PORTFOLIO MONTHLY REPORT – October 2021

Situation

I graduated from university in 1978 so I can well remember the late 1970s. Flared trousers, bad cars, Charlie's Angels on tv (a silly US detective series with three women's hair styles being the main plot) and of course *inflation.* These are the inflation rates in the USA which dominated the investment world :

Year	US inflation rate
1976	5.7%
1977	6.5%
1978	7.6%
1979	11.3%
1980	13.5%
1981	10.3%

That turns something, that cost $100 at the start of 1976 into costing $168 at the end of 1981 and we all know that the overall inflation number masks huge variations and under report anomalies. As inflation is now already rising this year (USA CPI Sept 5.4% pa) the question needs to be asked, if it is temporary or the start of a trend for several years.

The central bankers who are tasked with keeping inflation low still argue that it is "transitory" but that is looking increasingly unlikly as each month passes. In the meantime they continue to promote their easy money policy. The USA is reducing their QE but will continue it into summer 2022 and until then there will be no rate increases. The head of the ECB has said there is no chance of higher rates in 2022.

The text book policy to control inflation is to raise rates but there might be an argument that higher rates will not improve supply and distribution of goods now needed as a result of global lockdowns. But current policies risk huge bubbles building which do not end well.

We have seen such bubbles in the housing market. In the UK for example house prices were about 4 times the average median wage. Today they are 8 times and in London 12 times. A similar situation has developed in the USA and Germany, with their own unique features.

Bubbles have also developed in certain share prices. Tesla for example has continued to soar to valuations which make no sense on a fundamental level. This matters because the company is now in SP500 tracker funds which are widely used by pension funds. Tech companies in general are valued way beyond any fundamentals and if inflation is on the rise they are very exposed because their promise is all about future growth and discounting that at a higher inflation rate would impact current valuations.

Also very odd at the moment is the yield on government bonds. German bonds are still negative while UK and USA bonds yield somewhere between 1 and 1.5% which is far below the rate of inflation. If inflation starts to print out next Spring at 6 or 7% there is going to be a lot of volatility in those bonds markets as the “transitory“ narrative is seen to be incorrect.

The Bank of England refused to raise interest rates from 0.1% at their meeting this week in the face of higher UK inflation. At the end of September it was quoted at 2.9% and they expect the inflation rate to be at 5% next Spring, then fall to 1% by the end of 2022. That seems very optimistic given what happened to inflation at the end of the 1970s when they lost control.

Year	UK inflation rate
1976	16%
1977	15%
1978	8%
1979	13%
1980	18%
1981	11%

That rate means you need £210 at the end of 1981 to have the same spending power as £100 in 1976

Looking at stock market returns during the period the SP500 in the USA did keep up with the inflation rate if dividends are included. A similar picture can be seen in the UK if dividends are included, but there was stock market volatility as investors rotated into dividend paying companies and those with pricing power in the commodity complex.

Of course the star performer during the period was gold which started 1976 at $140, finished the period in 1981 at $400 and touched $700 in 1980.

So no more flared trousers or British Leyland cars but perhaps there will be some similarities to the late 1970s.

Best wishes

Tim 5 November 2021