



MELLON ON THE MARKETS

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By Jim Mellon

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As I write this, I am in Edinburgh, at the International Arts Festival. While there are many dramatic performances taking place in this beautiful city during the four week show, there is considerably more (expensive) drama going on in world markets.

The utter collapse of Chinese markets has taken many by surprise, particularly those who don't read much history. But what is genuinely surprising is the way that the Great Fall has had a contagious effect on other markets, with the US, Japan, Germany and to a lesser extent, the UK, falling sharply also. In addition, almost everything to do with emerging markets has been massacred, which is definitely not a surprise, given the parlous state of some of them.

China earlier this year displayed many of the signs of a stock market mania in full force; one million brokerage accounts being opened every week, record margin lending, shares that no one had ever heard of going up like rockets. [Those of us acquainted with Dutch tulip bulbs and South Sea Bubbles could see it coming.](#)

At the same time, the remarkable strength of the US dollar was overdue for a reversal. China's cack handed managed devaluation (and by the way there is plenty more to come there) was a trigger for rising concern about other Asian economies, particularly those, such as Malaysia and Korea, which have strained finances. Indeed, until last week, the Malaysian ringgit had fallen by a quarter against the US dollar this year, and suspicions of a huge "mislaying" of funds by the Prime Minister added to the fiery pot of decline.

But it wasn't just Asia; in other countries directly affected by China, the chickens have come home to roost. [Australia's mining based rentier economy is teetering on a nasty brink](#), and I remain convinced we will see further declines in the AUD. After all, there was nothing miraculous about Australia's twenty-odd year boom – it just digs up stuff and sells it to China. Not very much more apart from suntan cream and board shorts. And now China isn't buying so much, and the price of the iron ore etc. that Australia sells has fallen by more than half.

And of course, oil and gas exporter, and serial territorial expansionist, Russia, is fried toast in current markets.

So what now? Well, I confess to being a little early about getting back into some markets, but I don't think this is a time for universal panic and despair, although I note that Evil is less sanguine than me. I wrote last time that I thought the US market was priced to perfection, and so it was. It has fallen sharply but it is still priced in angelic territory, and I would caution about being too quick to get back in there. I have covered our short in **Apple**, which was a conviction trade at the Master Investor Show, but I wouldn't be in any rush to buy it. The CEO, Tim Cook has come out and said that China remains a robust area for Apple, but I wonder if he is spouting a bit of propaganda. After all, China's economic master has been fudging the national accounts for years. As I have said before, **China's growth is 2-3% in real terms and not the posited 7% so beloved of the Politburo. So it might prove with Apple.**

Germany, which has done so well from exporting to China, has been affected by this turmoil, as well as the rebound in the Euro (which was something that was going to happen when all of those who forecast a stronger Euro at 1.40 to the dollar forecast parity only a year or so later!). The **DAX** fell by 20% from its peak, and I think that is too much, so I am now a buyer.

I was a buyer of the **Japanese yen** at the 124 to dollar range, but now would be neutral. Although Japan has investments in China, I don't think the two are comparable. Japan's market is not overpriced, and there is little margin debt. **I would be a strong buyer of the Nikkei at these levels.** Japan's corporate earnings are poised to rise sharply, and there is little outlet for the massive savings of the population in an environment of zero or negative interest rates.

The usual chatter of whether and when **interest rates** will rise in the US goes on; I am not sure this is particularly important. Clearly, the Chinese problems and the fall in US markets will affect Fed thinking, but even so I would be surprised if they don't raise interest rates slightly, to normalise matters, and possibly, restore **QE** at the same time, which might seem paradoxical but would be warranted to mitigate the shock of rising rates at the short end.

In fact, given the China story, which in some ways is exaggerated and in other ways not, I wouldn't be surprised to see a more direct form of QE – for instance printing money to fund infrastructure etc. – in some key markets. Which ones? Possibly Europe, and possibly Japan, though it is not clear that Japan needs more roads to nowhere.

In terms of currencies, I would be a seller of **Euros** at the 1.17 level, and indeed I wouldn't be surprised to see the ECB do something to push the currency back at that level. Europe's economic recovery is just too fragile to support a strong currency.

I think some emerging markets are just too cheap, and I am looking at Brazil right now as an example. I would continue to be a seller of the **Australian dollar**. I remain a holder of **Greek shares** (rock solid in the turmoil!), and I am optimistic that Japan will do well.

Avoid the US for now, the UK is blah, and **get ready to buy China**. A few months ago, many commentators were pushing China. It will be years before those who followed their advice will get their money back. But at 8x PE (admittedly with economic problems ahead and a big debt problem), China isn't expensive anymore and one day soon it will be the world's largest economy. I would dip a toe in to a reputable ETF and avert your gaze as the roller coaster goes up and down in the next few months

Among stocks, I still like **Fanuc** in Japan, **Kuka** in Germany, and **Synergy Pharma** in the US.

Plenty to be getting on with... Oh, and the good news about this "performance" that has been going on while I am at the Edinburgh Festival is that a lot of hedge funds will have been crushed. Yaaaah!!!

Happy Hunting!!

Jim Mellon

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What Jim Read This Month

Amazon wants drone lanes in the sky

<http://www.thetimes.co.uk/tto/technology/article4511405.ece>

At the time mostly dismissed as a gimmicky PR stunt, it seems Amazon was serious after all. With the increasing number of unmanned aircraft, both professional and amateur, Amazon has called for the creation of high-speed sky lines to allow for the safe flying of automatic drones.

Robots could destroy us all, says Hawking

<http://www.thetimes.co.uk/tto/technology/article4510998.ece>

This reassuring article is another gem from the Times, as super-genius scaremonger Stephen Hawking voices his concern over the use of Artificial Intelligence for warfare. He and a thousand other high profile signatories call for a ban on autonomous weapons that could kill without human involvement.

\$100m project uses world's best radio telescopes to find aliens

<https://www.newscientist.com/article/dn27923-100m-project-uses-worlds-best-radio-telescopes-to-find-aliens/>

Yuri Milner, a Russian Venture capitalist, has launched a \$100 million project to bolster the search for extra-terrestrial life. The first stage of the project will focus on the closest million star systems and look to pick-up 'leaked' alien signals, the equivalent of stray alien TV broadcasts, and then hone in on the source and find intelligent life. Although, chances are we'll just be getting the re-runs.

The battery revolution that will let us all be power brokers

<https://www.newscientist.com/article/mg22730312-100-the-battery-revolution-that-will-let-us-all-be-power-brokers/>

The bane of the modern man, low battery. The race is on to provide more efficient and longer lasting batteries to power our increasingly tech dependent world. But with advances in the way batteries are made, they are becoming cheaper, more accessible and rechargeable, meaning that we could soon be able to generate, store, and distribute our own electricity from home. Power to the people and all that.

Apple car clues emerge from letter to test facility

<http://www.bbc.co.uk/news/technology-33945098>

Despite managing to overlook anything untoward penned by Corbyn, the Guardian (of all newspapers) has managed to get its hands on correspondence between Apple engineer Frank Fearon and officials from GoMentum Station, a car testing facility. The letters apparently fuel the rumour that Apple is building a car, dubbed 'Project Titan'.