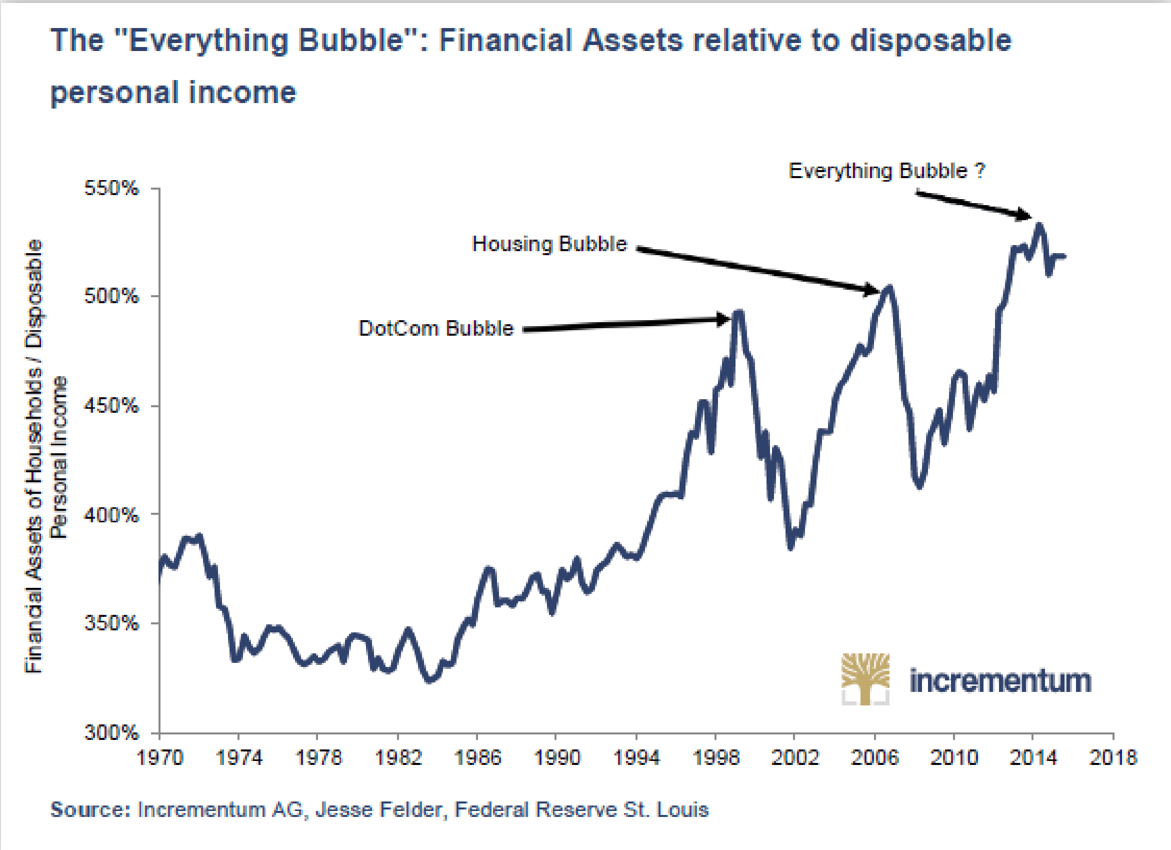
> QE means profligate politicians can spend spend spend with no consequences – voters can be bribed with spending. And secondly that young voters in the UK may have voted for Corbyn because QE has made housing so unaffordable (renting or buying)..
>
> Thanks to QE, the Bond Vigilante is dead. These are the investors who protest at irresponsible monetary or fiscal policies considered inflationary or damaging to the credit worthiness of a country. They would normally react by selling bonds (government debt) thereby driving up government borrowing costs (yields / interest rates). That normally brings politicians back to fiscal prudence. If the electorates can't or won't do it, the bond markets will. A government can only go on spending more than taxation raised, if they can find investors willing to lend them the difference…

> But thanks to QE this is not happening. Central banks are ensuring that profligacy or fiscal irresponsibility is never held to account..
>
> Let's take the case of a relative of mine, retired with savings. Now if interest rates had been more normal, say at the 5-6% of the 1990s, he would have left his savings in a bank. But he earns next to nothing on his savings and has done so for almost a decade now. He doesn't understand the stock market and doesn't trust it and so has put his savings into property. He has bought three buy to let houses.
>
> And those are three houses that the younger generation could have bought for family homes. Instead of which they are now renting from him and paying his mortgages.
>
> And this is a direct result of QE. QE distorts asset prices. It drives investors out of bank savings and bonds into other higher yielding assets – shares and property for example.
>
> There is a direct link from QE to higher stock markets and higher property prices. And that means QE is political.

Financial journalists should be reporting this, but aren't. And neither is anybody else. As one Twitter correspondent suggested last week,

> The Bank of England are given a free pass by the media, politicians and population. The Bank of England are the ones plunging the country into poverty.
>
> They expand the money supply to enable government borrowing. The Cantillon effect means bankers get first use of the new cash so buy penthouses.
>
> By the time people in Grenfell experience the Cantillon effect all it means is higher prices for food, energy, accommodation etc.
>
> It's not only the government that people should be blaming. The Bank of England are the enablers. They should be taking their share too – but there is silence.

But QE and ZIRP are not exclusively British economic phenomena. By dint of being global, they have made just about everything expensive, as Incrementum point out in their chart, below.



The first step in solving any problem is to recognize it. Subsequent steps, we would suggest, involve selective diversification and in all favoured asset classes a focus on defensive value. Given the market distortions being rendered by QE, ZIRP and the Gadarene rise of passive 'investing', nothing else makes any sense – to us, at least.

In the aftermath of the London Bridge terror attacks, the FT's Janan Ganesh wrote a sobering assessment of the gulf between the British people and its supposed leaders. What was relevant after London Bridge is even more relevant after the horror of Grenfell Tower:

> The overall impression from [recent] weeks is of a nation protected by the best of its citizens, and governed by merely the best available.

There is a void at the heart of our national government. With the start of Brexit negotiations now only days away, and at a time of acute economic and social stress, it is time that void was filled.

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