Lacomp plc

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

Well, I guess we must start with addressing the very high cost of living here in the UK and elsewhere, with inflation remaining stubbornly high.

In previous Newsletters, we have written about the various, ludicrous excuses offered by Governor Andrew Bailey about why inflation was getting out of control, and we do not want to repeat all those. We possibly would be accused of being smug by saying 'we told you so'.

However, it is a bit rich when we now hear his predecessor say that he was always right when predicting higher inflation – all due to Brexit. Yes, a small bit of a hike can be attributed to Brexit, but he is casually ignoring the Russian invasion of Ukraine, the food shortages and skyrocketing energy costs, as well as supply chain and other problems following Covid-19.

Let us just look at what Mark Carney had to say before the Brexit vote.

As Bank of England (BoE) Governor in 2016, he took off – purely figuratively speaking – his Lock & Co. top hat and jumped into the political arena with hobnail boots on, which is not exactly what you expect from the boss of the Old Lady of Threadneedle Street.

He warned that a Brexit vote would very likely push the UK into recession, cause a steep drop in house prices, massively depress sterling and increase unemployment as well as stoke inflation.

Please bear in mind that before the Brexit vote, the inflation rate was well below the 2% target range: it stood at 0.4%, and three years later, by 2019, it had risen to 1.8%, still short of its target range.

Furthermore, and Mark Carney seems to conveniently have forgotten this: there was no recession, and house prices did not collapse. In fact, in the following six years they rose by 32%. Unemployment, far from rising, fell to a 44-year low!

True, sterling lost about 10% of its value following Brexit, but that is not unusual in times of uncertainty, which the Brexit vote clearly provided. The purchasing power of sterling has been in long-term decline, mostly due to inflation. To put this into context, £100 fifty years ago had the equivalent purchasing power of £1,547 today.

Returning to today's Governor, Andrew Bailey recently told us that headline inflation (currently standing at 7.9%, down from 8.7% in May) is set to fall markedly over the remainder of the year. Having been so wrong previously, he is careful not to quantify 'markedly'. However, the UK inflation rate is still at odds with other developed countries. The rate in the US has fallen to 3%.

Also worrying is the fact that the 'core' rate inflation (which excludes energy and food costs) is still very high at 6.9%, near its peak for thirty years.

At the same time, financial experts tell us that interest rates could well rise further, and some predict a peak at 6% by the year end. That does not make good listening for houseowners who must come off their low-cost fixed mortgages and renegotiate a new one at much higher levels.

It will be interesting to see what the BoE's Monetary Policy Committee (MPC) decide to do when they next meet on 3rd August. As little as two weeks ago, the consensus suggested another 0.5% hike, but that now looks like being reduced to maybe 25 basis points. We shall soon know.

The consensus among economists suggests that remaining in a continued higher interest rate environment could seriously affect GDP expansion for some time to come, resulting in sluggish growth. Forecasts have been roughly cut in half for both 2024 and 2025, and if they prove correct, we are looking at a period of stagflation. The MPC has a difficult choice to make in a fortnight, indeed.

The MPC was created shortly after Labour's landslide victory in 1997. Five days after their electoral triumph, then Chancellor of the Exchequer Gordon Brown decided that the setting of interest rates should be moved from the government (HM Treasury) to the independent BoE.

The MPC consists of nine members, five from the BoE (the Governor, three Deputy Governors and its Chief Economist) as well as four independent members, appointed by the Chancellor for a renewable three-year term. An HM Treasury official also participates in the meetings, and can contribute and comment on proceedings, but does not have a vote. This official's role is also to keep the Chancellor fully informed of the monetary policy. Andrew Bailey is its ex officio chairman. As there are nine members, a vote therefore always must reach a decision, which is quite useful as it elegantly absolves the chair, i.e. Andrew Bailey, from having to exercise a casting vote.

Whilst we are concerned about interest rates and inflation, far greater worries are experienced by Ukraine daily, with Russian missiles continuing to hit civilian targets in Kiev and other cities, latterly including some Ukrainian ports. The Ukrainian counteroffensive has proved more difficult than many expected. Russia had spent months in fortifying its frontline, mostly by placing vast quantities of landmines (many of them are made of plastic that cannot be located by metal detectors), digging anti-tank ditches and defences, as well as trenches. After seven weeks of operations, Ukrainian forces had reclaimed some villages previously occupied by Russian forces, but overall, they only made modest gains.

Russia was held responsible for rupturing the dam spanning the Dnipro River, flooding vast areas in an effort to make the counteroffensive in that area virtually impossible. In so doing, it not only hurt Ukraine but also its own population living in the flooded region and cutting their food supplies.

Russia is now also trying to weaponize food supplies elsewhere as it withdrew from a major agreement to facilitate Ukrainian grain, wheat and sunflower oil exports which will affect vulnerable countries in Africa and Asia, potentially leading to extreme food shortages and even famine in some areas. China and Turkey are major beneficiaries of grain shipments, and they may well take a dim view of Putin's latest action.

In addition, Russia faces problems at home. Severe labour shortages – some due to conscription, some due to people fleeing conscription – are having an impact. The economy is suffering. There is virtually no foreign investment, sanctions are continuing to hurt, and the embargos on Russian crude oil and oil products all affect the balance of trade and Russian finances. The huge cash reserves built up before the invasion of Ukraine are dwindling away.

Of course, all this neither hurts Putin personally nor those of his cronies that he still trusts. Indeed, after the weird mutiny of the Wagner boss Prigozhin and his departure with most of his fighters to Belarus, who can Putin really trust? The security elites are hardly united, his army commanders seem to be in disarray, and the morale of Russian soldiers appears to be low to say the least.

One thing is certain: the longer this war goes on, the more painful it will become for the ordinary Russians, many of whom no longer support Putin's 'special military operation'.

With this ongoing war, stubbornly high inflation, and steep interest rates, how have the markets behaved in the first half of the year? After a truly dismal 2022, most markets have shown decent positive returns, with the only unimpressive positive coming from the FT-SE 100 (up just 1%). Gilts and other sovereigns and fixed interest investments have recorded negative figures. That the UK has shown itself to be the outlier probably points to the political uncertainties we are facing here.

In the game of musical chairs that is Westminster politics, Rishi Sunak must dread the brief moment of silence when the by-election ballot boxes close and he wonders how many seats remain occupied by Conservative MPs.

There can be no denying that Friday morning's news was calamitous for the Tories. Retaining Uxbridge was a fluke born of local disquiet over a specific local issue, the expansion further into Greater London's suburbs of the ULEZ (Ultra Low Emission Zone) – something that it is said will impact only about 10% of vehicles in that constituency.

Labour and the LibDems poured vast levels of concentrated campaigning effort into both Selby and the Somerton and Frome constituencies, something they will not be able to repeat nationally in next year's general election. Evident ennui with the Conservatives after 13 years and a growing trend towards tactical voting – employed unofficially across the country by Labour and LibDems alike to advance the 'progressive cause' regardless of what is admitted to by the leadership of both parties – makes it very probable the huge Conservative majority will be overturned next year in an echo of the 1997 result.

The Conservative cause is in some ways not being helped by what has been going on north of the border: the two-year police investigation into allegations of financial fraud in the SNP may be drawing to a close, and it has been reported widely in recent days that Nicola Sturgeon (ex-First Minister), her husband Peter Murrell (ex-SNP Chief Executive) and Colin Beattie (ex-SNP Treasurer) could all be charged in connection with the misuse of funds and allegations of embezzlement.

In opinion polls, support for the SNP is collapsing, and the biggest benefactor is very likely to be the Labour Party (and of course anti-independence Unionists of all political persuasions). Labour's catastrophic performance in Scotland over the last decade contributed to the Tories' general election victories in 2015, 2017 and 2019. It is entirely possible that Labour will regain some of their old footholds at the expense of the SNP, while the Conservatives will lose "red wall" seats to Labour and southern England seats to the LibDems.

The biggest danger for Rishi Sunak is that he listens too closely to the call of his party's right wing and scraps some or most of his party's 'green' commitments. The Conservatives are already unpopular with the under 40s and are seen as espousing policies that alienate young people. To be seen weakening on or even abandoning environmental and climate change policies is certainly not going to attract that electoral demographic. Doing so is also likely to further estrange older voters who are increasingly putting the interests of their children and grandchildren before their own.

One general view is that the Conservatives need to maintain and reinforce their "green" credentials, silence their pro-Johnson fringe, re-occupy the middle ground, and defend it fiercely and loudly. Even so, when the music next stops playing, they will still find they are occupying many fewer seats, but they may just have done enough to deny Labour an outright victory, even to deny Labour and the LibDems the prospect of a coalition majority.

That is one view. A completely opposing one is that the Tories should join the increasingly vociferous anti-green revolt. The 'net zero by 2050' commitment enshrined in law by Theresa May in the days before stepping down as Prime Minister, whilst very laudable, will be difficult to achieve without concerted and serious efforts by national and local governments, as well as leaders of industry.

The so-called ‘hard-to-abate’ sectors, steel and cement (construction), petrochemicals (plastics et al), heavy industry (heavily dependent on fossil fuels for heat production) and transportation are challenging examples. So far, we have not seen any ambitious and explicit investment strategies from the government in this regard. To be fair, Labour have not come up with any realistic policies either.

Wind farms everywhere, solar panel fields, fracking (or lack thereof), the banning of new internal combustion engines in cars by 2030 and heat pumps all present their own individual problems, plus lots of associated costs!

The various parties’ political manifestos before the next general election will make fascinating reading. Will we see constructive and fully costed proposals rather than the oft used platitudes we have been getting used to? Interesting times ahead!

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