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LACOMP PLC IS AN INDEPENDENT INVESTMENT MANAGEMENT COMPANY PROVIDING PORTFOLIO MANAGEMENT SERVICES TO PRIVATE INVESTORS WORLDWIDE

2021 was never likely to repeat the huge gains seen during the second half of 2020 as markets recovered from the lows of March. Momentum was particularly in evidence among large cap technology stocks, which were seen as beneficiaries of lockdown restrictions. Last year, funds with a more value or income driven bias were left behind as most indices posted comfortable double-digit gains.

This year started in similarly positive fashion despite the political turmoil in the US – particularly the terrifying storming of the Capitol in Washington on 6 January – and the coup in Myanmar at the end of January when Aung San Suu Kyi and other democratically elected leaders were detained and the military seized control. The brutality displayed by the new regime in Myanmar has been horrendous.

Despite these and other political headwinds, as well as the continuing Covid worries, equity markets had returned a decent 4 to 6% by quarter end, retreating somewhat from the record highs attained during February. Gilts, corporate bonds and other fixed interest investment, on the other hand, fell in value.

China, which seems to have avoided the worst and escaped relatively unscathed from the pandemic, posted travel restrictions for their Lunar New Year break to curtail the traditional return of migrant workers to their hometowns. Ordinarily, hundreds of millions of their citizens travel across the country to see their families. Chinese companies offered subsidies, free food, and cultural tours to help reduce the migration.

Despite widespread scepticism over its Covid reporting China seems to have largely recovered economically: even though economic growth in 2020 was understandably down on recent years it still managed GDP growth of 2.3%.

In the UK, we saw the FT All Share and the FTSE 100 record 4.3 and 3.9% respectively in the first quarter, no doubt helped by City firms posting record fees from floats and capital raising as companies either saw opportunities or needed money urgently to survive the crisis.

Precious metals suffered during the first quarter, mostly due to the hike in the US 10-year Treasury yield in anticipation of rising interest rates and expected inflationary pressures. Gold and silver prices do tend to fall when the yield rises, but we are seeing a gentle recovery at present. At the same time, though, gold and silver are both seen as hedges against inflation as well as safe havens in troubled times, which is why we bought them in the first place, and why we are happy to maintain our exposure.

Across the English Channel, Europe is facing big problems. First, there is the disorganised and slow procurement and rollout of Covid vaccines, resulting in EU member states lagging well behind immunisation programmes of other nations. This has given rise to a new wave of populism in several countries, and Monsieur Macron and Frau Merkel have become increasingly unpopular among their electorates.

The French Presidential Election will be held this time next year, and it probably is fair to say that it is Macron's to lose. However, Marine Le Pen, the leader of the far-right National Rally party whom Macron easily beat in the second round of the last election, was running neck and neck with him in a recent poll. Another stern critic of Macron is Jean-Luc Mélenchon, the leader of the far-left party, La France Insoumise (France Unbowed). Add the Republicans and the Greens into the mix, and you can see why Macron is feeling somewhat uneasy.

In Germany, their federal election is only six months away, with Mrs. Merkel handing over the reins after her 16 years and four terms as Chancellor. After weeks of infighting among the CDU/CSU sister parties, a marathon meeting on Monday finally saw CDU's Armin Laschet from the Rhineland beat his Bavarian CSU rival Markus Söder. This is rather surprising, seeing that Laschet is viewed as lacklustre, and he does not have much of a personality. Söder, on the other hand, is a typical Bavarian: jovial and politically erratic at times, but more favoured by the voters. So, why would they opt for Laschet? The answer might be that Laschet was very much part of Merkel's inner circle, more a yes man than a mover and shaker. Seeing that Mrs. Merkel's popularity has fallen by a large margin this choice of a 'continuity candidate' might prove a mistake, particularly as the Greens are snapping at their heels in recent polls. The Greens were only formed as a party some forty years ago, but it is entirely possible that they and the Social Democrats will be the dominant parties after September.

Thinking of Merkel shoo-ins, one need look no further than the EU Commission President, Ursula von der Leyen. As we said in our July 2019 Newsletter, on 2 July that year she resigned as German Defence Minister and, a mere two weeks later, she was elected – unopposed! – as President of the European Commission. At the time, we knew little about Mrs. von der Leyen, but we have learnt a lot since. We now know that her time as Defence Minister was beset by scandal after scandal, but as Merkel's protégé she kept her place in cabinet longer than any other politician. In 2015, there were allegations that large parts of her dissertation to gain a medical doctorate in 1991 were plagiarised. And only a month ago or so we had her ill-advised attempt to limit the flow of vaccines to Northern Ireland. That was quickly revoked, but she then threatened to block the export of vaccines from the EU to the UK, rather overlooking that vital ingredients for the Pfizer vaccine produced in Belgium originate from Yorkshire. Fortunately, a tit-for-tat 'vaccine trade war' was avoided.

Sadly, there are millions of unused AstraZeneca vaccines stored in fridges around the EU. The French have a history of being somewhat vaccination-sceptical – about 40% of the population, according to some polls. This was not helped by Macron questioning the efficacy of that vaccine, and even Frau Merkel had some doubts. By now they have reversed their reservations in this respect, but the rollout is still painfully slow, and the new infection and death rates are very alarming.

Unfortunately, the vaccine situation is only one of the problems the EU faces.

The eurozone's financial position, put bluntly, is in a mess. In Germany's top court, the Federal Constitutional Court in Karlsruhe, some 16 economists and businessmen have filed a new lawsuit against the ECB, saying the Central Bank is breaching Article 123 of the Lisbon Treaty by engaging in "blatant monetary financing of states". The ECB's primary responsibility is to maintain price stability, and the lawsuit suggests the ECB's additional QE and large scale buying of bonds (£1.6trillion under its Pandemic Emergency Purchase Programme) is throwing a comfort blanket over the eurozone problems, a comfort blanket that will be whipped away the moment inflation rises.

It is worth noting that last year the same constitutional court ruled that the ECB's QE asset-purchase program was violating European law.

Negative interest rates have been around for quite some years, predominantly in Europe and Japan. Central banks see it as a short-term measure to stop banks parking their money with them, thus encouraging lending and helping the economy.

The Chief Economist of the German Bundesbank predicts that inflation could reach 3% by the end of this year and bearing in mind that the current interest rates are at minus 0.5%, you can see the problem for banks. It is also a problem for German savers who traditionally keep large sums on bank deposits. In fact, Germany's biggest lenders, Deutsche Bank and Commerzbank, have started telling customers to pay them a 0.5% rate per annum to keep large deposits with them as they cannot afford to absorb the central banks' negative interest rates.

We have been concerned about the eurozone banking system ever since the Greek financial crisis which threatened the EU monetary union, and the situation is getting worse, not better. In July 2012, the ECB's then president, Mario Draghi, famously said "we will do anything it takes to preserve the euro", but we wonder how long this can go on.

Basically, banks make most of their profits from the interest rate differential between the deposits they take from their customers (paying a lower rate) and then lending to industry, commerce and private individuals (charging a higher rate). That works perfectly well whilst interest rates remain 'normal', i.e. above zero.

When central banks drop their rates to negative, however, as has happened in the eurozone since 2014, 'ordinary' banks must pay interest to the central banks on their central bank reserves, prompting the actions taken by Deutsche Bank and Commerzbank.

Whilst German banks are relatively stable, the same cannot be said for banks elsewhere, particularly in Italy, Spain and France. Many of them have extended loans to so-called zombie companies - firms that carry a lot of debt which they have difficulty or are unable to service, let alone repay. The Covid pandemic has exacerbated the situation, with many banks and companies obtaining further financial assistance. A day of reckoning as we emerge from the lockdown could lead to a bloodletting in the banking sector.

We are also worried about the reckless spending spree in America. The new President did not waste much time to open the money taps. In early March he announced a $1.9 trillion Covid relief bill, and earlier this month he unveiled his $2 trillion jobs and infrastructure package. Not surprisingly, he ran into Republican opposition, but he stated that he was happy to compromise (maybe lowering corporation tax from his proposed 28%?) but insisted that inaction was unacceptable.

'Sleepy Joe' looks like a moniker that is out of place right now, but we must wait and see what actually is proposed in greater detail. One thing is for certain: Joe Biden is changing the political agenda, and we can already see it will lead to more state control in the economy and a pronounced shift to the left politically. We can expect the biggest spending round in the developed world, rising welfare costs, a less competitive tax environment, and a substantial increase in debt. In the short term we can expect a boom, but there is the danger boom could turn into bust quite quickly.

We are happy to maintain our exposure to the American stock market but will keep a wary eye on it as well.

News at home presents a more benign but still mixed bag. Obviously there still are too many job losses and company failures, and opinions are split as to whether we should get rid of the shackles that still limit what we can do both in term of work and personal freedom. Many people believe Boris Johnson is doing the right thing in sticking to his roadmap out of lockdown. We guess a lot of views are formed based on personal circumstances.

We also have our own scandal: the multi-billion collapse of Greensill Capital and its supply chain finance business was extraordinary, the biggest failure of a global finance firm since the financial crisis. Valued at some $3.5billion only two years ago, with 16 offices worldwide, it filed for bankruptcy in London a mere week after a Sydney judge refused on 1st March to order an insurer to extend a policy that was due to expire at midnight that day, for the simple reason that the company had waited too long to bring the matter to court. The fallout was, and is, spectacular. Major banks took a hit, and it also threatens the steel empire of Sanjeev Gupta who employs some 35,000 people around the world.

What gave the British press more material to write about was the fact that our ex-PM David Cameron, alongside other former and current ministers, as well as other officials, got embroiled in the affair. It is too early to know exactly who did what and whether what they did was wrong, but it certainly has a strong whiff of poor judgment, whether or not it was against the rules. The suggestion that David Cameron received stock options potentially worth tens of millions does not help.

Shortly afterwards, we find that some of our senior civil servants were also enjoying gainful employment with private sector companies alongside their public role. If you thought the Westminster mandarins were simply enjoying a decent salary, a gold-plated retirement package with, hopefully, a gong thrown in, think again…

The one thing that is definitely positive about the UK is the success of our vaccine rollout. Well done, and long may it continue!

Bagshot 22nd April 2021