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MELLON ON THE MARKETS

By Jim Mellon

The times they are a changing

I was recently invited to a Conservative Party lunch hosted by the City and Westminster Tory Association. It was a jolly affair, with hundreds of well-oiled attendees, and despite the recent electoral setback, the mood appeared quite upbeat.

Mrs May, to her credit given the recent events, made a formulaic speech that was well received, despite the fact that it was a riff on the strong and stable campaign speeches (but with stable and strong being the new inverted word flourish!).

But of course, everyone knows she's on the way out – the only question is: *When?* And who will succeed her? It's interesting watching Conservatives at work – they really are a ruthless bunch. They do smile while they're knifing you in the back, which is a consolation.

It's pretty clear to me that the successor will be David Davis, with Boris running a couple of lengths behind. I've met Davis, and think quite highly of him; he's a pragmatic fellow, and despite being an ardent Brexiteer, seems to get on well with the Eurocracy, being of a similar vintage to the leaders of the Brussels empire.

I quite like the way the UK government is now going to have to work hard, to compromise and to be innovative to get some sort of programme into law. Modest stress (see the upcoming Juvenescence book!) is good for us, and it will probably be good for the government, notwithstanding the chaos that seems to be its current hallmark.

A more reasoned version of Brexit, without bombast and idiocy, a less assertive industrial policy than the one previously advocated by May and her Rasputin like advisers, and a reformed welfare strategy may well be a positive outcome as a result of the electoral shock on 8th June.

The idea that Labour will get into power is fanciful; we have probably reached peak Corbynism, and although the economy may be softening slightly due to consumer fatigue, manufacturers and exporters are experiencing record orders, and UK Plc is generally doing well.

It absolutely amazes me that despite the clear superiority of our British flexible economic model, so many domestic commentators keep making dire prognostications about Britain's future. They couple their unwarranted and invariably wrong prognostications with news from the Continent of surging growth, of renewed optimism and of competent governance – none of which is really true.

Sure, there is some modest, albeit unbalanced, growth happening in the Eurozone, and an obvious retreat is underway for the forces of anti-European populism. There is also a possibility that France just might institute some urgently needed reforms – but all of these positives pale in comparison to the fact that the Euro is doomed.

A bit like Mrs May's future, it's not a question of *if*, just *when*.

That doesn't mean to say that European stocks aren't much better value than US shares; there are some really good companies in Europe, and a few of them are cheaply valued. As examples, I like German company **Heidelberg Cement (ETR:HEI)**, which is on a prospective dividend yield of nearly 6 per cent, sells at about 9 times earnings, and is well managed. It is probable that German and French cement demand will expand, and the shares look attractive.

I also like some of the auto manufacturers on the Continent, since there will definitely be a trade deal of some sort with the UK, the second most important auto market in Europe. This augers well for **Renault (EPA:RNO)** and **PSA (EPA:UG)** of France, both of which seem ridiculously cheap to me. Macron will presumably make some inroads into French labour practices, which is another positive.

Jackpot Joy (LON:JPJ), a UK listed company, but one with mostly continental operations, looks very cheap, at only 5 or 6 times earnings, and with stable projected growth in earnings, as well as strong cash generation of over £100m a year.

Meantime, in the US the FANG or FAANG stocks are slowly having the lifeblood slowly sucked out of them, which is as it should be, given their inflated valuations. This is particularly so at a moment of great political sensitivity for these types of monopsony companies. In my opinion, their recent wobbles are just the beginning of a prolonged downturn.

Amazon's (NASDAQ:AMZN) proposed purchase of Whole Foods Markets might have some strategic benefit, as Amazon seeks to do in groceries what it has done in just about everything else, but to me it smacks of using a hugely inflated valuation to acquire old world assets, a clever standby trick for bubble companies. The effect of this will be to reduce Amazon's return on equity, which is already low, down to even lower levels. I know they are not paying in stock, but believe me they will do something soon to raise cash opportunistically on the back of a 100x plus PE ratio.

Google (NASDAQ:GOOGL), **Apple (NASDAQ:AAPL)** and **Facebook (NASDAQ:FB)** have plenty of cash – but also plenty of problems. My advice is to sell them all, and if you can, to go short. This might seem dangerous, but when these big stocks fall, they will really go to earth with a big thump. Meanwhile, every fund manager and their granny owns them, so watch the rush to the exits when the bad news hits.

Last month, I wrote that big biotech was super cheap, at least relative to the general market in the US, and since then there has been quite a big rally. I advise readers to hold on to my core recommendation of **Gilead (NASDAQ:GILD)**, which might just be a Whole Bio bite for, say, **Pfizer (NYSE:PFE)**. If I were Pfizer I would be running the slide rule right now. Last year, Pfizer paid US $14 billion in cash for Medivation, a single drug company which only owned 50% of the rights to its drug. Gilead must surely be a better asset, as the dominant factor in the global HIV and HCV markets, and with a very promising oncology and auto-immune pipeline. Oh, and with lots of cash on the balance sheet too.

I am also looking at Swiss company **Novartis (VTX:NOVN)**, which looks increasingly like the best of the bunch among Big Pharma companies, overtaking **Roche (VTX:ROG)** as the best positioned in the behemoth rankings. **AstraZeneca (LON:AZN)** of the UK is also cheap and well managed.

We still love gold at Burnbrae and at Master Investor, and I cannot emphasise enough how at this juncture every investor should have precious metals in his or her portfolio. Nobody knows what black swan lurks, but in my opinion, there's a whole flock hiding round the bend in the river, and they are coming to surprise all the ETF investors and other herd followers. The fact that the VIX, the principal indicator of volatility is at record low levels should not be taken as a comforting sign.

Nor should the fact that my relatives can talk of little else than cryptocurrencies and the daily rise and falls in Bitcoin and in Ethereum be any kind of solace to investors. The times they are a changin'. And it's best to sit this particular dance out.

Happy hunting!

Jim Mellon