ARIA | CAPITAL

INVESTMENT INSIGHT

A weekly look inside the investment world.

The problem with socialism is that you eventually run out of other people's money.
Margaret Thatcher

Friday, 24 February 2023

In this week's Investment Insight

Will it stay or will it go?
At some point this year, inflation is likely to drop significantly, at least partly due to the 'base effect', but aided along by falling energy prices. While it may drop, is inflation, or even inflation volatility, here to stay or is it a passing phenomenon linked to post-Covid reopening and supply chain issues? In *The Inside Track* we consider the issue

Chinese appetite
Each quarter, the People's Bank of China conducts a sentiment survey of 20,000 retail depositors to gauge, among other things, their appetite for consumption, saving and investment. In *Pic of the Week* we look at the latest release and its implications for China's post-Covid 'reopening' trade.

Newswire
Some interesting nuggets from this week's newswires.

Market view
A visual snapshot of recent market performance.

The Inside Track: Will it stay or will it go?

Anyone who thinks that a dip in prices means we are back to the old regime of 'permanently' low inflation may be in for a nasty shock according to Ajay Johal, Investment Manager at Ruffer. This is how he sees the situation.

The previous regime, which lasted from the early 1980s, gave way to higher inflation as economies reopened after the pandemic – a process which is still under way, most notably in China. Savings accumulated during lockdowns chased goods which companies struggled to produce fast enough, given covid-related labour shortages. The net result: higher prices, exacerbated by gas and oil supply pressures after Russia invaded Ukraine.

This initial inflation shock was triggered by one-off factors. But we see several reasons for thinking we have now entered a new era of higher but more volatile inflation.

Firstly, partial deglobalisation – marked by the new cold war between the US and China and accelerated by the Russian invasion of Ukraine – calls for more spending on many fronts. Both sides need to build more robust supply chains and secure access to key materials, from rare earth minerals to silicon chips.

Secondly, efforts to mitigate the current wave of inflation involve government spending on measures such as capping fuel costs. While these reduce prices in the near term, their long-term effect is inherently inflationary, especially given the rising costs of debt servicing.

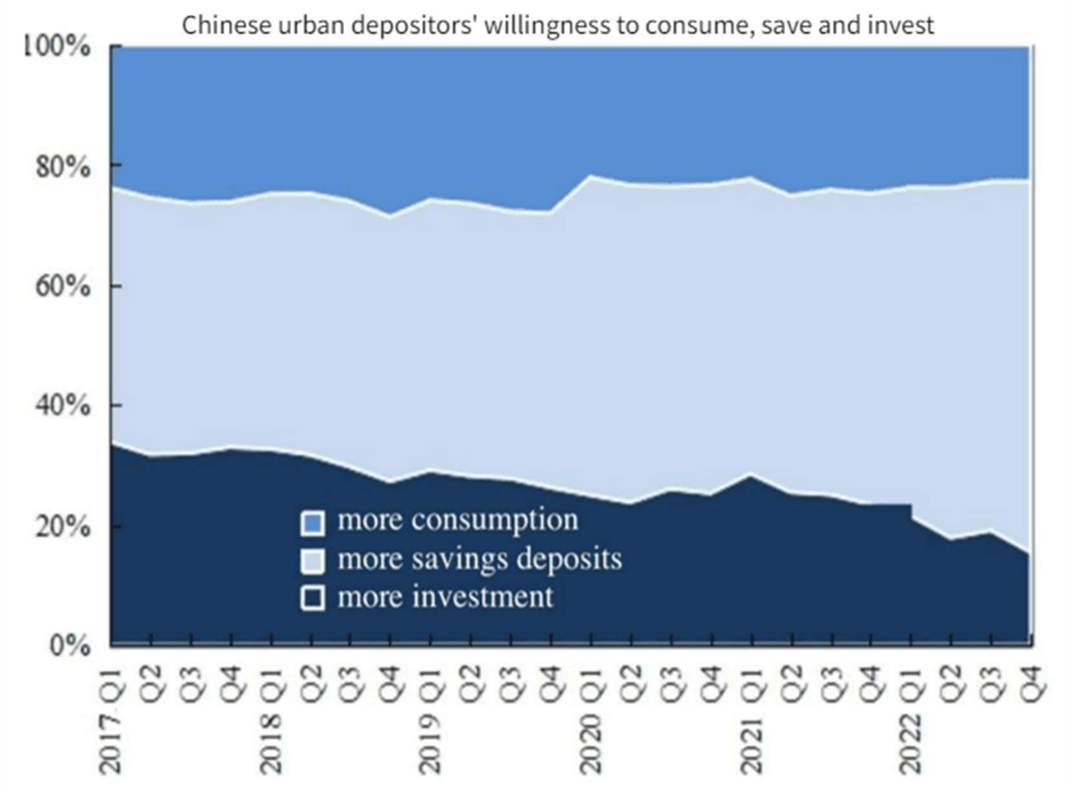
Thirdly, climate change also entails higher prices. For example, not only do we need to develop and implement the technologies and infrastructure needed to make the transition to green energy, but companies also have to comply with regulation.

Lastly, one sure sign that inflation is becoming entrenched is steeply rising wages. For decades, the power in wage negotiations has been moving from employees to employers. That power is now starting to shift back. Workers are demanding higher wages – and, given labour shortages, they are getting them. In the private sector, employers must either bear the costs, meaning lower profits and hence share prices, or pass them on, meaning higher prices for consumers. In the public sector, it means yet more government spending.

In summary, many of the disinflationary forces which drove the decline in inflation from the 1980s to the 2020s now appear to be reversing, ushering in a new inflationary regime.

Pic of the Week: Chinese appetite

As the chart from the People's Bank of China illustrates, a preference for savings has dominated Chinese consumer sentiment over the past few years as consumers' movements and, hence, their ability to consume have been restricted by Covid lockdowns. As a result, Chinese retail deposits have swelled, increasing by $2.5 trillion in 2022, the highest increase on record. As witnessed a year ago in much of the Western world, China's reopening this quarter has unleashed a wave of pent-up demand as consumers increase their discretionary spending, particularly in sectors such as hospitality, entertainment, travel and luxury goods. This 'reopening' trade has led to a strong start to the year for many Chinese consumer stocks. However, international luxury goods companies such as LVMH (up 16% YTD) and Burberry (up 20% YTD) are also beneficiaries. Given the level of savings available to fund the pent-up demand, there may be plenty more to go.



Newswire

...on Monday
Sales of homes in the US show a twelfth consecutive monthly drop.

...on Tuesday
Markets fall and bond yields rise on higher interest rate outlook.

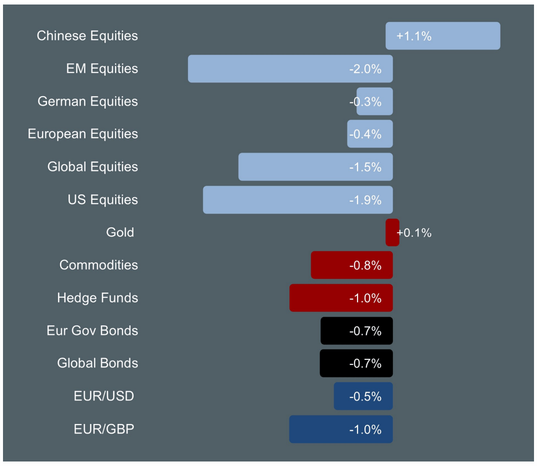
...on Wednesday
Tesco in the UK rations salad vegetables due to shortages.

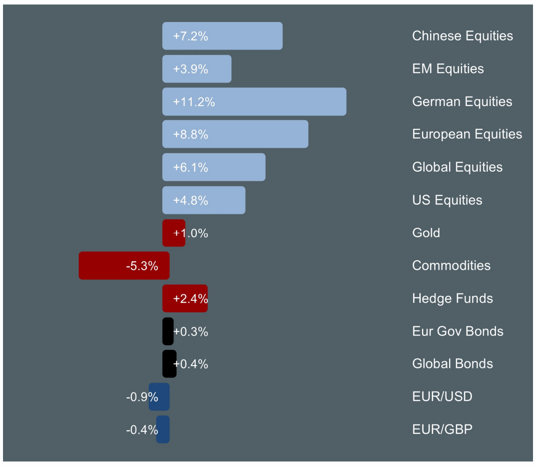
...on Thursday
Strong results and an optimistic outlook send Rolls Royce shares 20% higher.

Market View

Last 7 days (€)

Year to date (€)





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