PORTFOLIO MONTHLY REPORT – January/February 2022

Situation

As I write this newsletter the Press is full of stories about the conflict in the Ukraine which has become much more serious in the last week. It is very easy to start a war but much harder to see how it will develop and finally end. For people on the ground it will be very grim but the economic impact for many will also be hard.

1. Inflation

We have discussed this in newsletters all last year and how central banks in the West under estimated the rise in inflation. The word „transitory" used by the US central bank last year now seems comical. The central banks in the UK and EU were also dismissive of the threat. Well now it is real and clear. The UK central bank has stated they expect inflation to reach 7% this Spring and then fall away. It has already reached that level in the USA and Europe is not far behind.

The double digit inflation of the 1970s and early 1980s was persistent and did not fall away until central banks raised interest rates leading to a recession.

This time inflation is really hitting the consumer. Energy and fuels costs have soared and we can see that every day we drive into a petrol station. This will impact all prices as delivery costs gets more and more expensive. With Russia a major oil producer, globally the price of oil is unlikely to fall any time soon.

Inflation is also rising in food prices. This could have a massive impact. Russia and Ukraine are major exporters of grain and if their products are restricted by the conflict expect food shortages in countries in the Middle East which import from these countries. Russia, one of the biggest exporters of fertilizer, has recently halted exports. Farmers need fertilizer to support yields and this will be another problem. Globally food is going to get much more expensive.

2. Interest Rates

Prior to the conflict the rising inflation in the USA had led markets to expect higher rates from the central bank. Their first meeting is mid March and a rise of 0.5% is expected. Amazingly the forward markets are expecting a rise at every one of their 7 meeting this year, taking the over night rate from zero now to about 1.75% by the end of the year. Such a rise seems very risky given the huge debts in the economy but at least most people in the USA have 30 year fixed rate mortgages. In the UK such a rise would devestate the housing market as monthly mortgage payment would double.

The conflict might therefore be used as cover by central banks to increase rates by less than expected. Note however even if these increases are achieved the real rate ie. rate after inflation will still be negative.

3. Taxation

The measures to support economies due Covid19 resulted in governments spending huge amounts all with borrowed money. That will lead to higher taxes. The UK has planned an increase in NI contributions of 1.25% from April. That is a tax increase for working people and I am sure other countries will follow. In Germany following the fall of East Germany a 5.5% extra tax was introduced in 1991 and lasted until 2020, that is 29 years. From 2021 it still applies to singles earning over Euros 73,000 !

4. Health Insurance Costs

The long term effects of Covid19 on health are unknown but I cannot see health insurance companies doing anything but raise insurance premiums. In the UK where it is paid by general taxation the NI increase is, the government says, all going to the National Health Service. In such a politically charged system there is bound to be more needed.

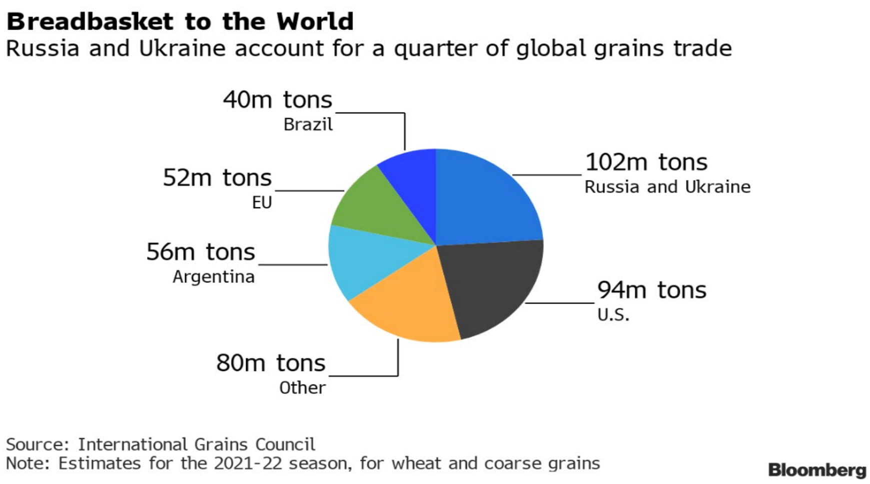
5. Energy policy

Germany and other parts of Europe decided to become dependent on Russian gas for power stations and now the conflict has brought that decision into question. The problem is that energy policies take decades to change and the politicians who decide on changes are rarely around decades later when the results are evident. This week the German Green party has stated that a new policy is needed and all options are on the table including coal and nuclear. This is directly the opposite of what has been the driving policy for the last decade, namely exit coal and nuclear power. Whatever they decide costs for consumers will rise.

The same is true in the UK where the current „net zero" green policy has resulted in new taxes and price rises on energy. One country that has avoid the problem is France which went nuclear years ago and that now provides 70% of the country's electricity.

Looking ahead

In the last weeks we have seen a significant drop in stock markets and then a recovery within days. Investors are expecting the central banks to support the markets. Hopefully the conflict will be ended soon but if it is not I suspect the above points will become more and more relevant to the investment world. One point in particular that could have a major global impact and that is food supplies. Russia and Ukraine provide one quarter of the world's grains. If the dispute lasts months and supplies are cut the impact will be a shortage of food in many countries.



Best wishes

Tim

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