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MELLON ON THE MARKETS

By Jim Mellon

How to make money in 2018

It's that time of the year again: when the pundits look back and either tell you "I told you so", or "mea culpa", or some variant in between. I don't really like looking back – except where the past holds some lessons for the future – but it sure has been an "interesting" year.

Bond yields have remained pretty flat over the past twelve months, but there are now clear signs of stress in credit. One indication is the severe flattening of the US yield curve, and another is that high yield debt is now coming under pressure. World money supply is no longer growing, and there is mounting evidence of a looming shortage of US dollars emerging, which could put the US currency bear phase into reverse next year. All the usual caveats – China, North Korea, Catalonia, Trump and Brexit, inter alia – still can't hold back the enthusiastic wave of dumb money. This wave has, in the words of Professor Scott Galloway of NYU, led to unprecedented multiples and zero accountability in the FANG world, of which I have written about at length for the past year (and will come back to later in this piece).

Bull markets around the world look increasingly narrow, with ever more rapid-paced rotation taking place, a phenomenon which normally marks a top formation. And of course, there is the cryptocurrency mania, which defies rational explanation – unless you believe that there are enough tax dodgers, dark web buyers and money launderers out there to justify the sprouting of the various offshoots of bitcoin, which now proliferate like colourful new tulip bulbs. I take a neutral (i.e. ignorant) view on bitcoin, as what cant' be readily understood cannot be properly judged. Indignation (of not understanding it) is usually envy dressed up with a halo, and I don't want to fall into that particular trap. My mole in the crypto world – he who has made a lot of money for his investors (me included) by being a committed bull – is even now taking some money off the table (only with difficulty can the coins be converted into spendable cash). This tells you a lot of what you need to know. It's not time to jump into the pool, just as it is beginning to drain. By this, I don't mean that the price has peaked – it may not have done – but the upside from \$100 to \$20,000 is a lot greater than any potential upside from here. It is estimated that just 1,000 people in the Bay Area own about 40% of all bitcoin, adding to the weight of money that no doubt will one day see San Francisco sink into the sea. That is, if the earthquake doesn't get them first.

But, it is a fact that bubbles can go on for a lot longer than even veterans of such things can imagine; and they can deflate and reflate as well. For instance, Amazon was $70 a share in 1999, fell to $6 in 2001, and is now (at time of writing) above $1,150. Who knows what the trajectory of bitcoin et al will be? At this level, who cares, except for those playing the game?

Much more importantly, how can we make money in 2018? Here are a few observations. These are not of the famous ilk of the "outrageous" predictions, which are from time to time promulgated as Festive Crackers by a friend of mine, but rather practical ones to advise what one can do in a (mostly) low return world.

1. Bonds, with the possible exception of index linked UK gilts, remain a near universal sell. There is no upside in lending to governments or corporations at a time of increased debt loads, insidious and mounting wage pressures (which are bound to be inflationary) and increased credit risks. If I were the UK government, I would (well done, Jeremy Corbyn) borrow vast amounts of money to invest in infrastructure, education and science – money repayable at the longest possible duration. It is most unlikely that the return on the debt would be less than the cost of the borrowing. Even the dumbest government officials – and there are plenty of those – must be thinking along these lines. I expect that the Germans and others are also so ruminating.

2. The eurozone, fuelled by massive but decreasing money printing, will not remain the momentum machine it is now hyped up to be. It still has vast problems, and my best guess is that the euro falls against the dollar and the pound in the next year, by as much as 10%. The combination of turbulent political issues, most notably the German coalition of the unwilling – which is being tortuously stitched together – as well as a probable slowdown in export growth, will put the euro under pressure. Certainly, some European stocks, notably **Unibail Rodamco (UL:NA)** (the company buying Westfield at the moment), **Total (LON:TTA)** (the French oil company), and the British firm **GlaxoSmithKline (LON:GSK)** (which has got an excellent new drug prospect in Multiple Myeloma, as well as a 6% plus yield) are all interesting in Europe/UK. I also continue to favour **Novartis (VTX:NOVN)**, the Swiss drug behemoth which boasts a reasonable yield and is the most advanced major in terms of pro-longevity science.

3. This *will* be the year of the FANG denouement. Ian Bremmer of Eurasia, a very respected commentator, believes that Facebook, Google et al's lawyers can outsmart any government lawyers – and anywhere – but I

am not so sure. I think the weight of public opinion against these companies is becoming heavier and heavier. This is because of their low tax loving cultures (in the past 10 years Amazon has paid less that $2 billion in taxes, whereas for Walmart, its major competitor in the US, it has been over $64 billion!). The FANGs are not deliberately doing bad stuff; they are just being given the opportunity to give capitalism a bad name. They are carefully avoiding the label of being media companies, claiming to be technology platforms, when in fact they are the principal source of “news“ for many, many people. The rectification of this clear anomaly, plus fines for monopolistic behaviour, and the imposition of normalised taxes – as well as questioning as to whether they are beginning to saturate their markets – make them the clearest fundamental sells I have ever seen.

4. Japan remains a buy, and my target is now 30,000 for the Nikkei in 2018, up from my previous target of 25,000, which is now close to being achieved. The PE of the Japanese market is about 14x forward, balance sheets and corporate governance are improving, and the yen is undervalued. If you want to hold a major market (and cash is not a bad alternative to any market) consider Japan. The banks there look particularly attractive, as there is a vague hint of rising interest rates in the air.

5. Gold and silver are up by about 8% in 2017. Normally, that would have been a lot more, but I feel that bitcoin has diverted a lot of speculative activity away from the precious metals complex. I am pretty sure that the yellow metal will regain lustre in the coming year, and I make a bold forecast of at least $1,600 on gold by year end 2018.

6. US stocks to buy – well I remain committed to **Gilead (NASDAQ:GILD)** – cash rich, innovative, aggressive and cheap US leader in biotech – and I also think that **Editas (NASDAQ:EDIT)** in the gene editing space and **Adaptimmune (NASDAQ:ADAP)** in the cancer immune therapy area look interesting.

7. In the mining area, among the smaller companies I follow/and or invest in, I like the look of **Zenith Minerals (ASX:ZNC)** in Australia, with interesting upside in lithium and gold assets. Recall that previous Master Investor winners from this same stable have included **Syrah (ASX:SYR)**, **Triton (ASX:TON)**, and **Critical Elements (CVE:CRE)**, all of which have provided more than 10x returns.

I would like to give a recommendation for each of the Twelve Days of Christmas, but I have run out of ideas and space, so I will just wish all readers a Happy Christmas instead. Don’t forget to book your entry to the Master Investor show taking place on 17th March next year. It's going to be amazing, and there is nothing else like it in the UK.

Happy Hunting!

Jim Mellon

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