# Quarterly Newsletter / Autumn 2022

**Lacomp plc is an independent investment management company providing portfolio management services to private investors worldwide.**

Lunchtime on Thursday, the writing of this Newsletter was unexpectedly interrupted – well, in truth, not entirely unexpectedly! – by the news that Liz Truss had resigned as Prime Minister.

Clearly the incumbent PM was living on borrowed time, but the speed of the resignation was still surprising.

Her government in chaos, after a hugely risky economic plan which was badly received by financial markets, resignations, U-turns, and changes of direction galore followed.

A new leader of the Tory party, and therefore new Prime Minister, will be appointed within just over a week, by Friday 28th October at the latest. That means we will have had four PMs in four years and four Chancellors in four months! Makes the Italian electorate system look a lot more acceptable!

We started the last Quarterly Newsletter with "*War between Russia and Ukraine, poor performance in equity and bond markets, threats of more strikes in the UK's public sector, high inflation, travel chaos, now a heatwave and a Tory leadership election...*"

Well, at least the heatwave is now behind us! The other issues remain.

Putin's illegal war and annexation of Ukrainian territory grinds on. In the face of Ukrainian advances and in the wake of the attack on the Crimea bridge, Putin appointed General Sergei Surovikin – aka "General Armageddon" – to command the entire military operation in Ukraine.

This is the man who commanded Russia's obliteration of Aleppo from the air using indiscriminate bombing of civilian targets. Under his command Russian forces used the nerve agent sarin, launching a chemical attack on a Syrian town in which more than 80 people died.

"General Armageddon" regards 'enemy' combatants and civilians as being indistinguishable, so it is unsurprising that following his appointment we have seen wave after wave of Russian missiles bombing towns and cities across Ukraine, hitting residential buildings, and killing civilians. With Russia running out of its own munitions, Putin has turned to Iranian Shahed-136 "sleeper" drones – with only an 8ft wingspan these are difficult to detect and designed to "loiter" until given an instruction to attack. As we know, with a third of all Ukraine's power stations now out of action, these drones are being used to destroy critical infrastructure, leaving Ukrainian citizens with no electricity, energy, or water as winter approaches.

While Zelensky and Ukraine stand firm, remarkably so, cracks are showing in Europe's resolve to do the same at his shoulder. Hungarian Prime Minister Viktor Orban, a long-term thorn in the EU's side, has overtly sided with Putin, and far from sharing Europe's energy pain, Hungary has signed a deal with Gazprom to receive Russian gas. Italy's presumptive Prime Minister, Giorgia Meloni, was openly critical of the EU's stance against Russia during pre-election campaigning, though she has since rowed back somewhat on her comments. Majority public opinion in Germany and Austria is opposed to the further economic pain caused by EU sanctions on Russia, and politicians in both countries have publicly favoured ending sanctions.

Energy supplies to the UK as well as Western Europe are ruinously expensive *and* at risk, and should this winter prove to be particularly cold, we are likely to see those cracks in Europe's resolve turn into gaping chasms … as intended by Putin and General Armageddon.

American energy prices are largely unaffected by the war, to some extent even by global supply factors, and US military support for Ukraine has been critical first for its survival of the initial onslaught, and then for the fightback. The US will remain in lockstep with Zelensky and Ukraine for so long as Biden and the Democrats are in power, but should they lose the mid-term elections next month it may be a very different picture. Given Donald Trump's historical fawning over Putin and his expressed admiration of Putin's tactics and ruthlessness, one wonders quite how stiff American resolve will be should the Republicans regain control in Washington. Current forecasts suggest the Democrats are likely to retain the Senate, but they could lose control of the House of Representatives.

Italy has not dissimilar problems, with its most recent elections returning the far-right's Giorgia Meloni as leader of the most right-wing coalition to form a government since 1945. She remains on course to become Italy's first female Prime Minister. The "Brothers of Italy"-led coalition has deeply unnerved the generally left-of-centre EU. The situation is not helped given Meloni's party will be in coalition with Forza Italia, led by another long-term member of the 'President Putin Fan Club' Silvio Berlusconi.

Italy is the third largest economy and democracy in the EU, and Meloni took umbrage and reacted furiously last week when French European Affairs Minister Laurence Boone said that "*France will monitor the rule of law in Italy*" once the new government takes power, and mentioned Italy in the same breath as Poland and Hungary – both states of course having had well-publicised rows with the EU in recent years, both with right-of-centre governments, and both with tendencies to take measures viewed elsewhere in the EU as being very undemocratic.

We have long argued that some EU central institutions, such as the single currency and European Central Bank, make it a fundamentally flawed concept and vulnerable to external pressures. It can only be as strong as its weakest link, and at present, with Putin mercilessly probing the EU from every angle, with inflation running rampant and nationalist tendencies coming to the fore, there are challenging times ahead.

Challenges are something that even China's President Xi is having to face. He is certain to win a third consecutive term in office, but his "Zero Covid" diktat is now giving rise to growing opposition from the general public, and strict lockdowns imposed on cities and regions across China threaten to derail the economy. The previous growth target of 5.5% is unlikely to be achieved without some interesting manipulation of the figures because of the damage being done to the economy.

A mark of authoritarian and despotic leaders the world over when economic problems surface is to divert the population's attention: Putin sought to do so in Russia with Ukraine, and Xi's bellicose rumblings about unifying Taiwan with China are very much in the same vein. The US is officially ambiguous over its commitment to Taiwan but recent remarks from both Joe Biden and his Secretary of State, Antony Blinken, have asserted America's intention to support Taiwan's ability to defend itself. In response, at the opening of the Communist Party Congress, Mr. Xi maintained that "*complete reunification of our country must and will be realised*" and "*we will continue to strive for peaceful reunification with the greatest sincerity and the utmost effort, but we will never promise to renounce the use of force.*"

Let us now look at the global economy. Until early this year central banks had behaved as if inflation were a post pandemic aberration which would subside as supply chain issues eased and working practices returned to normality. Remember we scoffed at the use of the term 'transitory inflation' by the Fed before? Among other things, they did not appear to appreciate the likelihood of wage and price pressures arising from labour shortages. Many over 50s elected not to return to the workplace.

The war in Ukraine caused an energy cost spike and shortage in food supplies – central banks have changed tack in a belated attempt to forestall inflation pressures which had been mounting for some time before the Russian invasion. This is evidenced by the fact that 33 of the 38 central banks monitored by the Bank for International Settlements have raised rates during 2022.

There is an inherent tension here – central banks are trying to impose policy restraint with rate rises, whilst government fiscal policy is often moving in the opposite direction.  Economic policy during the 2010s was dominated by tight fiscal rules and a loose monetary stance.  This appears to have been reversed.  Hawkish central banks on the one hand versus spendthrift governments on the other could prolong inflation pressures.

Disillusion with central banks has hit consumer confidence and could entrench inflation expectations leading to increased wage demands.  The adverse geopolitical news-flow and subsequent pricing issues have further depressed confidence and put pressure on governments to 'do something' to protect the weaker elements of society.  The support packages enacted during lockdown have painted a picture that indicates that such support is not an impossibility but a political choice.  There is a clear electoral disadvantage in being seen to be overly passive in the light of the current situation.

In addition, governments are faced with further costs arising from demographic factors.  Ageing populations will increase demands on government spending on healthcare and pensions across the globe.  Since the 1950s the percentage of the global population aged 50+ has risen from 15% to 25% whilst China alone will have 420m people over the age of 65 by 2035.

Japan shows where this is heading – expenditure on the elderly is 10% of GDP and the gross public debt has risen accordingly.  Such expenditure calls will become increasingly dominant, as will the inevitable costs of decarbonisation and the energy transition towards a greener world.

This is where the tension between monetary and fiscal policy arises.  An ageing population creates a savings glut which drives real interest rates down – governments can still borrow at relatively cheap rates adding to the temptation to retain a loose fiscal policy and postpone the day of reckoning for future generations to deal with.

The eye-watering double digit inflation figures will gradually work out of the system as the energy spike subsides, but we believe that the 2% inflation target set by most countries is now looking overly optimistic in the short term.

Financial markets have had a dismal year to date: to the end of September, the MSCI World Index was down 26.4%, the S&P 500 down 24.8%, the Euro Stoxx 50 down 22.8%, the FTSE 100 down 6.6%, the Nikkei 225 down 9.9%, and even the FTSE All Gilt down 26.3%!

To give yourself some peace of mind, please compare your portfolio value at the end of last year with the current valuation.  This will show you how we have done for you by comparison with these indices.

Another worthwhile thing to remember is this: markets always look ahead and try to anticipate what comes next.  A downturn such as we have just experienced (including any expectation of a potential recession) always affects stock valuations negatively, and when the economic cycle nears bottom (or a recession is upon us) the valuations will pick up.  The turnaround can be quite swift and pronounced, as we have seen many times in the past.

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