



Quarterly Newsletter / Winter 2021/22

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Ukraine

It has long been known that Vladimir Putin wishes to rebuild Russia into the equivalent of the former USSR by trying to destabilise the West (particularly the US and Europe). He does not want to recreate a superstate, but he wants influence and control over the previous Soviet Republics, particularly those abutting Russia's border towards the West.

In that he has been quite successful, latterly helped by a weak American administration and an increasingly fractious EU. Poland, Hungary and Romania are refusing the European Court of Justice's supremacy over their own constitutional laws, for example. Putin is clearly doing all he can to exacerbate these divisions, using vassal states where necessary like pawns on a chessboard – as we have seen over the last year with Belarus encouraging migrants to use its long border with Poland to enter the EU.

Another issue demonstrating the lack of unity within the European bloc is the differing views regarding gas supplies from Russia. Not only do EU member states disagree with each other, but individual countries also are split on this topic within their governments.

Russia is the second largest gas producer in the world (after the USA) and Western Europe is heavily dependent on provision from the East.

There are several established overland pipelines and most of those run through Ukraine, Belarus and Poland, costing Russia currently around \$3billion per annum in transit fees payable to Ukraine alone. However, the Baltic states see the pipelines as more than just a source of income: the pipelines also give them some leverage in their relations with Russia. There have been lots of quarrels for many years between the various nations with pipelines running through their territory. In 2005, Russia even accused Ukraine of siphoning off gas destined for Germany for its own use, and there have also been arguments about who owes whom how much.

However, in the 1990s Putin and the then German Chancellor Gerhard Schroeder agreed to build a new, separate pipeline under the Baltic Sea from near Saint Petersburg straight into Germany, thus circumventing Ukraine and other countries altogether. It was to become known as Nord Stream 1 and was financed by an international consortium. Crucially, Gazprom, a Russian majority state-owned energy corporation, retained 51% of that consortium's voting rights.

Nord Stream 1 was completed in 2011, and by 2015 another pipeline, Nord Stream 2, running parallel to Nord Stream 1 and again under the Baltic Sea, was commissioned, this time under Angela Merkel's German leadership. The project ran into stiff opposition from the Americans, the UK, and several member states of the EU, all of them fearing that the economic reliance on Russia could become problematical.

Even in Germany, so dependent on the gas following their decision to retire its nuclear power stations after the Fukushima disaster, there are differing views within its government. After all, the Greens only joined the coalition on the promise not to use Nord Stream 2.

Foreign Minister Annalena Baerbrock, a relatively inexperienced politician from the 'green' end of the so-called 'Traffic Light Coalition', is hindered by differing opinions within the coalition, and she is unlikely to be a match for her experienced counterpart, Russian Foreign Minister Sergei Lavrov, the hardliner representing the Kremlin.

The new German coalition clearly is split: the Social Democrats are largely pro-Russia, but the Greens insisted on no weapons being sent to Ukraine, very different from the UK's airlift of some 2,000 short-range anti-tank missiles, carefully avoiding flying over German territory when it did so. Germany, on the other hand, sent a field hospital to Ukraine...

Is Putin really thinking that NATO spreading further eastwards is an actual threat to Russia? That seems fanciful, seeing NATO has never been the aggressor, except on one occasion: when it acted in response to the terrorist attacks of September 11th, 2001.

However, Putin clearly is concerned about the Baltic states leaning towards the West, which would undermine his desire to exert more control over these countries. Putin has history when it comes to putting strongmen in charge whom he then controls remotely from Moscow. A recent example is the action he took in Kazakhstan when he sent his troops to quell what initially was a peaceful demonstration. Over 200 people died, and thousands were arrested. The Russian troops then left, having 'restored order'.

We now have the massive military build-up of Russian troops and machinery (including missiles and planes) on the border of Ukraine, and we don't know whether this amounts to mere sabre rattling or whether something more sinister is afoot.

Official talks about resolving the situation came to an end without a resolution a week ago, but there has been continued diplomatic activity since then, some of it behind the scenes, some more openly.

Whilst US Secretary of State Blinken was in the middle of talking to various leaders, culminating in meeting Mr. Lavrov in Geneva, President Biden's comment last Wednesday about the lack of unity in NATO - when he talked about "a minor incursion" into Ukraine - clearly has not helped and might well make Putin even more bullish in his approach. You may recall that in our last Newsletter we quoted President Obama saying of his own Vice-President, "*Never underestimate Joe's ability to screw things up.*"

A weak American President is the last thing we need right now, and worrying times lie ahead.

Boris Johnson

Worrying times also for our Prime Minister as he and the rest of us await Ms. Sue Gray's conclusions following her investigation into Downing Street parties during the pandemic.

At a time when one would hope Number 10's full political attention was being focused on matters such as Ukraine and Putin, Covid, spiralling energy prices, the rising cost of living, and the UK's post-Brexit relationship with the EU, to name but a few, instead Boris Johnson is fighting for his political life in the face of what even many of his own Party regard as clear evidence of double standards and hypocrisy, lies and evasion.

Last weekend, most Tory MPs went back to their constituencies and took soundings from their voters. Some MPs have already made their views known, but most of them are waiting to see Ms. Gray's report before they decide whether to write 'that' letter to Sir Graham Brady, Chairman of the backbench 1922 Committee, or continue to support Boris Johnson. Under Tory party rules, 54 such letters (15% of Tory MPs) are needed to trigger a vote of no confidence, and if that vote confirms 'no confidence' (it needs 50% of the votes), then Boris must resign, and a full leadership contest follows.

Politics is a weird business. Is our Prime Minister, who has a rather strained relationship with the truth, deemed to be damaged goods or might he survive? If he does, we shall call him 'Teflon Boris'.

The EU

Tempting though it has been of late for European politicians to look across the English Channel or Atlantic and express relief – or other rather less charitable thoughts – that in the EU things were done differently, in reality the situation is rather worrying.

Most visibly there have been the (sometimes quite violent) mass protests against Covid measures in the Netherlands, Belgium, Austria, Germany, France, Brussels and even Luxembourg. The protests comprise an eclectic mix of the politically disenchanting, the anti-state, and others who are anti-restrictions or anti-vaxxers. As with the French Gilet Jaune movement there are a number of different social groups, all with their own motivations, but united by frustration with Covid policies, with democracy not apparently working for them, and with political institutions.

On the political stage, this week will be very interesting: if the 1,009 Italian MPs and politicians due to elect a new President to replace Sergio Mattarella choose Mario Draghi, current Prime Minister (and former president of the ECB), the fragile coalition of national interest he heads is likely to collapse. With Italian elections due in 2023 anyway (they do seem to be almost annual events!) this next year was always going to be difficult for the government, but at a time when the EU needs unity, determination, and strength of purpose in the face of Putin's aggression to the east, distractions in Rome will not help.

There are of course also Presidential elections this spring in Paris, so two of the top three European economies face months of political uncertainty.

All this at a time when after many years of annual surpluses, the EU trade balance has now moved into deficit. Germany is no longer the economic powerhouse it once was, and that's to do with rather more than just a global chip shortage. We have been saying for a long time that the EU economy is in a parlous condition, and the ECB appears to have run out of options: it apparently has little choice but to continue printing money to prop up what has become a dysfunctional currency.

This is doubtless a subject to which we will return during the course of the year.

COP26

When we penned our last Newsletter, we wondered whether we should comment on the then upcoming Climate Change Conference. As we had written so much on the Afghanistan debacle – and what a mess that turned out to be! – we thought we should wait and see what the outcome of COP26 would be, a conference billed as “Humanity's last chance to save the planet”.

Well, the conference lasted 13 days. 120 heads of state flew into three Scottish airports and 25,000 delegates congregated in Glasgow. Police presence was extraordinary – 10,000 officers per day, at an estimated cost of £250million.

Sadly, Chinese President Xi Jinping and Russia's Vladimir Putin did not attend, but US President Joe Biden did, arriving in a 20-car motorcade – so much for protecting the environment! Mind you, a couple of days before, he visited the Pope at the Vatican, and on that occasion his motorcade consisted of a massive 85 cars! And true to his unkind Trump-inspired soubriquet ‘Sleepy Joe’, he promptly fell asleep during one of the speeches...

What of the climate deal itself, though? The drafted text called for countries “to accelerate the phasing-out of coal” but, at the insistence of the Indian and Chinese delegations, “phasing-out” became “phasing-down” in the final version.

In our opinion, COP26 can be summed up as “long on promises, short on achievements”.

The Markets

When we wrote to most clients earlier this month explaining our rationale for building up cash positions, we said that we did not expect the markets to be driven upwards soon, and so far, this prediction has been proven right.

In fact, most major indices have shown negative results over the period 23rd December to 21st January, with the MSCI World Index falling 6%, the Dow Jones 5%, S&P 500 down 7%, the Nasdaq down 12% and Nikkei down 4%. What one used to term “technology” stocks but which are now more accurately regarded as media companies – Facebook, Netflix, Google – have all fallen very sharply indeed over the last month.

Closer to home the FTSE E300 and DJ EuroStoxx 50 were both down 1% at Friday’s close of trading, and while the (oil and gas heavy) FTSE 100 is an outlier and was up 1.6%, the FTSE 250 was down 4.3%.

We continue to keep a close watch on geo-political developments and the effects on the markets but given all these uncertainties for now we are content to hold higher than normal cash balances in most client portfolios.

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