Spiritual Opium and Common Prosperity

At first glance, neither of these two phrases appear to be a major threat to parts of the global stock market. If anything, they sound quite soothing. However, they have made us sit up and take notice.

China has been changing its outlook and tremors are being felt beyond its borders. It started in November 2020 when the regulators pulled the ANT IPO on the eve of its listing. There were 870 times more subscriptions than there were shares on offer and ANT’s CEO, Jack Ma, was valued personally at around $50 billion. He presumably saw this as offering himself some protection against criticising the financial regulators. The message that the Chinese Government sent out was clear. We don’t care how much you are worth or how many investors we affect – you don’t forget who is in charge here.

Alibaba, Tencent, JD and Meituan are among huge internet companies who have seen billions wiped off their valuations as the Chinese Communist Party (CCP) concentrates more on its financial and social policies domestically than worrying about overseas investors. A theme that we followed, Educational Technology, came under similar attack and we were glad that we heeded the warning sounds before the burgeoning sector collapsed.

Which is why we are listening again now. When a Chinese state media outlet brands online video games as being “spiritual opium” you know that they are not top of their list of favourites. Similarly, when President Xi Jinping champions the need for “common prosperity” one wonders how long the luxury goods sector can remain immune from its association with overt displays of wealth by those who can afford them.

Even more recently we’ve seen further extensions of President Xi Jinping’s regulatory crackdown which has been described in Chinese state-run media as a “profound revolution”. It has been decreed that under 18s will be limited to playing video games for just three hours most weeks, an hour each on a Friday, Saturday and Sunday. Gaming companies are expected to comply.

Further, it was reported that “this is a return from the capital group to the masses of the people, and this is a transformation from capital-centred to people-centred... The capital market will no longer become a paradise for capitalists to get rich overnight.” And in a clear shot across the bows for the luxury and entertainments sectors the commentary stated that “the cultural market will no longer be a paradise for sissy stars [their words], and news and public opinion will no longer be in a position worshiping Western culture.” [Bloomberg 30th August 2021].

Times appear to be changing quickly. It’s a time to stay wary and flexible as an investor. There are plenty of opportunities for the thematic investor to pursue that have little or no association with what is happening in China, but there will be others for which the easy money has probably been made.

The World Is Watching

Another reason that we are proceeding with caution at the moment is that the world is watching what is happening in Afghanistan closely. Leaving to one side the political aspects of the sudden withdrawal of troops and the humanitarian consequences that this has triggered, we have to wonder what signals are being sent to, and being received by, Beijing and Moscow.

Stories are already circulating that China is offering assistance with infrastructure projects in Afghanistan. We have no idea if this is true, but regular readers of this piece will know that a major concern to us has been the situation regarding China and Taiwan. To a lesser extent as a global threat, Russia’s relationship with Ukraine is not one that appears any more “good neighbourly”.

So what do China and Russia make of the apparent lack of unity shown by the US, UK and European governments in Afghanistan? Does it make more, or less, likely that the West’s resolve is going to be tested with regard to Taiwan and Ukraine?
One Thing We are Not Short Of Is Shortages

If you've tried to buy a new car recently you will know that there is a shortage. If you have tried to hire an HGV driver in the last few weeks you will know there is a shortage. Buy building supplies? There's a shortage. Order chicken at Nando's? There's a shortage. Heaven help us all, you can't even buy a milkshake at McDonalds because there's a shortage!!

About the only thing that there is not a shortage of at the moment is shortages. Sadly, the other area in which there are no shortages are geopolitical and economic risks, which is not good news for the short term direction of markets. It has tended to be a classic “sideways" market through this Summer and it is difficult to see where the catalyst is that will drive prices higher, which can not be said about seeing the opportunities for prices to break out to the downside. But then, that is usually the case and it may be wiser to block out some of the short term noise and concentrate on the bigger picture.

Is TINA On Her Holidays?

TINA (there is no alternative, as I'm sure we're all aware by now) has been the dominant character since 2008 when interest rates plummeted, bond yields evaporated and no one was left with any alternative other than buying equities if they wanted to see a meaningful return. It appears that TINA took advantage of a green or amber destination to make good a temporary disappearance as discussion raged and bond yields spiked as her old adversary, inflation, made a reappearance earlier in the year. Now, TINA’s place of hiding may have turned red, enforcing a period of quarantine before she can properly re-emerge, but re-emerge we expect her to do as the consensus view builds that inflation this time around was merely transitory.

If this turns out to be the case, we need not fear a sustained yield expansion in the bond markets and its’ consequential rise in interest rates just yet, which could see equities resume their decade-plus bull market. The continued effects of the Delta variant in many parts of the world that are not as fully vaccinated as here lead us to expect a lower growth environment which was what we had pre-pandemic.

“Equities” is such a blanket term. It’s like saying that the humble anchovy is the same as a Great White Shark. There’s a world of difference depending upon whether you want to eat, or be eaten by, it. They may have gills and fins but that’s where the similarities end.

The “value” rally appears to have run out of steam, which backs up our opinion that value investing in this low yield environment can only ever be more successful in the short term or when used tactically.

If we are to see the extension of the low interest rate/low inflationary scenario, then we fully expect our strategy of investing in what the world wants, needs and uses most to be the more successful one.

This includes investing in sectors such as cloud computing, cyber security, electric vehicles and healthcare innovation (amongst others) rather than the previously favoured strategy of geographic allocation. As we are seeing, geography changes. What the world needs and wants does not change as much.
In our view it is a safer long term strategy to overweight the future and underweight the past. Quite what that future holds is uncertain, but that is why we need to be flexible and adaptable in how we approach it.

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