Weekly Digest

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Empty Desks

August has always seemed to me to be the month that epitomises summer, not least because it was the only month that was completely devoid of school days. In South Wales we lived only a few minutes' walk from the beach, and even from home one could hear the faint sounds of everyone enjoying themselves carried up on a warm breeze (our house was called "Awel-y-Môr", which is Welsh for "Sea Breezes", although there were times when "tymestl yn oernadu"/ "howling gales" might have been more appropriate!). I'm pretty sure that our beach was not highly populated with City bigwigs on their holidays, but as we enter August there are, as ever, plenty of warnings that markets could be unsettled by any unexpected bad news when liquidity is in shorter supply than usual owing to "key decision makers" being away. And this year the situation might be exacerbated by the holiday backlog, given the fact that very few people have been willing or able to take as much as leave as normal during the pandemic. Also, given constant warnings of a resurgence of cases during the autumn and winter, there's a sense of "make hay while the sun shines".

Having said all that, just because the conditions might be ripe for a bout of volatility, it doesn't necessarily mean there will be a trigger. Indeed, one must go back to August 2015 to find the last time we had to convene an "emergency" asset allocation committee meeting (we normally suspend all committees during August). That was on account of China's surprise "devaluation" of the yuan, which they then claimed was nothing of the sort. Even so, it sent shock waves through the system, signalling a weaker underlying trend in the country's economy, and eventually leading to a rout in the commodities sector – a situation that was made worse in the autumn by OPEC and Russia joining forces to drive the oil price down with a view to putting the United States' shale oil industry out of business

Six years later, though, the results of that episode are being seen in a way that was certainly not envisaged at the time. The big falls in commodity prices presented an existential threat to the highly leveraged commodity producers, who had been living high on the hog of post-financial crisis Chinese demand which they expected to be maintained in perpetuity. There was a rapid reassessment of capital expenditure

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requirements and balance sheets were repaired. That has led us to a position today where companies in the Energy and Mining sectors are generating surplus cash hand over fist and rewarding shareholders with juicy dividends. It is also contributing to the rise in overall inflation, as the supply of some commodities cannot keep up with resurgent demand. And there is little sign yet that producers are in the mood to reverse their austerity drive. Environmental and social factors are also increasingly weighing on the progress of new extraction projects. Still, it's all a reminder of the cyclicality of financial markets, and that opportunity often arises out of adversity.

China's authorities have been springing a few more surprises on investors recently, although it's not yet entirely clear what the ensuing opportunities might be. It all started off with the postponement of Ant Financial's Initial Public Offering in Hong Kong last October. Ant is the part of technology conglomerate Alibaba that controls the Alipay online payments company, whose services are used by more than a billion people. It seemed at the time that the authorities were reining in the influence of Alibaba's founder Jack Ma, following critical comments he had made about the predominantly state-controlled banking system. Ma himself mysteriously disappeared from public view for several months, before reappearing as a more contrite character than he had been.

There was more justification given for undertaking a review of Ant's activities in that its enormous cash deposits were undermining the stability of the traditional banking sector. Therefore, it would be subjected to more stringent regulation. On the face of it, that is not unreasonable. Some of China's unregulated financial activities, notably the selling of "wealth management" products (nothing like what that label means in the UK), have seen investments come to a sticky end after initially offering incredibly attractive "guaranteed" returns.

There was a relatively limited reaction to the Ant situation initially, as it was seen as a specific case. However, there were further subsequent interventions, which gradually undermined investors' confidence in China's technology giants. These included a crackdown on Tencent's music licensing business and then the threat of huge fines for ride-hailing company Didi, which was accused of illegally collecting personal data from users. One can only assume that such activity is the sole prerogative of the government! The Didi news came just days after its own listing in the United States, sending the share price sharply lower, which was seen in some quarters as a deliberate kick in the shins to US investors.

The final straw came just over a week ago, though, and took everyone by surprise. Notice was served that private education companies - mainly those involved in tutoring outside normal school hours - must convert themselves into non-profit entities. This wiped out billions of dollars' worth of equity value. This time though, the emphasis was placed more on the social benefits of lowering the cost of education, as it would encourage families to have more children. A similar social angle was also evident in an investigation into the pay and working conditions of delivery drivers at Meituan, the local leader in the food delivery market.

It's hard to know exactly what is going on here, but it certainly looks as though corporate profits, in some sectors at least, are subservient to the goals of the Chinese Communist Party (CCP). And there is definitely no sugar-coating on the pill for investors, especially foreigners (with the main emphasis on the US). It does little to make one feel more confident about any short-term rapprochement between the world's two largest powers.

We have been of the opinion for some time that the unwritten contract between the CCP and the citizens of China runs along the lines of "we improve your lives and you let us run the country". Taken at face value, what China is doing to "level up" the playing field for its citizens is reminiscent of what governments in the West are offering their voters. The big difference for China's government is that it does not have to

pay heed to the ballot box and can therefore make dramatic policy interventions without warning or fear of backlash, which creates its own risk of market volatility. The positive take is that moves such as these create a more sustainable platform for increased consumption in the longer term. As with the events of 2015, there will most probably be a silver lining, but the clouds have yet to part sufficiently for it to be clearly visible.

I'm not quite going to relive my childhood with no "school days" in August, but this is my last Weekly Digest until we are on the other side of the Bank Holiday weekend. Unlike some other publications that take the summer off, this one will be entrusted to a few of my colleagues who will provide you with their own refreshing insights into financial markets. In the meantime, I hope everyone manages to get some sand between their toes for at least a few days.

Last week's Economic Highlights

FTSE 100 Weekly Winners

Company	Change
Fresnillo PLC	9.8%
Anglo American plc	7.6%
Rentokil Initial plc	7.1%
Croda International Plc	6.2%
Royal Dutch Shell Plc Class B	5.8%
Royal Dutch Shell Plc Class A	5.7%
Just Eat Takeaway.com N.V.	4.6%

FTSE 100 Weekly Losers

Company	Change
Reckitt Benckiser Group plc	-11.8%
Weir Group PLC	-9.0%
Intertek Group plc	-7.8%
BT Group plc	-6.0%
Smith & Nephew PLC	-6.0%
Royal Mail plc	-5.4%
SSE plc	-5.0%

FTSE 100 Index, Past 12 months

Source: Factset

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