Our Weekly Paid Newsletter

Richard Cluver Predicts

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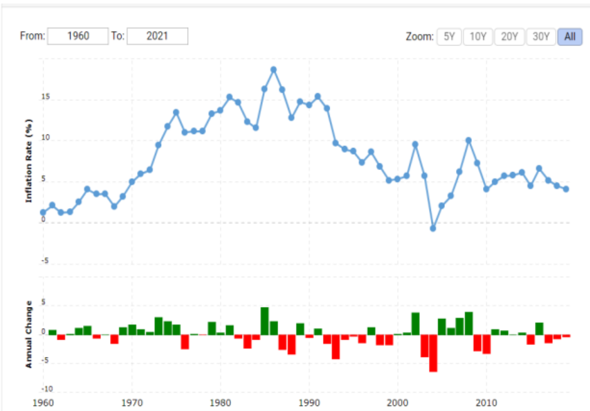
Back in the 1970s when anyone with half an interest in economics would open a newspaper you could virtually guarantee that "…cost push..." and "...demand pull" would be phrases that would leap out at you and, furthermore, everyone was then familiar with them.

Today, probably not so because we have lived through one of the longest deflationary eras of modern history. But back then inflation was a global problem that consumed nearly everyone; it was the hidden tax which was destroying life savings and stripping salary and wage earners of their buying power at an alarming daily rate. Everyone then clearly understood that if you were likely to need to buy a big-ticket item like a house, a car or even a new refrigerator you should waste no time in buying it because tomorrow it was likely to cost far more than today.

The result was the phenomenon of "Demand pull inflation," because producers were struggling to get their goods into the stores fast enough to meet public demand. It accordingly paid them to keep factories running 24 hours a day and to pay top dollar to attract the best employees in order to get their goods out of the factory door as quickly as possible. Naturally, because of the laws of supply and demand, prices tended to rise as a consequence and every worker naturally expected his employer to give him a double digit annual pay increment in order that he might, in real (inflation adjusted) terms just be able to maintain his own buying power out in the marketplace of the world.

The big problem, of course, was that the economic cycle itself was as a result constantly accelerating and so everyone tended to price both their goods and their wage demands higher than the official inflation rate and so inflation itself became an exponential equation based even more upon expectations than upon the normal market dynamics. It had become deeply entrenched into society.

There was also another partial consequence which they named "Cost-Push Inflation" which was the result of the rising input cost of factory raw materials. Wise manufacturers accordingly tried to get into long-term supply contracts at fixed prices so as to be able to fix their materials costs while simultaneously benefitting from being able to pass on ever-higher sales prices for their products. Not-so-smart suppliers, who entered such contracts because they seemed to offer continuity of business, soon went broke when their own costs overwhelmed them. So it was a time fraught with uncertainty, but in one aspect things looked good because investors, looking to protect their savings, saw the stock market as the perfect hedge against inflation and blue chip share prices soared.



Coming from a long period of relatively stable prices, the first part of the story probably sounds quite attractive. Who, you might ask, would not want to be sure of a steady stream of shoppers rushing to buy from their shops? It sounds a whole lot better than a recession when customers tend to count their pennies very carefully before going out to spend. The problem, however, is that the whole process is very unstable and, that as the public learns to live with inflation, the consequence is that it can quite quickly become a runaway problem when both aspects of inflation come together as a self-sustaining force. So the graph on the right illustrates, how in South Africa, inflation climbed as a consequence of the forces I have just described to a peak of 18.5 percent in 1986 from a low of 1.99 percent in 1968.

Ending the cycle, as folk who lived through the subsequent period between 1986 and 2004 can uncomfortably attest, required massive global austerity. Aggressively increased interest rates imposed a huge hidden tax on individual spending power, effectively preventing ordinary folk from affording to buy anything other than necessities. That cut out the "demand pull" part of the equation and gradually price inflation came down.

But it was not without instability. The wealthy few who could afford to invest on the share market prospered through the process as my next graph illustrates. JSE share prices soared in value at a compound annual average rate of 60 percent until, in October of 1987, the bottom fell out and prices crashed. Between then and the second week of November the average share price fell 40 percent. Shares recovered briefly until November 27 and then fell again in a gut-wrenching further phase until they finally bottomed in February 1988.

Overall, the decline was 45 percent and it destroyed many fortunes. But the resultant destruction of money was massively deflationary and so it also finally killed off inflation which in turn ushered in the period of relative price stability we have since lived with.

Of course the smart few could visualise what was coming and, overcoming their natural greed which had been the consequence of seeing their paper profits soaring day by day as the share market had climbed, they sold their shares and created a cash pile ahead of the crash which, less than a year later, allowed them to buy back their previous shareholdings at bargain basement prices. They were the fortunate ones. Far less fortunate were the majority of small investors who retreated licking their wounds and vowing never again to enter the share market. **But by then half their life savings were gone!**

Why do I seek to remind readers of that awful period in global history? Well, it's all coming back with a vengeance because now we have the simultaneous combination of both cost push and demand pull forces mounting rapidly in a lethal monetary cocktail. In their rush to counter the recessionary impact of the Covid pandemic governments and central banks created more fiat money than the world has ever seen in so short a time and, as economies have begun recovering, pent-up public demand for air travel, holidays, restaurant meals and social drinking is pointing the way to an unprecedented phase of free spending the like of which none of us have ever before witnessed.

The markets have, of course, seen it all before and they have an uncanny way of foretelling the future. So, in the graph below – denoted by a red trend line - consider how New York's Nasdaq climbed at compound 21 percent annually between 2009 and 2018 under the influence of central bank monetary expansion: they named it Quantative Easing but it was just old fashioned money printing with a fancy new name. There was a pause to reflect in 2018-19, a last hiatus and then the Covid crash which I warned readers about in my book The Crash of 2020.

Then, to bring us to the present, the central banks of the world united to pour money into the system to stave off a Covid-induced economic depression. Of course they inevitably overdid it. Then, not to be outdone and obviously seeking a public seal of approval after a bitterly-contested election, new US President Joe Biden came to the party and poured petrol on the flames with the biggest additional stimulus package the US has ever seen; one of unprecedented proportions.

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Finally, add into this now roaring monetary furnace a new group of retail share market investors who, with fistfuls of Biden dollars to spend and fractional share ownership available to them for the first time in history making big-ticket shares available to ordinary folk who could never before afford them, and you might now understand why share markets were suddenly primed with rocket fuel. That's why markets have lately been climbing at a compound annualised rate of 125 percent as denoted by my green trend line on the graph below…as far as I can ascertain it is the fastest growth rate in living memory!

So now it is time to underscore the fact that mankind never seems to learn the lessons of the past and so we keep on making the same old mistakes. I thus thought it was timely to take readers back to another period when the world was climbing out of a pandemic known as the "1918 Spanish Flu." Back then they were running the money printing presses in a similar fashion to the present, creating new money out of thin air to ward off pandemic job losses and also to pay off the 1914-18 US war debt. America had just created the US Federal Reserve and, through a partial relaxation of the strict monetary standards imposed by a gold-backed dollar, they were able to create fiat money on a scale the like of which the United States had never seen before. And initially the moves were immensely popular because they seemed to launch a new wave of great prosperity for all.

It laid the foundations for a period known as the "Roaring 20s" which was the visible effect of all the extra money they had created." But monetary inflation was the initially less visible but also inevitable consequence. Recognising that their assets were under threat, the well-informed wealthy rushed to the stock exchange as a hedge against the collapsing value of the Dollar. Inevitably then, as now, share prices rose to ride a wave of capital gains.

The graph on the next page shows the course of New York's Dow Jones Industrial index which climbed at compound 13.4 percent annually between 1921 and 1928 before it really got going as ordinary folk cottoned on to what had formerly been the exclusive preserve of the wealthy. Using easy credit, the latter piled mindlessly into a marketplace that few really understood, often chasing the latest fad-offering that might have had no realistic underlying value. Soon the Dow began to reflect the new madness and from June 1928 to October 28 1929 it rose at compound 43 percent before, on a day that is forever etched in economic history as Black Tuesday, it began a horrific crash.

The resultant destruction of money created a deflationary wave which ushered in one of the worst periods of joblessness the modern world has ever experienced, the Great Depression.

Of course, a century later the world might perhaps be forgiven for forgetting the lessons of the past. But I am not sure that we can offer the same excuse to our central bankers who should surely have some economic history on their CVs. But perhaps not. They think they know better and are offering us something called Modern Monetary Theory which seeks to debunk history.

Meanwhile, the NASDAQ has given us its first real warning. Analysts call what I have graphed below an inverted head and shoulders formation. Often it presages a catastrophic price decline.

Just saying!

So what are the underlying parallels? Who would have guessed that computer chips would take the strain following the Texas deep freeze last February when temperatures reached their coldest levels in 30 years and the power grid collapsed? NXP Semiconductor was forced to halt manufacturing at two Texas facilities, while Samsung and Infineon Technologies both shut down.

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The result has been a backlog of semiconductor supply that is expected to take a year to correct itself. Meanwhile, if you need chips you have to pay the price. In the process motor vehicle production lines have stalled all over the world and items like laptop computers have increased 25 percent in price. That's what we call supply interruption cost-push inflation. But demand pull is also present as US second hand car prices attest. People are out there spending that surplus Biden cash!

Meanwhile the post Covid industrial recovery in China has sent the demand for industrial metals soaring. Prices for hot-rolled coil, a benchmark steel product, are up threefold in North America from pandemic lows and they are also soaring in Europe. In China, which has already enjoyed a year of robust demand, steel is the most expensive since 2008.

After a volatile 2019, zinc prices started 2020 trading at US$2,297 per tonne. With the Coronavirus hitting the market hard, prices had sunk by March to their lowest level of the year at US$1,773.50. But the second half of 2020 told a different story for zinc, with prices rising above US$2,800.

"Zinc's price rise has rallied far above our expectations," said Helen O'Cleary of CRU Group. This week it reached $2 942.

Meanwhile, note my graph on the right, a key indicator of industrial activity, the copper price, has been rising at compound 106 percent with no sign of a slow-down.

Gold bullion is a key indicator of inflationary expectations and so it is worthwhile considering my next graph which shows that since late March gold has been rising at compound 102 percent. Note the graph below:

Meanwhile, a year ago crude oil producers were paying tanker companies to take away their product because their own storage tanks were full to overflowing. As my next graph below makes clear, the price of Brent crude broke this week above 70 dollars a barrel in part of an unrelenting rise at compound 237 percent.

But the surest proof that the market is expecting inflation to rise is the performance of 10-year US treasury bonds. I have shown you this graph a few times recently because it is impossible to ignore. Note my graph on the next page, that from August last year until the end of March, 10-year T Bonds were rising at compound 526 percent. Since the end of March, however, they have been retreating at an annualized rate of 66.5 percent which suggests that for now, inflation fears might have subsided a little.

But, like the 1980s, investors are now alert to the fact that inflation is a threat and they have begun shopping like there is no tomorrow……because costs of items like cars are soaring.

Meanwhile politicians are mounting a campaign of reassurance that inflation is a temporary phenomenon. It cannot be so given the entrenched price gains of the commodity markets which are now becoming protracted. But there is another sinister fact. Governments worldwide have never been as deeply indebted as they are now and there is only one way to get out from under a sovereign debt burden……. you allow inflation to destroy the value of the currency in which the debt is denoted! As I have said, inflation is a hidden tax that hits the poor and the pensioner the worst but it is the only realistic way that governments can get out of debt once they are unable to raise taxes any further!

If you would like a more detailed explanation, you should read my book 'The Crash of 2020.' You can order it now off the ShareFinder website. I warned readers then that all of this was coming.

Do enjoy your weekend!

The month ahead:

New York's SP500: I correctly forecast a decline which I saw lasting until early August followed by a recovery until late November ahead of the next decline.

Nasdaq: I correctly predicted declines. Now it is likely to be a volatile sideways trend until early September followed by a recovery until early December.

London's Footsie: I correctly predicted a decline until October together with the current short-term recovery which should now be over followed by a protracted decline through to next April.

Germany's Dax: I correctly predicted that the declines which began in mid-April will continue well into the New Year.

France's Cac 40: I correctly predicted the start of volatile declines likely to last for the rest of the year.

Hong Kong's Hangsen: I correctly predicted a long slide down to mid-July and then a partial recovery to the end of the year before another slide begins.

Japan's Nikkei: I correctly predicted the declines that are likely to continue until mid-June followed by a partial recovery until the end of October ahead of steep declines thereafter well into the New Year.

Australia's All Ordinaries: I correctly predicted a fresh bear phase from mid-May until mid-September followed by a short recovery until the end of November when another slide is likely.

JSE Top 40 Index: I correctly predicted the start of a long volatile slide until early September followed by a brief recovery to early October and then a further slide until mid-February.

ShareFinder JSE Blue Chip Index: I wrongly predicted the beginning of a volatile decline likely to last well into next year. However, the present up-trend is likely to be transitory and over by mid to late June.

Rand/Dollar: I correctly forecast gains to the end of June followed by weakness until late September and then further gains until mid-October and then a longer period of weakness that could reverse many of the present gains.

Rand/Euro: I correctly forecast gains which I continue to see lasting until early September when a long reversal is likely to begin.

The Predicts accuracy rate on a running average basis since January 2001 has been 86.21 percent. For the past 12 months it has been 92.88 percent.

CHRIS GILMOUR: How Covid-19 is affecting inflation

Republished from Business Day

Global equity markets have been rocked recently by the spectre of inflation and associated higher interest rates returning. Once inflation is left unchecked for a while, it is very difficult to get it under control again. So it is important to understand the root causes of the current spike in inflation and determine which are structural and which are cyclical.

Much of the reduction in inflation in the past couple of decades has been due to technology driving down the cost of manufactured goods, coupled with much of that production being outsourced to low-wage economies such as those found in Southeast Asia.

Technology will probably carry on driving down the cost of goods, but globalisation may be capped by a desire of many countries to bring back manufacturing onshore and away from the Far East.

If so, this would be a structural change in an inflation vector and could presage a sustained rise in costs and inflation. While establishing greater onshoring of supply chains aids employment in local economies, it goes completely against the grain of the basic tenet of the law of comparative advantage.

While many consumers experienced temporary food shortages in the early days of lockdown, that passed quickly, as people realised that food security wasn't an issue. However, the physical cost of food production has risen, due to a variety of Covid-19-related events.

Social-distancing measures have increased the cost of food production. Covid-19 outbreaks in meat packing plants around the world have often resulted in these packing centres reducing the number of staff, which has crimped productivity. Pandemic legislation often dictates that trucks may have only one driver instead of two, which means more rest stops and longer delivery times — all of which ramp up costs. While acute, it is an example of a transitory event that will pass once Covid-19 restrictions have been lifted.

The UN Food & Agricultural Organisation (FAO) maintains indices of food prices, a measure of the monthly change in international prices of a basket of food commodities. The overall FAO food price index was 30.8% higher in April 2021 than April a year earlier. Cereals were 26% higher, dairy products 24% higher, meat 5% higher and sugar almost 60% higher than in the previous April. Once again, while acute, the effect is likely to be reversed once base effects are eliminated.

But many hard commodities have surged. Iron ore and copper, for example, have reached new highs and there are few, if any, signs of that momentum slowing. The genesis of this appears to be a structural change in demand for these metals, with enhanced electric vehicle production being the prime reason for sustained high demand.

After a year of staying at home and only wearing casual clothes, people are starting to go clothes shopping again and supply isn't keeping up with demand. This phenomenon has been worsened by stimulus, in the US especially where cash-flush consumers are price-insensitive and are splashing out after a year of enforced home living. A transitory effect that will reverse once more normal living returns.

Probably the most talked-about shortages relate to motor car electronic componentry and, specifically, semiconductors.

Shortages arose here due to global motor manufacturers reducing production significantly when the pandemic started and cancelling orders for semiconductors. Prices of second-hand cars in the US increased by 20% in the first four months of 2021. This may be partly driven by stimulus and partly by a shortage of new cars due to the ongoing semiconductor scarcity. The situation will probably persist for the whole of 2021 and well into 2022.

All factors considered, it seems most of them, though certainly not all, will abate once pandemic restrictions are relaxed. However, other factors such as shifts to electric vehicles and greater onshoring of production should result in structurally higher inflation. It is, therefore, perhaps worth considering including a small gold exposure as an inflation hedge in prudent portfolios.

Should you buy cryptocurrencies? Which ones? Expert insights – multinational investment firm CEO

by Jarryd Neves for Biznews

Are cryptocurrencies the new gold? Should you build a digital currency portfolio and, if so, which ones should you choose? Kunal Sawhney, CEO of Kalkine Group – a multinational equity research firm – spoke to BizNews from his headquarters in Sydney, Australia about Bitcoin and alternative cryptocurrencies like meme-inspired Dogecoin. He shares how mathematicians and computer scientists are likely to replace traditional equity analysts at investment firms as younger investors embrace the digital economy.

We are finding that more people are speculating on cryptocurrency. The reason I use the word speculating, is that right now we are not seeing a lot of usage in real life. I haven't seen people buying coffee or breakfast with cryptocurrency – but people are trading it quite a bit, using platforms like Coinbase and Luno. There is a lot of trading and speculating happening on these currencies right now. There's also a lot of fascination with cryptocurrencies because people have read about others making billions or millions of dollars on cryptocurrency.

On whether cryptocurrency is a bubble:

We don't believe it's a bubble. We believe it's here to stay [and that] it's for the long term. The world's leading cryptocurrency, Bitcoin, has gone above the $50,000 mark recently. I think it went as high as $60,000 after Elon Musk invested in it.

Cryptocurrencies are being looked upon as the future of payment and [the] of future of settlement systems as well – where people can settle a big amount of transactions using cryptocurrency.
The other thing that we are seeing is [that more] central banks want to regulate it. That is also coming into play – it might become mainstream in a in a very short time span. The international apex authority of banks, Bank of International Settlements and other central banks have concluded that there is no harm to monetary and financial stability in the coexistence of a conventional dollar or pound based system and digital currency. This is a very good thing which has happened lately, where the central banks are saying that these things can coexist.

On building a cryptocurrency portfolio:

I think it depends on how much you plan to invest. Obviously, everyone knows Bitcoin. Bitcoin is one which is the most expensive. Then we have Bitcoin cash, Litecoin, Ethereum and Stellar. The key thing over here is that cryptocurrencies are for different kinds of investors – someone who can take a high level of risk and who can basically have the appetite to lose 25%-30% value in a day. They are very speculative still. One has to be very careful. I would not use the word investment; I would use the word speculation – because right now there is a lot of speculation happening on cryptocurrencies.
The main reason is most cryptocurrencies listed have limited supply of coins to keep the balance in check and to reinforce the value of these things. There is a fixed number of Bitcoins as decided by the creators of Bitcoin – though some remain to be mined. That's where there's a lot of mining happening. One of the disadvantages that people talk about of Bitcoin mining – or of cryptocurrency mining – is the CO_2 emissions, because you need a lot of computing power to do that. There is a limited amount of cryptocurrency and hence the value for them keeps on going up. They say cryptocurrency is the new gold, because it's very similar to gold They're saying it's a safe haven asset, limited amount. People are more inclined to invest in cryptocurrencies rather than gold.

On Coinbase:

I think the first step in investing in Bitcoin or any cryptocurrency is that you need to have a good platform. Coinbase is one of the best platforms. Once again, the US listing shows the amount of interest there is in Coinbase and in cryptocurrency. What we have to look at, besides Bitcoin, there are 95 other digital assets that have a market cap of about $1bn. I think Coinbase is really going to take advantage of all these 95 digital assets. This is really going to help the cryptocurrency market, having a good, solid coin broker/player in the market.