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MELLON ON THE MARKETS

By Jim Mellon

Google and the UK Property Market Might be Headed the Same Way

I made a speech a few days ago to a gathering of property entrepreneurs in London. I intended to speak of my excitement about the new science surrounding longevity – and I did – but I think had I not mentioned property I would have been lynched!

So I improvised some thoughts on real estate, and particularly about the UK property market. What is clear to me is that British, and London property in particular, remains generally overvalued relative to the incomes of the average people buying it. Although sterling's fall has made some property more interesting to foreign investors, this is more than offset by the overbuilding that is evident everywhere in the capital and in the major regional cities.

In addition, George Osborne's politically calculated increase in stamp duty (soak the rich!) has backfired, as has so much of what he did. Stamp duty only brings in about 2% of government income, but it has a disproportionately high impact on property sales, which have fallen sharply in recent months. The friction costs of UK property as an investment, already high, are now among the highest in the world, and although there is plenty of pent up demand for housing, squeezing landlords, first time buyers and developers isn't going to solve any crisis.

So, my on-the-spot rumination led me to bet the current Chancellor reverses stamp duty increases, which will probably lead to a short-term bump for real estate. But short-term it will be, because the key issues of affordability, rising interest rates and overbuilding of multi-storey apartment buildings remain.

I would generally stay well away from anything to do with UK property, and I wouldn't be surprised to see a fall of 20-30 percent in the next few years. That's a big fall, and will drag developers, overexposed banks, estate agents and some builders down with it. Even if it doesn't go down that much, it sure as heck isn't going up, so be careful. If you are in the market for a house or flat, my advice is… wait! If you must buy one, put in low ball bids. You might just get lucky. There is a whiff of desperation in the air.

Of course, the smart operators will always find a way to make money, but I know from experience that when developers are offering high interest rates on "short-term" loans with supposedly high security, there is real distress in the market.

Now, of course, inflation will eventually find its way into property prices, and inflation is coming back – with a vengeance. For the UK, it's a combination of devalued sterling pushing up import prices, the delayed effect of monetary easing, the end of the Chinese goods deflationary period, but most importantly the "gig" economy is significantly underpaid and the workers want more!

There's a great article in this week's New Yorker about Uber drivers (in the States – but this could just as well apply in the UK). They are making less and less money and working ludicrously long hours, borrowing to buy their cars, and facing higher fuel prices. They and all the other "gig" army people (Deliveroo workers, Sports Direct workers, Amazon packers etc.) have been the backbone of the low wage economy for years now and have been the main reason behind the very low levels of unemployment.

My view is that something has got to give. While I am not for formal pay caps for company managers, I *am* in favour of remuneration at the boardroom level being much more closely related to performance and subject to much greater scrutiny.

Despite the lurid headlines, it isn't true that the world is getting more unequal – in fact quite the opposite. But for the employees – and there are millions of them – who form the "precariat" in the UK (and in most other developed nations), life is just too miserable and employment conditions are basically feudal.

The effect of this – and I think it will be a global phenomenon – is that corporate profits as a share of GDP will start going down soon, and labour's share will start going up. Already, minimum wages are rising fast in the US (they can't go up too fast or workers will be replaced by machines), and the unemployment rate continues to fall, as it does in the UK.

This is where the bulk of the inflation is going to come from in the next few years – higher wages for low paid employees – and my guess is that with additional fuel being added by improved bank lending, still loose monetary policy and competitive devaluations everywhere, we could really see some spiky inflation, higher interest rates and ultimately a deep recession.

In those circumstances, load up on gold and silver – I still hold that view, which was a Master Investor 2016 recommendation. Love anything to do with gold, because it is your surest protection against inflation..

Keep selling all bonds, particularly those of the eurozone periphery (and I see that Mr Trump's new ambassador to the EU agrees with me that the common currency will be obsolete soon). I don't have a strong view on many currencies right now, except that the pound is undervalued against the Euro and that the Mexican peso looks dramatically oversold. We did very well shorting the Japanese yen and then buying it back but it's in a neutral range now. Inflation will probably be good for the Australian dollar; I've reversed my long standing short on that one and am now long.

When Al Chalabi and I published *Fast Forward* a couple of years ago, we had one solid recommendation that encapsulated everything in the book: buy Google (now **Alphabet**

(NASDAQ:GOOGL)). Since then, it's up by 49% and the Fast Forward (LON:FFWD) company we listed is up, weirdly, by the same since listing.

Google once looked like the future – driverless cars, medical innovation, space, AI and machine learning, quantum computing – all rolled into one package. But I now think Alphabet is a huge short, as indeed is Facebook (NASDAQ:FB) – but for different reasons. I suspect hubris is creeping into Google's ranks – or put another way, it's just been too easy for them to make money. In summertime, the parties of the Mediterranean are littered with Google executives living high on the hog, and why not?

But this is coming at the expense of the former dynamism of the business. Results released yesterday show expenses soaring as more money is thrown away on quixotic ventures. Meanwhile, the key ad business is slowing and Google is facing competition from other digital platforms.

The fresh-faced enthusiasm the company exhibited 20 years ago has waned, and the rumour is that most of their side ventures are failing. All the while, there is a serious risk that the main search engine might even be regulated (and with it, its returns) as a quasi-utility sometime in the not-too-distant future.

But of course, being the sensitive soul that I am, I have a personal story to relate. Subscribers know that I am researching a new book, and am shortly going to the US to conduct some interviews. I am fortunate to be meeting some seriously big hitters in the longevity field, including leading scientists (Nobel Prize winner included), institutions and companies.

The *only* company which declined to meet was Google's medical venture, Calico. No reason given. That's despite the fact I know a Top Dog at Google!

Since Google was founded on the principle of bettering humanity, one might imagine that there is no better way to further humanity than by keeping people alive in a healthy state for longer – it's surprising that they don't want to explain what they are doing.

Among the many harsh lessons I have learnt in my career (and I know I'm not as rich as the Croesus-like gods who run Google!) is that hubris is the first sign of a flawed enterprise.

It's time to short Alphabet.

Happy hunting!
Jim Mellon
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