DOWGATE CURIOUS INVESTOR

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## Dollar Pressure Valve Release

June's CPI data signalled that US inflation worries were finally over. While this data series had been falling for over a year, the Fed perpetuated the fear of persistent inflation. This CPI print was different. It came in below the prior month, down year on year, and under expectations in both reported and core (sticky) measures. US CPI is now lower than Japan's CPI for the first time in a decade. The inflation dragon is dead. The Fed can now relinquish its sword and ease monetary policy. The dollar has lurched lower in anticipation.

This move finally released the valve on non-dollar assets, kettled for 18 months under the dominant dollar's overbearing pressure. As the dollar fell, everything else went up: gold, oil, copper, the Pound and UK equities. Simultaneously the SEC's securities case against Ripple Labs suffered a decisive setback, allowing obscure cryptocurrencies, long believed dead, to rave from the grave. It was an everything bubble redux.

| Index | Value | YTD %Δ |
|---|---|---|
| FTSE 100 | 7,646.05 | 1.24 |
| FTSE 250 | 19,311.73 | 0.66 |
| S&P 500 | 4,530.75 | 18.59 |
| Gold $/oz | 1,969.38 | 8.02 |
| Brent Oil $/bl | 80.34 | -7.3 |
| Copper $/lb | 3.81 | 1.82 |
| UK 10yr yld | 4.34% | 17.38 |
| US 10yr yld | 3.84% | -0.72 |

As recently as last September, the dollar wrecking ball was at full momentum, swinging up to 115 on the DXY, as Fed Chair Powell used his Jackson Hole speech to burnish his Paul Volcker credentials. By last week, it had swung back through the symbolic 100 level. Anyone importing dollar denominated products into the UK has seen a 20% terms of trade improvement since Q3 last year. And the dollar's journey lower may have further to fall. (See Jackson's Chart below for perspective).

But there are always new things to worry about, and welcome disinflation transitioning into a deflationary recession now moves up the investor checklist. Chinese deflation, inverted yield curves and the lagging impact of overzealous policy tightening on weakening economies all raise recessionary fears. Adding to our woes, the heads of the Fed, the BoE, and the ECB all remain committed to further hikes. As we discussed last time, there are more grenades to come and yet unexploded ordinance.

But for now, UK PLCs are signalling that their costs have become more certain and are typically falling. Those with visible revenue and pricing power can leverage higher returns. By contrast, those in more cyclical and economically sensitive sectors must rein things in and push through to better times. Investors have to judge how well-equipped each company is to make the journey.

Barratts, the UK's largest housebuilder by volume, expects to build about 20% fewer homes in the current year but is signalling a slower land spend and a balance sheet cushion of more than £1 bn in cash. Meanwhile, UK brick manufacturer Forterra reported that UK brick demand was 30% lower in the first five months of the year but has mothballed a plant to save cost, unsurprisingly stating that demand for its products remains subject to significant uncertainty.

In contrast, Wetherspoon (referred to as a consumer champion in issue #1) had a typically meandering but upbeat update in which founder and 23% shareholder Tim Martin said that costs (particularly energy) were falling as sales were continuing to improve. Despite pushing prices up in Q1, 'Spoons retains its significant cost and price advantage over its competitors. Martin described the view that his pub chains' low prices meant that they offered low service levels, poor quality food and drink and low employment standards as urban myths—a real-world explanation of how sharing scale economies builds customer loyalty.

Dowgate's Onward Opportunities identified UK consumer champion Angling Direct as its first core equity position. With only a £22m market cap, £14m in cash and £16m in stock, Angling Direct is the UK's leading fishing equipment and tackle retailer and an example of the extreme value lurking in the depths of the UK's unloved equity market. It is profitable and cash generative from its passionate repeat UK customers. However, its profitability is heavily diluted by a loss-making European business that needs strategic action to grow or close. Either outcome should be value-enhancing for Angling Direct, representing an exciting first step for Onward.

The UK's inflation path is a few months behind that of the US, but the long-term correlation is clear. And sure enough, this week's UK CPI data came in lower than expected. Yet, most politicians and policymakers continue to fight the last war by blaming UK PLC for its uniquely greedy greedflation. When Milton Friedman said 50 years ago *inflation is always and everywhere a monetary phenomenon*, politicians didn't want to believe him. Nor do they today.

In this context, Jeremy Hunt's Mansion House Speech at least offered hope for some modest supply-side reforms. Included in it was a voluntary compact from nine large pension providers to invest 5% of funds in UK growth companies by 2030. With AIM and The Aquis Stock Exchange included in its definition, their pledge should be worth c.£50bn by 2030, compared to a total AIM market cap today of just £76bn. Just a minority allocation to these venues would be meaningful.

Lower US inflationary expectations have released the pressure valve on the rest of the world through a lower dollar. Global equity benchmarks that are 60% weighted to the US represent a vast pool of potential investment for the rest of the world. Sterling's recovery from its lows in Q3 last year can mark the way for future global risk asset flows.

Global allocators have limited scope to reduce UK weightings from their current de minimis levels. But at some stage, US retail investors will fear missing out on better value non-US equities already appreciating in dollar terms. Greed quickly replaces fear when the lows are in. Add the incremental Mansion House flows, and the medium term outlook for smaller UK equities looks positively exciting. There just remains the minor issue of a looming recession.

**- Jeremy Mckeown, Editor & Market Strategist**

## Jackson's Chart The DXY - Analysis by Jackson Wray

Since breaking the downward channel in May 23, the DXY, $ trade weighted index, entered into a condensing wedge formation. Last week this aggressively broke out to the downside following the release of inflation data. As you can see from the chart, there was a clean rejection of 104.50 region which was also the location of both the 61.8% & 78.6% retracement targets (C) of the current Fibonacci sequence. Holding these levels was a sign of a move back to the lower trend line of the wedge, which on tightening, broke down below. Fundamentals aside, the DXY was compressing to a point of tension with a big move likely to follow. With that being to the downside, target extensions for this move are at the - 61.8% (97.70) which also brings into play resistance and a channel trend line retest. Prior to this a retest of the broken wedge is likely before the full move continues which would require some short-term strength returning.

## Further Reading & Listening:

- US deflationary risks
- US inflation will keep falling
- Onward Opportunities Ltd Q2 factsheet
- If Britain is still worried about inflation this time next year, I'll eat my hat