DOWGATE CURIOUS INVESTOR

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15 Fetter Lane, London, EC4A 1BW
Phone: +44 (0)20 3416 9143
Email: hello@dowgate.co.uk

Welcome to The Curious Investor, a periodical from Dowgate, where we aim to identify some of the markets' drivers and offer a few insights. While not exhaustive, we want to inform the debate on investment issues while remaining firmly outside the legal confines of financial or investment advice. We hope you enjoy it. If you do, please share it with others who you think might also enjoy it and offer any feedback, hopefully constructive, to the email address above.

	Index Value	Year to Date Change
FTSE 100	7,308.89	-3.25%
FTSE 250	17,997.65	-4.21%
S&P 500	4,387.81	14.74%
Gold	1,938.45	4.25%
Copper	3.74	-2.60%
Brent Oil	75.32	-8.26%
UK 2 Yr.	5.48	53.50%
UK 10 Yr.	4.67	27.95%
US 2 Yr.	5.09	16.48%
US 10 Yr.	4.06	8.27%

Fishing For Value

Controlling the economy through monetary policy is like fishing with a hand grenade; it is effective, but it takes time for the bodies to float to the surface. Thames Water is a case in point. It has unsupportive shareholders and a £14bn debt pile, demonstrating that even a monopoly right to supply a basic human need is insufficient protection when the financial tide goes out on a balance sheet built during the high tide of free money.

The Thames Water crisis also illustrates how pension funds had to goose their low-risk assets to deliver returns in times of yield scarcity. Liability Driven Investment (LDI) layered derivative risk onto bond holdings, and debt complexity layered risk onto quality infrastructure assets. Both proved costly bets on rates remaining benign. Meanwhile, pension fund allocations to UK equities are at multi-decade lows, as they remain underweight in the highest-returning asset class with a track record of adapting well to inflationary conditions.

Andrew Bailey reiterated his view that the fight against inflation was not over last weekend in Portugal. Fellow central bankers Lagarde and Powell broadly echoed Bailey's hawkish stance. However, recently appointed Governor Ueda said Japan's current inflation blip was transitory. Japan has no plans to change two decades of QE explicitly instigated to create inflation. Japanese interest rate normalisation remains too horrific to contemplate. Its consequences for the tsunami of debt piled on the Bank of Japan would make Thames Water's balance sheet look like a minor ripple.

Two experienced former BoE economists criticised Bank policies last week. Former Bank chief economist Andy Haldane thinks the monetary medicine has already worked, and the risk of collateral economic damage from further tightening is excessive. At the same time, currency specialist Neil Record worried about the absence of growth and the ability to fund growing fiscal deficits. Market strategist Mike Howell at Cross Border Capital is adamant that the only way out is for central bank capitulation and a tacit resumption of QE to fund structural deficits. While the independent analyst Lyn Alden views our monetary medicine as ineffective in fighting fiscally created inflation, pointing out that our inflation is more like the 1940s than the 1970s.

The monetary policy debate and its consequences will continue long after the economic slowdown has deflated the currentcost of living balloon. As we enter H2, companies are more sure of lower costs than higher revenues. Those companies that guided to abnormally H2-weighted profits will have to test their pricing power on budget constrained customers in the coming months. It is little wonder that low-cost suppliers who share the benefits of scale with their customers have performed strongly. These consumer champions, such as Greggs, Wetherspoons, B&M Stores, Whitbread (trading as Premier Inns), AB Foods (trading as Primark) and Telecom Plus (trading as Utility Warehouse), have more pricing levers than their competitors, often with outsized benefits to profitability when pulled effectively.

Over the dog days of Summer, we could see liquidity issues drain some support for the AI-inspired US tech rally. With the lead time on Nvidia GPUs running at over 12 months, we remind ourselves that whether it is AI, the internet or the railways, the market overestimates its impact in the short term but underestimates it in the long term; the very thing that briefly made Cisco the world's largest company in the late 1990s.

But investor interest in UK smaller companies drained away months, if not years ago, and what is left resembles the post-WW2 cigar butts celebrated by Warren Buffet when, in the 1950s, he achieved some of his highest ever returns. Buffet said in his 2014 shareholder letter that my cigar-butt strategy worked well while managing small sums. Indeed, the dozens of free puffs I obtained in the 1950s made the decade the best of my life for relative and absolute performance. With Japan rerating, thanks partly to Warren's recent buying spree, the UK looks increasingly isolated as the final value equity play in developed markets. While any recovery is unpredictable, falling inflation and the end of rate rises would be helpful. Unfortunately, the Bank of England seems determined to drop a few more hand grenades and see more dead bodies before the recovery can take hold. **- Jeremy Mckeown, Editor & Market Strategist**

Jackson's Chart: GOLD

When the banking instability of March 23 reared its head, Gold went on to retest the $2000+ highs of the previous year. Since then, we have seen a rejection of a significant diagonal and horizontal monthly resistance. As of today, we are at an inflection point, where 3 important supports are currently in play on the weekly timeframe. The horizontal 1920 level, wick to wick trend line and the 61.8% retracement from the March 23 low to the high, are all holding firm. Gold from a technical standpoint is ultimately describing the current environment, which is an uncertain one. Do we see another banking collapse or something breaking in the financial system which will move Gold to the upper extensions at 2150 (-27%) and 2250 (-61.8%)? Or do these fears continue to fade, resulting in a break of these 3 support confluences and we see a $1770 once again.

Further Reading:

- Austerity is back - **https://www.ft.com/content/b70b7a8f-cc1a-4be9-b51a-866f5d0dab23**
- Return of QE? - **https://www.ft.com/content/6d14cad1-00f2-4d39-969f-c01ae1860d34**
- Record plc results - **https://recordfg.com/regulatory_news/final-results-3/**
- Fiscal dominance - **https://www.lynalden.com/july-2023-newsletter/**