



Introduction

JP Morgan Chase is the largest bank in America and the highly respected CEO is Jamie Dimon. In his (66 page) annual letter to shareholders last week, he made the following observations about the US:

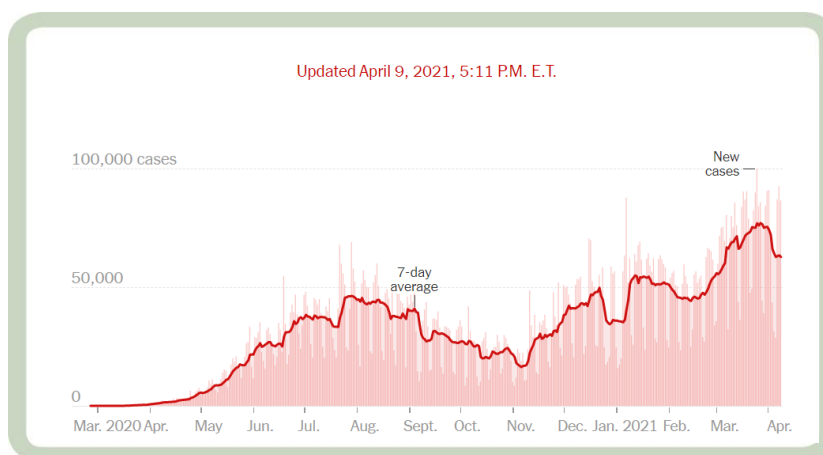
- The "horrific murder" of George Floyd and the painfully slow economic growth of the past two decades are all symptoms of a broader problem: "inept" public policy and broad government dysfunction.
- Many of America's problems are self-inflicted and the result of extreme polarisation and "broken policy."
- Problems include inequality in the nation's education system, a costly litigation and regulatory system, "terrible" infrastructure planning, wasteful spending, ineffective immigration policies and "poorly designed" social safety nets.
- The tragedies of the past year merely expose enormous failures that have existed for decades and have been deeply damaging to America. The nation was "totally unprepared" for the pandemic.
- The fault line is inequality... as well as the failure to move beyond differences and self-interest and act for the greater good.
- He said: "Americans know that something has gone terribly wrong, and they blame this country's leadership: the elite, the powerful, and the decision makers - in government, in business and in civic society. This is completely appropriate, for who else should take the blame?"
- He warned that the banking industry disruption from technology is finally at hand, with enormous competition from the shadow lending system. "Fintech and Big Tech are here ... big time". Traditional banks are being consigned a shrinking role in the global financial system.
- Brexit and financial pressure may create a tipping point where all of the functions servicing the European financial system could be shifted out of the UK and into continental Europe.
- Government stimulus checks have reduced personal American debt levels to the lowest in 40 years, which they have stashed away in savings, generating huge ability to unleash spending due to the realisation of pent-up demand. As result, the US economy is growing at its fastest pace since 1984 and this should extend into 2023. He believes it could be a Goldilocks moment where growth is rapid, while inflation remains relatively dormant.

Coronavirus

- The global tally for confirmed cases of Covid-19 reached 133 million last week, and the death toll neared 3 million.

Brazil, now considered the epicentre of the crisis, reported just under 4,200 Covid-related deaths on Tuesday, the highest figure for a single day since the beginning of the pandemic. It has had 13.3 million cases and just under 350,000 fatalities.

The case trend in Brazil is shown below.



India counted 126,000 new cases that same day, a record one-day surge. Tokyo is looking to return to stricter virus containment measures as cases have continued to rise. The Japanese capital recorded 545 cases on Thursday, after hitting a two-month record on Wednesday.

- Shifting guidance by vaccine manufacturer AstraZeneca, combined with growing concerns over the risk of blood clots, has severely affected the vaccine rolled out in the EU and elsewhere. Although scientists consider the risk of side effects exceptionally low compared to benefits, the adverse publicity is affecting the use of the product.

The Australian Financial Review said (08/04/21):

Unlike routine clotting problems that cause a standard stroke or a heart attack, this new clotting problem is immune driven. Something goes awry with the immune system and antibodies activate platelets (clotting cells), deplete them in the bloodstream and cause clotting in unusual places.

The vaccine has advantages, being reasonably cheap and able to be stored at higher temperatures than alternatives and is considered the answer for many low-income countries. However, Germany, Italy and Spain have restricted use to people over the age of 60, while Australia will also not recommend it to people under the age of 50.

AstraZeneca also got offside with US regulators when it submitted trial data that was out of date.

Equities

- The S&P 500 (shown adjacent) and Dow Jones Industrial Index reached record levels on Friday, capping three straight weeks of gains.

Growth stocks came to the fore after lagging value companies for most of the year. This was assisted by a pullback in the 10-year Treasury Yield - now at 1.67%.



Investors are getting their heads around inflation, particularly after Jerome Powell, the Chair of the US Federal Reserve, has consistently said that the central bank expects a spike - but this will be temporary. The surging US economy, now exiting from the pandemic, is also contributing to the cause. Investors also seem to be taking the new prospect of a minimum tax for large international companies on their chins.

However, the market has lost substantial energy in recent sessions. Selling has been contained, but volume has fallen, and speculative action has disappeared. Shares prices are struggling to hold support due to a lack of dip buyers. It is thought that this may be due to speculative retail investors leaving the market, now that the opening of the economy allows them to follow other pursuits.

The dull action is likely to persist until US first quarter earnings are released over the next few weeks, or another catalyst for change arises.

- US investors are borrowing huge amounts of money to feed their addiction to share markets. At the end of February, there was \$814 billion outstanding against portfolios, according to data from the Financial Industry Regulation Authority. This is 49% more than at the same time a year earlier and the fastest annual increase since 2007. Before this, the last time that margin debt grew so rapidly was in 1999, just before the dot.com collapse.

Lending of this type fuels bull markets, but exacerbates bear markets, and there is concern that it could be a catalyst for a collapse in equities. When markets fall, brokers issue margin calls, which accelerate the sale of stocks to provide cash.

- The contrary view (and our view) observes that by the end of March US households had accumulated around \$2.25 trillion of excess savings over what they would have normally generated without the pandemic. i.e. there is a savings glut of about 10.5% of GDP. The percentage of households in a survey by the US Conference Board who expect stock prices to rise over the next 12 months is still around its long-term average – which is positive for equities.

The US economy is also strong, and vaccinations are rolling out apace. Although the quantity of money has increased, the velocity is way down (as discussed below). The Fed argument for only a short-term spike in inflation is therefore reasonable.

With monetary policy still easy, stocks can continue to move higher.

Investment Strategies

- According to the results of the latest American Association of Individual Investors survey, 56.9% of respondents expect share prices will rise over the next 6 months, up 11.1 percentage points on the previous week. This is the highest level since January of 2018 and is significantly above the long-term average of 38%. Bearish respondents measured at 20.4%, down 2.8 points on last week.

The difference between bullish and bearish respondents was 36.5%, again the highest level since January of 2018.

Ironically, above average readings for bullish sentiment have historically been followed by below-average performance for the S&P500 index (a countercyclical reaction).

- Analysts are now suggesting that investors should short companies, such as online gym operator Peleton and Zoom Video Communications that did well during the pandemic and could see earnings affected by the lockdown release and increasing numbers of vaccinations.

They are effectively betting on a reverse pandemic effect.

- With Joe Biden's \$2.25 trillion infrastructure program having a good chance of passing the Senate, investors in the US are considering equity infrastructure plays as having good potential.

An easy way to play the sector is to consider exchange traded funds, including the iShares US Infrastructure (US: IFRA) fund, and the Global X US Infrastructure Development ETF (US: PAVE). They are both up by more than 15% so far this year.

- Barron's Magazine (06/04/21) believes that we should buy airline stocks as the world is about to embark on a "golden age of travel". Wall Street is expecting air traffic in 2022 to exceed the level of 2019.

They cite the 1920s, after the Spanish flu and World War I (as an analogy) where US car miles driven doubled in five years; and commercial air miles in the 1950s, after World War II, expanded six fold.

Debt, Bonds, Interest Rates & Inflation

- With the post pandemic economic recovery gaining traction, the IMF has warned that the central banks of advanced nations could quickly tighten interest rates. They say that this could result in a "disorderly" unwinding of the price of risky assets – such as housing. There has been a "disconnect" between struggling economies and asset markets "powering ahead" around the world.

The IMF recommends that central banks tackle asset market vulnerabilities by deploying non-interest rate regulatory tools to dampen down asset prices and to contain financial risks.

- Despite numerous pledges by US Federal Reserve Chair Jerome Powell to keep interest rates at record lows through to 2024, the futures market is pricing in earlier increases. Eurodollar futures, a closely tracked measure of interest rate expectations, now indicate the Fed will initiate lift-off by the end of 2022, with three additional interest rate increases penciled in by early 2024.

This explains why the yield on the US 10-year Treasuries has risen 85% since the start of this year - to just under 1.7%.

In contrast – the view of the Fed has been that inflation and interest rates will pick up in the short term, as the economy returns to normal and may even overshoot to the upside... but this is transitory, and inflation will slow as the economy returns to a sustainable trend.

The Fed has said that the risks of unexpectedly high inflation are about the same as for unexpectedly sluggish inflation – i.e. they are broadly balanced.

- In a break from nearly every other central bank, the People's Bank of China has begun tightening monetary policy. As well as guiding key interest rates higher, authorities have increased banks' capital ratios and restricted lending to high-risk borrowers. They are also reducing local government borrowing, which has exploded higher in recent years.

The daily fixing of the benchmark for banks' cost of funds is now 3.5%, compared with 2.5% for most of 2020. China can afford to de-escalate its financial stimulus, with the IMF forecasting GDP growth of 8.4% for 2021.

Asia Times said (08/04/21):

"China, in short, is fixing its roof while the sun is shining. The Chinese authorities are doing the responsible thing, while America continues to run up its plastic."

- In a meeting on Tuesday, the Reserve Bank of Australia voted to keep its record-low cash rate of 0.1% in place and continue their \$200 billion bond-buying programme. However, they flagged rapidly rising house prices as an area of concern.

The Governor said:

"Given the environment of rising housing prices and low interest rates, the bank will be monitoring trends in housing borrowing carefully and it is important that lending standards are maintained... The bank is prepared to undertake further bond purchases if doing so would assist with progress towards the goals of full employment and inflation... Wage and price pressures are subdued and are expected to remain so for some years"

He reaffirmed the bank's expectation for the cash rate to remain at 0.1% until at least 2024.

- Investors taking large risks to invest in high yielding assets have done well out of the pandemic. US high-yield bonds, which rate lower than investment grade bonds, have returned more than 23% for the year up to the end of March - the only time in history when it has exceeded 20%.

An example has been cruise operator Carnival Corporation, which issued \$4 billion of bonds at 11.5%, which are now yielding 4%, reflecting a massive capital gain (bond prices are negatively correlated to interest rates).

- Readers will have noticed that there is a significant divergence between the attitudes of central bankers over inflation and the increasing concerns of investors, as witnessed by trends in financial markets (such as rising interest rates).

Nobel Prize winning economist Milton Friedman said:

"Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output."

While the quantity of money in the US has significantly increased, this has been balanced by a decline in the *velocity* of money - which is the frequency with which each unit of currency is used to produce goods and services within a given period of time. Back in 1980, this was 3.5 times, but was down to one last year.

A major reason is that economies are increasingly becoming financialised, with money flowing into investment assets (such as equities, shares, commodities and real estate), rather than goods, services and productive investment. Technology, particularly capital-light information technology, is also playing an ever-increasing role in industry and commerce.

It is why central bankers are hanging onto their hats in the face of market trepidation about inflation. The side effect (and a major problem) is the rise in inequality.

Economies

- The International Monetary Fund has updated key economic forecasts in its half-yearly World Economic Outlook report, citing successful vaccination campaigns and various stimulus packages as key to the upgrades. They say that economies are growing faster than expected and that advanced economies will emerge from the pandemic with little damage.

After contracting by 3.3% in 2020, the IMF has forecast the global economy should now grow by 6% in 2021, and 4.4% in 2022. The previous report in October 2020 had forecast growth of 5.2% in 2021 and 4.2% in 2022. The pandemic resulted in a massive global policy response totalling \$16 trillion, and the IMF says that without it the global economy would have contracted by 10%.

The US economy is now forecast to expand by 6.4% in 2021, its fastest growth rate since 1984, while China will see growth of 8.4% and the Eurozone 4.4%. Of the 83 countries that have now reported 2020 fourth-quarter GDP figures 11 have posted figures higher than pre-pandemic levels.

- Australian job vacancies have hit a 12-year high and are now 23% above pre-pandemic levels. ANZ Australian job postings rose by 7.4% in March, following an 8.8% rise in February and are at their highest level since November 2008. The unemployment rate has declined from a pandemic high of 7.5% to its current rate of 5.8%.
- The US Institute of Suppliers March survey showed that the confidence of service businesses reached 63.7 (where anything above 50 is expansion), which represents an all-time high. The

manufacturing purchasing managers' index hit 64.7, the highest level since 1983. The biggest problem is that businesses cannot obtain enough employees or supplies to meet order books.

Business

- The US government has thrown its weight behind a push to rewrite international tax rules and introduce a global minimum tax rate. This would deal a major blow to multinationals engaging in tax dodging by shifting income to low-tax regions. Under the plan, companies would be forced to pay taxes to national governments based on revenue earned in each country, irrespective of where they are headquartered. Leaders of the G20 major economies hope to agree on the tax by the middle of 2021.

It would help with the problem of the “race to the bottom”, where countries lower their tax levels in order to be competitive on an international scale.

Academics at the University of Copenhagen and the University of California have calculated that “profit-shifting” accounts for almost 40% of multinationals earnings, using countries such as Ireland, Jersey, Luxembourg, the Netherlands and Switzerland... with an associated impact on tax payments. The IMF has estimated that the issue accounts for a total tax avoidance amount of around US \$650 billion per annum.

The Guardian said (08/04/21):

The proposals are designed to tackle the very low rates of tax paid by the digital giants Google, Facebook and Apple, and major brands like Nike and Starbucks, which have become adept at using complicated webs of companies to shift profits out of major markets like the UK, where most of their revenues are earned, and into low-tax jurisdictions like Ireland and the Caribbean.

- New research indicates that China, with its inexpensive coal fired energy resources, controls 75% of global bitcoin mining and the process is likely to consume by 2024 about the same amount of energy as the entire nation of Italy - the equivalent of 130.5 million metric tonnes of carbon emissions. This would place it 12th, out of all countries, in energy consumption - just for bitcoin generation.

North America generates 6.8% of the supply and the rest of the world around 14%.

- The market capitalisation of all cryptocurrencies hit an all-time high of \$2 trillion last week, according to market tracker CoinGecko. Bitcoin alone is now worth \$1 trillion, while Ethereum hit \$244 billion.
- Shipping companies ordered a record number of container ships in March from shipbuilders, an indication that they have high expectations that global trade will continue to surge. They are signing deals on the back of record earnings from the supply of freight to commerce.

The companies ordered 72 large vessels, with a combined capacity of 866,000 20-foot containers, significantly exceeding the previous record of 50 vessels with a combined capacity of 570,000 containers, set in June 2011.

Politics

- Iranian and Western officials reignited talks on Tuesday, with the goal of reviving the embattled 2015 nuclear accord. The accord placed limits on Iran's nuclear activity in exchange for the lifting of sanctions on the country. The Trump administration withdrew from the accord in 2018.

The goal of the meeting is to produce a roadmap for the US and Iran to return to compliance with the deal.

- Share market guru Jim Cramer made the following interesting comments on US President Joe Biden, in comparison to previous incumbent Donald Trump (Real Money 08/04/21):

I don't think President Biden pays much attention to the stock market at all. I have known him for years and I would often see him on the train going South when he hopped on at Wilmington going to the Capital. The President is the one of the most convivial souls I have ever met and one time he saw me walk by him and stopped me to talk about the stock market. First he introduced me to the conductor because he was right there and Biden would have thought it rude not to. He had just asked the conductor to play a game of golf with him so he delighted in introducing us.

Then he got right down to it. He said that he found my obsession compelling, but sadly he couldn't take advantage of it - in part because he didn't have the money for stocks. He said to me that he would, but from the disclosure forms he was the poorest person in the Senate. Number 100, the bottom. I remember saying that's too bad, but he didn't seem to care at all.

So let's see, you have one president who was obsessed with the stock market and another who couldn't care less about it. One president who bragged about how rich he was and another president who makes sure you know he's the poorest senator. One man who reveled in being the real estate mogul builder, the other proudly pointing out when he introduced his jobs program that he was a union man.

- The US National Intelligence Council, in a recent report, said that the Covid-19 pandemic has deepened global inequality.

The report, which charts likely global trends over the next 20 years, commented:

The ongoing Covid-19 pandemic marks the most significant, singular global disruption since World War II, with health, economic, political and security implications that will ripple for years to come. The response to the pandemic has fueled partisanship and polarisation in many countries as groups argue over the best way to respond and seek scapegoats to blame for spreading the virus and for slow responses, while contributing to low levels of trust in political institutions.

They believe that the pandemic is slowing, possibly reversing longstanding trends in human development, such as gains in poverty reduction and gender equality.

- New strains of the Covid-19 virus, vaccine distribution, and inequality across and within countries topped the list of risks officials reported at a virtual panel on the global economy at the annual spring IMF/World Bank Meetings.

The unevenness of the economic recovery was a focal point, with IMF officials emphasising that although the US and China will have strong recoveries this year, the rest the world will lag behind.

The lack of equality in vaccine rollouts was also of concern, with 86% of vaccines currently distributed to middle and high-income countries, while only 0.1% has gone to low-income countries.

Commodities

- A number of analysts are predicting that the declining trend in gold prices is set to reverse, with a number of factors soon to be in its favour. Gold futures rose by around 25% in 2020 but are down 8% so far in 2021.

The adjoining chart shows that it is attempting to form a platform and is flirting with the (falling) 50-day moving average.



Gold is likely to rise if the equity market softens and the US dollar falls - both reasonable predictions.

- Australia earns nearly US \$600 million a day from exporting iron ore to China. This is up by about 100% in the last 12 months.

The price of ore is now under threat by the development of the Simandou project in West Africa (Guinea), where Rio Tinto has 47% and the Aluminium Corporation of China holds 41% of a partnership. It is considered the best (and largest) deposit of high-grade iron ore in the world and could deliver 150 million tonnes a year.

The ore is easily retrieved, seemingly able to be “dug out with a shovel”. However, it is a remote area and a rail line to the coast will cost over US \$6 billion, and a new port with a 2 km wharf will need to be constructed.

China’s interest is not just about returns for the project, but also assisting in tipping the balance of iron ore prices down from the current level of around US \$160 a tonne. The country imports around 1.2 billion tonnes a year, of which 800 million tonnes comes from Australia. Every dollar saved on the price of iron ore reduces costs to Chinese mills by US \$1 billion.

Real Estate

- According to the Australian Financial Review (06/04/21):

From Canada to the UK to New Zealand, authorities struggle to manage the effects of a low interest rate world translating into asset inflation in general and house prices in particular.

Nor is it just the West facing the dilemma.

China is trying to rein in its own housing price boom, with the number of new home sales surging more than 130% in January and February. A modest fall in Japan's home prices over the last year is the exception.

- In Australia, 25% of first homebuyers now take between five and ten years on average to save for a 20% house deposit, which currently averages more than \$100,000. Over 11% take 10 years or more. Around 60% of first homebuyers in New South Wales are likely to experience mortgage stress, compared to 51% in Queensland and Victoria.

Australian house prices surged by 33% in the year until the end of March. Super low interest rates, government homebuyer grants and increased demand for larger detached houses during Covid-19 are pushing up prices - which are expected to extend further.

The Reserve Bank of Australia and Australian Prudential Regulation Authority insist they should not target asset prices, saying: "It's not our job to solve house prices and it's not our job to solve house pricing affordability".

- The S&P CoreLogic Case-Shiller National Home Price Index, which measures average home prices in United States metro areas, was up 11.2% in the 12 months to January, marking the highest annual price move in 15 years.
- According to Infometrics, the median house price in New Zealand is now 6.7 times average annual household income - among the highest in the world. Auckland is the fourth least affordable city in the world.

To return to an affordable level - estimated to be 3 times the average annual household income – house prices would need to fall by 55%, or incomes rise by 123%.

John Ryder and Devon Ashby

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