Quarterly Newsletter / Autumn 2021

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When we penned our Summer Newsletter in mid-July, we knew that a withdrawal of the American military and the rest of NATO forces from Afghanistan was in the offing. It was generally accepted that the baton would be handed over to the Afghan army, and based on the Doha Agreement, signed by the then US president Trump and the Taliban leadership at the end of February 2020, the dialog between the Afghan government and the Taliban was envisaged to bring about a peaceful end to the long conflict. One of the conditions was that the Taliban would stop al-Qaeda operating within the area controlled by the Taliban.

The Doha Agreement was supported by Russia, China, Pakistan and the UN Security Council. However, it did not involve the Afghan government, and with the benefit of hindsight, that might have been a mistake.

The Afghan National Security Forces, thought to have been properly trained and well-armed, offered hardly any resistance when the Taliban advanced on Kabul during August 2021 and took control of the country.

The withdrawal of American and the remaining NATO forces (the latter by now predominantly British) was chaotic and reminded one of Saigon in 1975. Many Afghans who had helped the NATO allies during the war scrambled to make it onto the last few flights out of Kabul. Sadly, many were left behind.

The Taliban had said it would allow anyone who wanted to leave the country to do so peacefully and without repercussions. We shall see.

It is early days, but there are already some restrictions. Whilst girls of school age were not allowed any formal education pre-2001, they are now given permission to attend primary but not secondary school. On the other hand, women are out on the streets wearing Islamic headscarves rather than the all-encompassing burqa. Maybe that is progress.

So, what, if anything, have the US and the Western Allies achieved? Too early to say, other than the hope that the Taliban and its leadership, who have been ensconced in Qatar for the last ten years, have realised that they need to change their previously horrific and abhorrent human rights violations if they wish to trade with other, Western nations and be taken seriously on the international stage.

For many, their families and loved ones, any improvement in the situation comes too late. 457 British and 2,401 American soldiers have died, alongside those from other nations, and there were well over 30,000 wounded, with some of them sadly permanently disabled.

Of course, we were not the first to try 'controlling' Afghanistan, albeit for different reasons. On Christmas Eve 1979, the Soviets invaded, under the pretext of honouring the Soviet-Afghan Friendship Treaty of 1978, but they clearly intended to give them a strategic stronghold in the area. They were there for ten years, fighting opposition from insurgent groups collectively known as the Mujahideen who, ironically, were heavily financed and supported by, yes, you guessed it, America and Britain. The Russians suffered heavy casualties (26,000 killed and over 53,000 wounded, according to Soviet estimates) and financial overcommitment which turned out to be a contributing factor to the demise of the old USSR.

Of course, some people might start wondering whether we ever should have been there. If you think of Iraq, Libya, Syria and Somalia, what have we really achieved? Are we really helping by wishing to instil into other peoples' minds our Western values and decency, as well as our type of democracy?

Afghanistan is made up of many ethnic and tribal groups, and over 50 languages are spoken, not just the two official languages Dari and Pashto. There are many splinter groups across the country, with some ruled by established warlords, and then we have the Islamic State Khorasan (ISIS-K) with a stronghold in eastern Afghanistan along the border with Pakistan. Despite its recent successes, it is no easy task for the Taliban to claim nationwide legitimate dominance.

ISIS-K claimed responsibility for the cowardly mass killing outside Hamid Karzai International Airport on 26th August, and there were many people across the globe that worried about a new wave of terrorist attacks elsewhere. MI5 and MI6 are certainly concerned about such a possibility within the UK.

After the hasty exit of Western forces, one read with horror that tens of billions worth of army hardware were left behind. How was that allowed to happen? Why wasn't most of it disabled or destroyed? But then, another thought occurred. Given the fractious and fragile nature of the political situation in the country, is it just possible that hardware was left behind deliberately? Might it not allow the Taliban to talk to the various warlords and other splinter groups from a position of (military) strength?

On 1st September, President Biden addressed the nation to explain his decision to stop the war. He started in an almost triumphalist way, talking about 'one of the biggest airlifts in history' and the 'extraordinary success of this mission'. He also called it a 'mission of mercy'. To be fair, he then spoke well about the reasons he felt the war had to stop, and it ended up being one of his better speeches, even though the defiant defence of his decision did not go down well with the leaders – both political and military – of the NATO allies. Some saw it as an act of betrayal and a mistake of historic magnitude, weakening the Western Alliance and signalling the end of US hegemony.

In his election campaign against Trump, Joe Biden said he wanted to 'regain the respect of the world'. A columnist recently reminded us of what Barack Obama said at the time of his former Vice President: "Never underestimate Joe's ability to screw things up."

How did the American public react? The very next day, the highly respected Marist Poll showed that President Biden's approval rating had fallen to 43%, the lowest mark since he had taken office. Furthermore, 71% considered the war in Afghanistan to have been a failure.

Bearing in mind that President Biden is also under pressure from both the left and right wings of his own party over his spending plans, this does not bode well for next year's mid-term elections, and it is entirely possible that the Democrats will lose control of the US Congress.

Staying in America, but thankfully moving away from the war theme, the Federal Reserve has coined a new buzz word, 'transitory' inflation, which is now being used by central bankers around the world. Why not call it temporary or short-term? Well, apparently, 'transitory' inflation is caused by the effects of the pandemic, and whilst prices are set to rise, they will then return to more normal levels, or so the theory goes. We have difficulty with this concept, as we have for some time believed a rise in inflation to be inevitable.

Last year, the average inflation rate in the UK was 0.85%, well below the Bank of England's target of 2%. It has gradually risen since and now stands at 3%, and it is expected to reach 4% by Christmas, i.e., double the target. In May, the BoE predicted it would peak at 2.5% by the end of the year. At that time, it was also mooted that interest rates would probably increase next year, but we now learn that a rise might be in the offing as soon as early November, to be followed by further, small hikes next year.

In view of the measly returns from bank and building society deposits, a higher inflation rate will further diminish the purchasing power of savings. Whilst considered 'safe', cash deposits these days are not the answer. One needs to weigh up risk and reward and decide on one's own, individual 'comfort' zone. Any form of investment carries an element of risk. Investments other than cash deposits will also experience periods of flat or even negative performance, and the first nine months of 2021 prove that point.

The Afghanistan debacle had relatively little impact on the markets which have been largely flatlining in the third quarter of 2021. Gilts and Corporate Bonds have shown a negative performance (FTSE All Gilt down 1.7%, Iboxx 15+YR AA UK down 3.1%), and the S&P500 is down 1.9%.

However, if you look at the year to date, equities still register around and above double-digit positive numbers, but Gilts and Corporate Bonds are down 8% and 13% respectively. You can see now why we mostly have avoided the fixed interest environment – where the mandate allowed us to do so –- and concentrated on equities.

We are all aware of rising energy costs, and we notice unusually high pay increases for blue collar workers as employers struggle to fill vacancies, particularly in hospitality, food and logistics businesses. Furthermore, given the supply chain problems in many sectors, we see this as creating supply and demand imbalances that could easily drive prices higher. Believe it or not, the temporary halt of production of some models in the automotive industry – virtually every car maker is affected by the semiconductor shortage which could last for another two years – means that you can sell a recently acquired and therefore used car at a premium to the list price of the equivalent new car!

In our Spring Newsletter of this year, we thought the choice of CDU's Armin Laschet as Mrs. Merkel's chosen successor candidate might prove a mistake and that the Socialist and the Green parties might possibly be dominant after the federal election which was held on 26th September. That proved to be prophetic: the Socialists won 206 seats (53 more than in the last election), the CDU/CSU managed only 197 seats (down 49) and the Greens had their best result ever with 118 seats (up 51). In essence, we will now be witnessing complicated and rather messy inter-party wrangling to see what form of coalition can be agreed upon. After the last federal election in September 2017, it took nearly six months before a coalition was finally announced.

The new German Chancellor, whoever he or she may be, is facing a massive economic uphill struggle. A group of the country's foremost economic research institutes has just published the forecast for GDP growth in 2021. These experts reduced their recent prediction (in spring of this year) from 3.7% to 2.4%. This means that Germany is lagging the average of the eurozone and is well below the UK which expects GDP growth of in excess of 6%.

Germany's next-door neighbour, Poland, is causing the EU, or more precisely the Brussels based EU leaders, a lot of problems. Poland's constitutional tribunal recently ruled that some articles of the EU constitution were incompatible with the Polish constitution, and that they would not accept the supremacy of the European Court of Justice over their own judiciary. That caused near apoplexy in the Brussels power corridors, and Ursula von der Leyen was quick to threaten withholding Poland's share of the Coronavirus Fund (which amounts to nearly £50billion) as well as some rights the member states enjoy. That caused a strongly worded and defiant response in the EU parliament by the Polish PM Morawiecki (the leader of the far-right Law and Justice party) who spoke for over half an hour rather than the allotted five minutes. Public opinion in Poland suggests the country wants to remain in the EU, and their PM said as much. They simply want the EU to remain a club of equal and sovereign member states rather than become a dictatorial superstate without democratically elected leaders. Sounds familiar?

Turning to the UK, not so long ago, we heard predictions that the City would be unable to trade with the Continent once Brexit took effect, and the then boss of the London Stock Exchange warned that there would be a mass exodus of jobs, with as many as over 230,000 lost. Well, the Square Mile proved them wrong. According to the Office for National Statistics, the first quarter of 2021 saw an *increase* of British financial services exports to the bloc compared to the first quarter of 2019 (ignoring the Covid-affected 2020), whereas the same exports from the EU to the UK slumped by more than a third. Weird, isn't it, and maybe we should drop the 'despite Brexit' from our vocabulary…

Of course, the UK still has its problems with the EU. A renewed and deepening rift between France and Britain revolves around fishing rights. London and the Channel Island of Jersey have rejected dozens of applications by French boats to fish in British territorial waters. Britain claims it has already granted such fishing rights to nearly 1,700 vessels, but the French say that is not enough. You will remember that fishing rights were a hot topic in the run-up to the Brexit vote and in subsequent negotiations, and British fishermen claimed they were sold down the river (no pun intended!) by Britain allowing French boats to continue fishing in their waters. Monsieur Macron declared his complete support of the French fishermen's plight years ago, and with an eye on next year's French general election, he wants to retain his strong man image. The French now threaten reprisals in the form of energy supplies to Jersey, trade restrictions and trade tariffs.

Another water-borne issue concerns the never-ending invasion of small vessels bringing illegal immigrants – some genuine asylum seekers, others less so – across the Channel, despite an Anglo-French agreement signed a year ago to prevent such crossings.

M. Macron is also fuming over the deal between the UK, US and Australia for nuclear submarines after the Australian government cancelled the deal for French-built and diesel-fuelled subs.

And finally, we have French opposition to break the deadlock over the Northern Ireland Protocol – stupidly signed under duress to get Brexit across the line – fearing it would threaten the very essence of the Single Market if it allowed its customs controls to be reduced. The European Commission's own vice-president, Mr. Sefcovic, has drawn up plans that would considerably simplify checks on food, plant products and medicines, and that seems to make a lot of sense. Maybe M. Macron will give in now rather than nearer to his general election?

Boris Johnson has no looming election worries, but he has a plethora of problems to face. To name but a few: NHS and Social Care concerns, higher inflation, higher mortgage costs, an energy crisis (fuel and gas/electricity), food shortages, a hike in council taxes, higher National Insurance contributions and Climate Change (COP26). We all are in for a tough winter!

Bagshot 21st October 2021