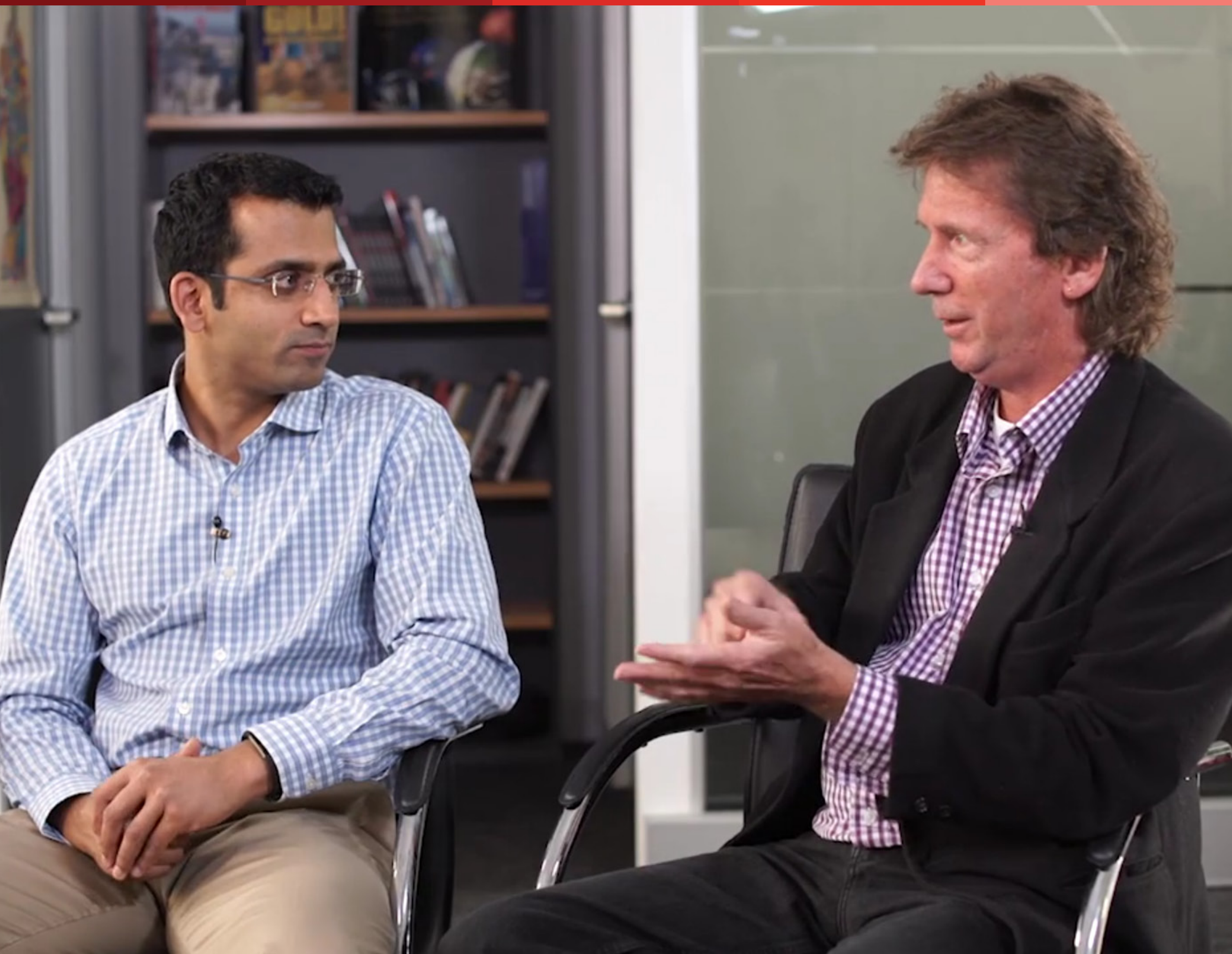
CYCLES • TRENDS • FORECASTS

The timetable of future events

The Grand Cycle and what's next for stocks, property and commodities



The timetable of future events

The Grand Cycle and what's next for stocks, property and commodities

An interveiw with Akhil Patel and Phil Anderson

Dear reader,

Sometimes it's good to be asked a few difficult questions.

It helps you find clarity.

I've been a student of history and the recurring patterns in the markets for many years now. Phil Anderson has been at it even longer. One thing we are both conscious of avoiding is getting lost down the rabbit-hole of analysis.

We want to share our knowledge and understanding of market cycles with you in as clear and unambiguous a way as possible… always keeping in sight the two main goals of our work: to help you understand these cycles and profit from them.

With that in mind, while in Melbourne recently, I sat down with Phil for an interview. Our colleague Callum Newman of Port Phillip Publishing was our "interrogator".

We thought this was a good way of drawing out some of the nuances of the coming cycle… and revisit the overarching forecast of where stocks, property and commodities are heading in 2017 – and beyond.

Callum asked us some great questions, and we hope that we answered them in a way that will add greater definition to your growing understanding of market cycles.

What follows is a transcript of the interview. It should prove very useful to you as your mind continues to "recalibrate" to viewing the patterns that govern the financial markets.

Many thanks,

Akhil Patel
Editor, *Cycles, Trends and Forecasts*

Cycles, Trends and Forecasts is an unregulated product published by Southbank Investment Research Ltd. Registered office: 2nd Floor, Crowne House, 56-58 Southwark Street, London, SE1 1UN Registered in England and Wales No 9539630. VAT No GB629 7287 94.

...continued on next page...

Speaker key

CN: Callum Newman
AP: Akhil Patel
PA: Phil Anderson

CN: Hello. My name is Callum Newman and I'm a financial editor out here in Australia. And today, I'm being joined for a studio session with your UK *Cycles, Trends and Forecasts* editors, Akhil Patel and Phil Anderson.

Today, we're going to do three big topics for you. We're going to talk about the worldwide boom that they see coming, and part of that is the Kondratiev wave, which is to do with commodities. We're going to talk about the real estate cycle and how it can help you invest in both property and the stockmarket. And I'm going to ask them, putting on my devil's advocate hat, the hard questions for the objections and scepticism that they get when they talk about this stuff. Gentlemen, thank you for joining me.

AP: Thank you.

PA: Yes, hi Callum.

CN: Gents, it's really serendipitous that you are out here this week. Last year, you published… you went on record and said, commodity prices would bottom in 2016. We see it definitely here in Australia – commodity prices have…

PA: Not only in 2016, but early in 2016.

CN: Yes, thank you, Phil. Commodity prices have really come back. Iron ore, especially for Australia, is flying. But it's happened in copper and some of the other big ones. BHP reported this week they're going to boost their dividend, their profits are back up. I think they've made more in this quarter or half than they have all of last year. Akhil, in your words, could you tell us a little bit about this cycle called the Kondratiev wave?

AP: Well, it's first of all very nice to be here, Callum. Essentially, Nikolai Kondratiev was a Russian economist who discovered that commodity prices move in long waves of about 55 to 60 years – 25 to 30 years up and 25 to 30 years down. And he wrote about it in the 1920s and used his analysis to predict a global commodities boom into the 1970s, which we certainly saw.

And then extrapolating his analysis, you would have forecast a fall in commodities during the 80s and 90s and into 2000, which again is exactly what we had. And we are now experiencing the next upside of the K-wave or Kondratiev wave, which we expect to peak in or around the mid- to late 2020s.

CN: Phil, just to bring you into the conversation, I remember, I think it was two years ago we spoke about Marc Faber, the man called…

PA: Dr Doom.

CN: Dr Doom, yes. Guys like him think we're in a Kondratiev winter, but you take the opposite view. How can two groups of analysts be looking at the same thing and draw the complete opposite conclusion?

PA: Callum, yourself and, you know, the viewers and the listeners, you've got to be really careful. When you research Kondratiev on the internet these days, the predominant thing

…continued on next page…

you're going to get called up, what you're going to see, is those sorts of point of views which seemingly seem to be coming from a position of fear really, doom and gloom and that everything is going to collapse.

But from all the work I've done and what Akhil has extended, if you take Nikolai's original work, it's totally clear that commodity prices have bottomed about every 54 to 60 years. So they bottomed through the 1940s, they bottomed in the 1990s. If you just extrapolate that out and make, you know… as an economist, we love to make assumptions, so we're going to perhaps assume here that history will repeat, but it's done so for a long time now. Just that repetition will tell you commodity prices are on the way up and they're going… the next peak will be around 2026 or thereabouts, that's 25 to 30 years up.

If you look around you really… you don't even have to look around you carefully – you can see that with the huge rise of China, the up and coming rise of India and all the stuff that's happening in the Middle East and everything else, the commodity prices, they're… the commodities are… demand is just not going to cease here. It's just going up.

Now, of course, the equations of, you know, demand and supply are that the more… the more demand, the more we're going to supply. But I just think, the way I look at stuff, just the way you look at the repetition, when you compare – and probably this is the key point really, Callum – simply break down the K-wave into two component parts, the upside and the downside.

And on the upside of the wave, you get relentless technological innovation and you get low inflation, tending to have bottomed, slightly starting to increase on the upside, and you also get a bottoming, very low interest rates, both in the nominal and the real sense, which also then start to increase. Now you tell me – look around – that's the scenario you see. It is not the… what everybody else calls the Kondratiev winter.

This is not the scenario that we're going into. And I'm sure Akhil can talk about the relentless technological stuff that we're seeing now [that] is absolutely massive.

CN: Well, let's talk about that for a moment. Akhil, can you tell us why this upside of the Kondratiev wave is so positive for the world, because I know you get a lot of feedback questioning this idea, and some of these tech developments that you're watching and excited about?

AP: Well, firstly, let me just say my overall view is that I think over the next ten years we'll see more wealth created in those years than possibly in any other ten-year period in human history. It is going to be utterly prodigious. And the reason I think that is that you have so many parallel technological developments. You have developments in cheaper and cleaner energy, you have technological innovations in the way we build things, in the way that we're going to transport ourselves with driverless cars, in the ways in which we communicate.

In almost all aspects of human existence and our economic behaviour, you're seeing amazing disruption. It's making things more efficient, which creates greater, sort of, value and surplus which are then recycled back into economies. You're seeing totally new industries being born. And it's going to affect almost every aspect of our lives.

...continued on next page...

CN: I just wanted to bring in there – most people, when we talk about tech revolution, see the jobs being lost in all the industries. So you see that actually as a very positive thing, so not this idea of the rise of the robots taking all the jobs; it's actually going to create more wealth.

AP: Well, I think at every, sort of, era of major technological disruption, you start to see that, you know, people who are employed in so-called dead industries or the industries that are being disrupted lose jobs. I mean, that's an inevitable consequence. Then there is always an issue about whether they can transition into new industries which arise as a result of the technological innovation. And that's not a given.

And so, for certain segments of the population, you know, potentially older people who maybe don't have the ability to retrain, yes, it can create very significant problems. But essentially, as long as the human being has an infinite capacity to want things, there will always be opportunities for new companies and new technologies.

PA: You can see it with Elon Musk, with the jobs he's creating in his field. You can see it with, for example, Uber and Uber's competitor. They're going into India now. The first thing Uber has to do before it can actually start its business – they have to teach some of the local, indigenous population actually how to drive.

Uber has a programme running at the moment – they're going to teach a million Indians how to drive. Now, if you extrapolate that even further… if you go into the African continent, IBM just announced they're going to teach 25 million Africans how to be more familiar with computers. 25 million people. IBM are not doing this because they just want to… because out of the goodness of their hearts they're just… with humanity; they're doing it because they know their business in Africa is totally dependent on teaching the people that are there new skills.

I don't think this has ever been done, anytime, anywhere, ever in world history. It's just one of the most productive eras we are ever going to see. But, as Akhil mentioned, if you're on the other side of the coin, if you're in an industry that's being disrupted, then you're going to feel [that] you're going to lose your job and you're going to feel like you're in a depression. That's the nature of the upside of a K-wave – that's how we know we're in the upside of a K-wave. Absolutely.

AP: I think Warren Buffett actually made that very point in his most recent shareholder letter; that actually, you know, you do need social safety nets to address some of these issues for people who are feeling left behind. But actually, the answer is not then to stop productivity because that will happen, regardless. It's an inevitable consequence of what's going on.

CN: And I would say too that the mainstream focus is on the jobs being lost, not those being created. Just to bring it back, how some of this stuff can play out in the share market, we've seen that here in Australia – you talked about Elon Musk. Electric cars have sent lithium stocks through the roof. So a bit of knowledge of charting and you could clean up on some of these.

PA: Which we picked up first, I might add.

...continued on next page...

CN: Yes. To bring it back, obviously commodity prices, Kondratiev wave, bullish for a country like Australia. When I think of the UK, I don't really think of commodities, but there are actually a lot of commodity stocks based in London, aren't there?

AP: Absolutely. Some of the largest stocks on the FTSE 100 are commodity or resource related stocks. Which is one of the reasons why, when the pound weakened against the dollar after the referendum last year, the FTSE actually did rather well because a lot of those companies are earning their revenue in dollars.

CN: Well, let's talk about UK stocks for a minute. You've said that you're very positive on UK stocks. And where do you see the UK stockmarket going in the next three years?

AP: Well, I've said in my newsletters and email updates that I reckon that stockmarkets are going to be going full steam ahead into the end of the decade.

The FTSE has had a very interesting pattern, if you look at its chart. It had tested the 7,000 or thereabouts level over the number of years and it's now decisively broken through that. I think it's now at around 7,300. When stockmarkets and stocks indeed break into all-time highs, it's very bullish. I don't think it's much of a stretch to say that by the time we're done with this bull market, towards the end of the decade, we might be seeing the FTSE at or above 10,000.

CN: So if you're watching this and you're a little bit sceptical, why do we hear so much about negativity around stocks and the economy? Well, why – there's deflationists, there's people say it's a bubble. Do they concern you, those issues?

AP: Well, I mean, for the reasons that we've described, all I see is innovation, rising corporate earnings, sort of, a very optimistic scenario, enormous growing middle class globally, that want things, that want to buy things, and want to buy a lot of the things that are produced in the UK.

PA: It's a…

AP: And in the US. Sorry.

PA: It's a funny thing, though, when you see this… you can see this throughout history. When stockmarkets break into all-time new highs, and brokers will tell you this, they get a lot of phone calls from people that are wanting to sell for some reason because they see the market state.

Markets do have a bit of a memory and when the stockmarket was last time at those highs, the stockmarket tanked and we went into recession. And here we are again, when the stockmarket breaks through those numbers again, people are thinking, oh gee, last time we were at this number, the stockmarket then absolutely tanked. So they get fearful. But it's because of that reason that…

CN: That's a brilliant segue actually. The reason UK sharemarket collapsed in 2008 was what you guys talk about, the real estate cycle. And this is another cycle so it's… you, sort of, have the Kondratiev cycle as a major, even longer cycle, then a 20-year real estate cycle that you talk about. Can you tell us why… Phil mentioned that US stocks are in new

...continued on next page...

highs – why this time they won't fall over according to the real estate cycle?

AP: Well, you typically find that… actually, very clearly when you look at a chart of the stockmarket, that the major falls in stock prices occur at key points within the 18-year real estate cycle. Typically in the middle, and we call that the mid-cycle slowdown, and at the end. And the last time we went through this was the bear market during the period 2007 to 2009. We are not yet at one of those critical junctures within the real estate cycle.

In between those critical junctures, you get economic expansion which we're seeing in the UK, we're seeing very much in the US, in… I'm sure in Australia and elsewhere, and stockmarkets are riding those up globally. I was actually looking at the chart of the FTSE world index, I think, or an ETF of that, and world shares have broken into all-time highs. So the world is breaking out into this kind of bullish, optimistic scenario.

Just to go back to a point that we were discussing a few moments ago, I think one of the reasons that people think that, you know, we're in a stockmarket bubble, is they use the price earnings ratio and they see that stocks are very expensive relative to historical earnings. I think this is one of the most useless metrics that you could possibly imagine for stocks.

PA: Yes.

AP: And they say things like, well, the last time it was this high was in 1929, just before the Great Depression.

CN: I just read that yesterday actually – in 2007, with the Cape – [the] Shiller price-to-earnings ratio.

AP: Absolutely. I mean, that metric is really simply a metric of how up to date our accounting practices are. Because accounting practices determine how companies report earnings and as you know, actually, accounting doesn't really take into account the new tech-based economy that now is in operation.

PA: And the other thing, and here's the point of difference, this is what Akhil explains over in the UK which is… sometimes in Australia – Australia didn't get the really significant fall in 2008 and 2009. We went down a little bit but the commodities… for the reasons we've already discussed, commodities bounced back and actually kept going. Whereas, and as Akhil knows, I based what I was doing in London in those days, 2009, 2010. The people in England really felt the downturn. I mean, they really saw it.

The key theme which Akhil shows is that if you can view your history in 18.6-year segments, then when a stockmarket goes into all-time new highs very early within that 18.6-year cycle, so when we're really in the first phases, it indicates that actually a very bullish cycle is happening because the market is pricing in the production and the earnings and the productivity gains and everything else that happens. And we've now seen, as Akhil has just mentioned, the US went in early, 2013…

AP: Germany.

PA: Germany went in… the same. The UK has now followed. Even New Zealand has been

...continued on next page...

in all-time new highs for several years now.

When that happens so early in a cycle, it's really bullish. That is why… one reason why it's so important to understand the real estate cycle so when that happened, when the stocks… when the UK stocks had gone into all-time new highs, it's not a time to be panicking; it's a time to be really, really bullish. Now, of course, markets are going to price the earnings and everything else in early, so we've still got to get those earnings and still see them. But they're coming over the next 12 months because the market is telling you.

CN: Well, I can tell you from personal experience that, looking at the real estate cycle, when you get rising property prices, it generates wealth effect and so people are more comfortable spending, you get expanding bank credit, and that shows up in company earnings because people go out and spend. Is that what you're seeing on the UK stocks that you track?

AP: I think at the end of the last cycle, we saw people releasing equity and then spending it on holidays and cars and so on. I don't think we're yet at that, sort of, point in the cycle. I think people have, over the last few years, been fairly conservative, paid down loans, saved more. I don't think the kind of prodigious spending which you're referring to has really yet started. And so that is still to come in the future.

CN: That's probably more of a… as you said, Phil, Australia saw less of that downturn so it's probably more apparent here in Australia.

AP: Right.

CN: Talking of that, part of the cycle is banks expanding, bank credit. A big objection I know you get from people is that, well, debt is incredibly high…

AP: Compared to…?

CN: Compared to global GDP. I think it's about 300%.

AP: Okay.

CN: Can you tell us, in your words, how debt can actually go higher? Indeed it must, if the cycle is to go up.

AP: Indeed. Well, the reason that I asked that question is that it's always compared. You know, I went to the *MoneyWeek* conference in October last year and I think the equivalent conference here was the similar kind of theme, and everyone was talking about debt to GDP ratios. What people weren't talking about was debt to global wealth ratios. And Credit Suisse produced a report at the end of last year saying that, yet again, global wealth, household wealth had expanded, and it was now at $256 trillion. And that's net wealth, that's net of the debt that households have. And that's never… the two things are never put side by side.

CN: That's a good point actually. And I know from my own research that GDP is a very flawed measure to look at the world.

AP: Indeed.

CN: But the mainstream uses it and so that's what people see.

AP: Yes.

PA: Yes. Don't forget as well, I don't think the world has ever seen so… listed stocks having so much cash in the bank.

AP: That's true.

PA: What is it, Akhil? I don't know the exact figure, 150…

AP: The UK… sorry, not the UK, the US stocks, the tech stocks, have hundreds of billions in cash.

PA: Yes. And in fact, Callum, as you noted in one of your recent newsletters, because of all the share buybacks and because companies have got so much cash on their balance sheet, we've actually got a shortage of investible assets now. There's actually money looking for places to go but they actually can't find it.

I mean, when you get that sort of situation, you have to start looking at wealth rather than debts. Yes? And I happen to think, and if you follow the real estate cycle, usually in the first half of the cycle all the focus is on the debts, the problems, the issues and everything else. And when you study markets, you know that markets climb these walls of worry. That's why they go up – they climb the walls of worry. And the more worries we've got, the higher the markets are going to go.

And then, as we get into 2023, 2024, suddenly there'll be so much wealth around, if the cycles… if all the history repeats as we think it will, as it should, suddenly nobody will be talking about debts anymore. And we'll get to 2025, you won't see and won't read about debt; all you'll be seeing is banks, credit, people will be sitting at their parties, their poolside parties again, talking about how much real estate they've just bought. That is the time when our readers, that's the time when you've got to start worrying about the debts, when absolutely… when absolutely nobody else is worried about it. That's one of the secrets of knowing the real estate cycle.

AP: Yes. The cycle turns on fear, as we're seeing in this part of the cycle, and then greed, which we'll see in the next part of the cycle.

CN: Talking about debts, we need to bring up interest rates – that's important. They're very low in the UK.

You mentioned, Phil, a little bit earlier that part of the Kondratiev wave is them staying low. Do you think that's another fear that keeps people back, Akhil, this idea that interest rates are going to go higher and higher and higher and they're going to be stuck with this debt that they can't repay?

AP: It could be a fear but it would be a fear that people have had while interest rates

…continued on next page…

have gone down. I think we're actually now at a point where you will start to see yields on bonds and in the corporate bond market and the swap market – yields will star to rise. But not much. Central banks don't have to do very much because inflation is still globally very low. I think there was some concern about the impact of the referendum result on inflation in the UK and yet we're still talking about inflation at or below 2%, which is historically very low. So there's plenty of opportunity for interest rates to remain low, though I think we've seen the lowest points there.

PA: Here's a practical example, Callum, that I can give you from my own personal circumstances. This is what everybody forgets. Having a real reasonable commercial interest rate… a commercial interest myself, our loans, from a commercial viewpoint, are on the fixed ten-year periods. So it was just… it was about a year and a half ago where we sought to renegotiate with the banks our interest rate for the next ten years, going forward. They were set over the ten-year period, up until a year and a half ago at around 7%.

Now, of course, interest rates haven't come down in that period. We have now set them again at slightly below 4%. They're a little bit higher in Australia than they are in the UK. That's now set for the next ten years. From our point of view, and it's all commercial owners are pretty much the same, it's a little bit irrelevant what, sort of, happens, our rates are fixed. So this is one of the determinants of why a real estate cycle goes 18 to 20 years – we'll tell you 18.6 precisely – and why it doesn't… why real estate doesn't fall over every five years. There's a shorter term trend of about seven years. These things take a while to play out.

And so… Callum, as you've already realised, when the interest rates kept coming down like they have, and we've probably, as Akhil mentioned, probably reached an inflection point now where things are starting to turn, certainly if you're watching the bond market… And bonds themselves, again, there's a 30-year wave pattern in the bonds as well.

CN: Yes, absolutely.

PA: So that's a whole new raft of things we could talk about. So these things take a while and we've reached that inflection point. But over the last, well, certainly almost 30 years they've been coming down, from 1982 really, the thing that happens is real estate prices price in the gains of lower interest rates and so they've been doing that for a long time now. Now, with this inflection point, over the next five, seven, ten years, if interest rates rise a little bit, because the interest rates came down so much, people just take on more debt, which you've seen.

Over the next couple… once we get to about 2025, 2026, because the debt will be so significant by then and because the gains have been so prodigious, it probably won't take such a huge rise in interest rates to then actually start upsetting the cycle, which is something you'll be wanting to watch towards the middle of the next decade. So rates could never… they can't go back to 18% or 15%, but they could rise a couple of percent which, next decade, will probably be significant.

CN: Well, your point about changing the rate on your properties, commercial properties – the British government did the same thing, I think it was a couple of years ago now, when they sold off those old consols that they issued in the 17th century or something.

...continued on next page...

AP: Yes, indeed. About time.

CN: Paid them off and redid them at lower rates. Akhil, with UK property, out here in Australia, we hear about London all the time, it's booming and things are happening there.

AP: Yes.

CN: What about the rest of the kingdom?

AP: Actually, you're starting to see higher growth rates outside London. So last year, I think the highest growth rate was in the east of England at about 11%. The southeast was also a bit higher than London. And London itself did still grow at 8%, despite the fact that we had such a turbulent year. We had a big disruption in the market when the government introduced stamp duty changes and particularly on investors who wanted to buy an investment property. And then, of course, we had the referendum result and the fallout of that, and the uncertainty that brings. And despite all of that, you saw quite healthy growth in the UK property market.

CN: We'll, [we should] just should mention the Brexit decision. So it's not something that worries you long term? It's…

AP: No. I think there may be some short-term disruption around 2019 when the UK formally leaves the European Union potentially. It times in with the mid-cycle slowdown that I mentioned earlier. I don't think it'll be the cause of it. I think the UK is part of a global economy and we'll probably look to developments in the US to have an effect on the global economy perhaps more so than the actual Brexit result.

But essentially, I think we've seen, in the aftermath of the referendum result, that British consumers are still spending. The incentives that are at play are the same every cycle. So people recover, the economy starts to expand, people start to spend, they buy property, the property market goes up, etc, the impact of technological development.

And then it all, kind of, rises into a crescendo. And it seems that events just fit into that framework, rather than the other way around.

CN: I just want to touch on a couple of risks. I remember Jim Rickard said at a conference once, it's not the risk you know about that you should worry – it's the one you don't know about, [you should] worry about. What about a couple of wild cards? Are you worried about Donald Trump, currency wars, trade wars, these kind of things?

AP: Well, I find it a bit hard to really, sort of, understand what he's up to. I know that Phil and I have maybe slightly different views about Donald Trump. But I would say this. I mean, some of his perhaps clearer policy positions are actually similar to developments in previous cycles. So essentially rolling back bank regulations which were put in place in the aftermath of the previous financial crisis to supposedly prevent the next one, and also massive fiscal stimulus, public works, spending on infrastructure which, you know, creates jobs, creates an expansion in the construction sector which, for most economies, is a very significant part of it. And also, it drives up land value. So it supports property prices and people then feeling wealthy because of housing equity and so on.

...continued on next page...

CN: I'll come back to a point on that. Just Phil, you actually see Trump in the White House as wildly bullish for America, don't you?

PA: Well, Callum, we've discussed… we were waiting for this development, as you know. If you just have a look at history, and this goes back right to 1800, after the downturn, it's often a more democratic political organisation that moves to put in a whole heap of bank regulations, and then we are told the regulations are there in place to make sure a downturn can never happen again.

And I've been saying to you for ages and ages, if history is to repeat, we'll probably see a republican administration get in of some sort, they'll be backed by the bank and the first thing they're going to do is remove those regulations, get rid of them completely, so they can get back to extreme lending. And look what we've got. I mean, it's just… you know. So that's the, sort of, cyclical thing you'll see.

Now, I happen to think… I have to laugh about America sometimes. For the first time in years and years, they've got a real capitalist. He's a monopolist capitalist, he's not a genuine wealth creator capitalist – he's a real estate man. He's in the White House and half of America is complaining because they're all dead-set capitalist economy, and they think they haven't got a capitalist in the White House. However, I think – now, this is an opinion, I can't prove this – but I think in one sense [he's] a brilliant strategist. He wants to build a wall, he wants to stop the immigrants coming in, and he wants to do a couple of other things which you've seen puts half of the populace, a lot of the populace, up in arms, so they all start demonstrating.

It's smoke and mirrors because the real agenda, and all the people that voted for Trump, over the next ten years – not yet, but after 2024 – they are going to get screwed. Why? Because most of the people that voted for Trump, they're not land owners as such, they're not real estate speculators – they're genuinely hard workers. And with Trump coming in and everything that he's doing, you're simply going to see lower wages, higher land values, more debt and no regulations, so that the banks and the multinationals can simply do what they want. I mean, we've seen this before. We saw this under Reagan. And what happened? Land values went spectacularly upwards. They just didn't go upwards on a steady stream like this; they went spectacularly upwards. This is possible again under Trump.

Now, of course, there are risks. You don't want to see a trade war. And I think Trump… I think he wants to put America in a position of strength by some of the stuff he's bargaining and what he says beforehand, which I think that's doing, but I don't think he's insane enough to want a trade war. The Republican Party itself doesn't want a trade war because trade wars are bad for land values. So in a sense, he's got his own self-interest to think about. He doesn't want that to start happening. So nobody wants a trade war. If you saw a trade war, that would be slightly… that would be a… that's a risk.

AP: Yes. I think we've found that it is the world wars which started out through, you know, trade tensions and other, sort of, geopolitical rivalries, that have been the only things that have temporarily knocked the real estate cycle out of sync.

CN: If you want an example of how the property cycle clock, which you would've seen on the website, can play out in the stockmarket, on that clock, there was a call or a fore-

...continued on next page...

cast, if you like, for the expansion of banks and increasing credit. That was the next move that Akhil and Phil were expecting in the property cycle. And since Trump's election, US banks are up around 15%, 20%, depending on which one. But if you grabbed an ETF or something like that, that's how the property cycle can play out in the stockmarket. We're talking about the UK today. There, UK banks took a massive hit in 2008; they're still on the floor. Is this a sector you're watching?

AP: Absolutely. You're starting to see an uptick in lending in the UK. It's probably a little too early to say it's a confirmed trend, but it is right on cue. You saw the other elements of the property clock play out, including an expansion in construction. Before that, rising house prices. So UK bank stocks had been going sideways at lows for a number of years. A number of them have started to test the… any of the, sort of, highs that they made in that period of consolidation, I think maybe are not quite ready to break out, but certainly something that I'm looking at.

But the US, absolutely. [The] US tends to be slightly ahead of the rest of the world in terms of its real estate cycle. And they priced in the potential for Trump and the Republican Congress to roll back bank regulations very quickly after the election.

CN: And we should say with the UK banks, when they're going sideways like that, they're dealing with the old problems from the previous cycle.

AP: They are. Yes.

CN: All the… all the bad debts. And that's what gives them the platform to launch off once those are done…

AP: Absolutely.

CN: … and the market sees that they're healthy again.

AP: And I think rising yields actually are very positive for banks. I'll give you an example. Some of the mortgage lenders in the UK have started withdrawing their lowest price products and so slightly starting to increase interest rates. But not by as much as, say, yields in the bond market have gone up, because there's now more competition in the market and so that's putting a squeeze on margins.

So I think what you'll start to see, even if you have an interest rate… a rising interest rate environment, is actually more competition to gain market share and so therefore more lending, more easily available credit. And that's very bullish for the banking sector.

CN: I think the UK is a little bit behind on the interest rate rises, aren't they? The US is looking to raise now. I think, Mark Carney is going to keep them low for another couple of years. Is that what you said last time?

AP: Well, yes, so after the referendum, they had a cut in interest rates and they said they'd be willing to do more, but now they've changed their tune, having seen the economic data in the last half of 2016. And actually, if anything, the… I think the bias is towards perhaps raising interest rates. It may not happen during 2017 but certainly within the bond markets, you're starting to see yields start to… So the longer end of the yield

…continued on next page…

curve, you're starting to see rates raise.

CN: Okay. Well, you mentioned the banks, that you're watching them. You're a trader, you trade the markets, US markets, British stocks. Is there any other sectors you're watching with interest?

AP: Well, you start to find within the later stages of a mature bull market that energy and resource stocks start to come into their own. So I'm looking at, you know, oil and gas and similar resource stocks, which actually tend to peak after the broader market.

I've actually done a piece of analysis going back to 1800 in the US, and have found almost every time a bull market ends within the cycle, that commodity or resource prices peak afterwards. And so I think the play now within the UK, once financials break out, is both financials and resource.

CN: Okay. Well, one of the… you're doing a forecasting service. One of the dangers of forecasts is you, sort of, are attached to this outcome. It's natural enough that people can be sceptical and, you know, theories are a dime a dozen in the financial world. For anyone who is now starting to watch this move, what signs should they look out for, if you're wrong? How do you know you're wrong?

AP: That's a really good question. And I think, you know, my work on forecasting has taught me that you have to be constantly humble and openminded. For me, I'm a great believer that stockmarkets are an information discounting mechanism, and if we are wrong, we'll see it first in the price of stocks, which will start to trend downwards when, you know, we're expecting them or saying that they're going to be trending upwards. And so that… assuming that you're still paying attention to what the charts are telling you and that really is the key skill that I try to use in producing material, you will start to see that before it's in the news.

CN: So once people have accepted that, they're looking at the risk, they're looking at their downside, what's the one best thing they can do with the material that you give them, in your view? Or is there one thing, or is it a suite of things?

AP: Well, I think, first of all, learn how to read a chart. And I've tried to introduce material in my newsletters to give people tips on how to do that. I mean, it doesn't need to be particularly sophisticated, for want of a better word. You don't need to be, you know, a high-end technical analyst to understand how to read a chart. The second thing is to know your history and to know the cycles and how they've played out historically. Because, you know, every time the cycle repeats, it doesn't repeat in exactly the same way, people aren't saying the same things about the cycle. You've got to understand how much of it is day-to-day noise and when we're actually seeing a fundamental shift in the underlying forces at work.

The thing I would say about, kind of, forecasting and so on, for us, for Phil – and he's taught me a whole lot about this – is essentially it is fundamentally driven by the law of economic rent. That's what drives the real estate cycle. And I have gone into that in my newsletter. And if that fundamental cause hasn't changed, then the cycle has to repeat. It's guaranteed.

...continued on next page...

CN: And Phil, I just wanted to bring you in. For you, do you agree or is there something else you think people need to be aware of?

PA: Yes, they're good questions, Callum, important questions to ask, because as a forecaster, you know, just as Akhil said, you can get wedded to… you're investing your emotion in it and you want it to be right.

AP: Yes.

PA: And you want it to be proved and everything else.

AP: Your reputation is on the line, etc. Yes.

PA: Yes, all that. Apart from reading the market, there's one other thing you could look at, and that's the US yield curve. It's probably the most important indicator. So what you would do is you match the ten-year bond rate against the federal funds rate and when you do that back, you know, the easiest is to do it back to the Second World War but you can do it even back to 1913 really. When you see that, the yield curve is spoken of as being steeply sloped when the federal funds rate is way lower than the ten-year bond, which is what we've got at the moment, and steeply sloped.

Now, when we've got that case, when we've got that scenario, as we have at the moment, never in the history of the world has there been a recession start. The recession starts roughly… as a very rough, rule of thumb guide, recessions have started from about three years after interest rates started to be progressively lifted, after we were coming out of the downturn. Or then you'll get to the scenario where the federal funds rate – that's the short-term interest rate – starts to rise above the long bond. And you just watch that.

CN: Well, we should say, Akhil watches it in *Cycles, Trends and Forecasts*.

PA: Yes, of course he does.

AP: Yes, absolutely.

PA: The most important thing.

AP: It's one of the most reliable indicators that you can use.

PA: Yes. And historically that's…

AP: Yes.

PA: … yes, that's exactly right. Very simple.

AP: Now, I just would add one thing to that. There are times when you do get an inversion of the yield curve and yet you don't get the recession. So it's not absolutely perfect. But this is where the knowledge of the cycle comes in.

PA: And the other thing, Callum, of course… oh gosh, if you can just understand your history, and what stands out for you when you look at your history is tall buildings. And

…continued on next page…

the tall buildings, the world's tallest, has traditionally so far, since… As you know, Callum, way back to 1837, the world's tallest building opens, everybody breathes a sigh of relief, it's empty and we're in recession.

CN: It's true. And that's another indicator that you track as part of your…

AP: Absolutely, yes.

CN: Well, to finish up, just finally, I mean, we've had a great conversation here; you get a lot of questions from readers – have we covered everything that they ask? Is there any other common question that we haven't addressed so far that you can think of?

AP: Well, one question that I get a fair amount, and this is particularly pertinent in London, is how can people continue to afford housing because they… you know, they're just astronomical? And I'd be the first to agree that housing in London is far too expensive. But we mustn't confuse expensive with what people are willing or unwilling to buy.

And it just seems that as property prices go up, people find different ways of buying. They buy later in life, they buy as couples, they take on more debt, they take on debt for a longer period, they stay… they move less often, etc. So people talk about, you know, house prices being ten times, you know, median earnings in London. But again, a bit like the discussion we had about the P/E ratio for stocks, you've got to use that very carefully because it doesn't necessarily reflect the actual underlying reality of what people are doing in the housing market. But that's something that people come up with quite a lot in their discussions with me.

And actually, sorry, just to finish that point, I looked back at a previous edition of the Independent newspaper and it pointed out that first-time home buyers were panicking at not being able to get on to the housing ladder. I thought that was very interesting. But the really interesting point about that was that was written in June 1998. And we now look at that period as being a period of very affordable housing, before the boom in the 2000s. So people have always thought that housing is far too expensive and yet have continued to buy and the real estate cycle just continues up.

CN: Well, we should say UK politicians are the same as Australians – they talk about housing affordability but they don't actually do anything that would change it. Akhil, I just want to touch on briefly a, kind of, counterpoint to the cycle, if you like. From my own experience, understanding the cycle, the Kondratiev wave, all the factors, has been brilliant for understanding what's happening in the world.

But the market never makes it easy for us. For example, I mentioned earlier that Phil and I were watching for the US banks to expand last year, so we were watching the stocks. And what actually happened was they actually collapsed there, had a mini collapse. And the reason was of negative interest rates, which had never happened before in history, which is terrible for banks. So here we were, expecting an expansion in the banking sector, and the bank stocks started going down. I said, what's going on?

That's history now. Interest rates have picked up, the banks are now moving up but it's just an example of how even knowing the cycle and what's moving, the market always throws these curve balls at you. Do you see the same thing in your own trading and in-

...continued on next page...

vesting and analysis?

AP: Absolutely. I mean, the cycle never repeats exactly. If it did, then you wouldn't need people like us. You would just look at, you know, what happened last time and do the same thing again. I mentioned before that fundamentally the underlying forces that deliver the cycle are still with us and I think the real benefit of what we do is combining our insights on, and historical knowledge of, the property cycle alongside the Kondratiev wave, which gives us a very optimistic scenario in terms of the impact of innovation and commodity prices on generating real wealth within the economy.

But every time there is a new development and you always have to try to understand how that is going to have an impact on whatever particular asset you're looking at. Negative interest and very low interest rates historically seem to be the thing this cycle around, which has had a kind of, caused a lot of angst between commentators and central bankers and economists and so on.

I mean, the only thing to say is you've got to try to understand if this is a fundamental change or it just seems to be one of the features that is apparent in this particular cycle and invest accordingly. And then use your tools, look at charts, look at the indicators, the yield curve that we talked about, and so on, to really understand how to play it from an investment point of view.

CN: And we should say that the economic world, it's like a big puzzle. You have commodities, you have the bond market, the equities.

AP: Yes, absolutely.

CN: And they're all shifting and throwing different signals at you all the time, and there's always other commentators with different opinions. It's not easy to navigate that, both intellectually, the understanding it all…

AP: Yes.

CN: … and emotionally. It becomes… can be a real roller coaster.

PA: What you could say about that – and that's a good point because now that Mr Trump is unleashing all of his erratic comments and everything else that takes place, it's going to get volatile.

AP: Absolutely.

PA: The cycle is going to get more volatile as we go forward. And what I always do is attempt to come back to the basics. And the very first basic says: the cycle is driven by the enclosure of the economic rent. In other words, that something for nothing that everybody chases. Unless that changes, we have to get a cycle. And then, I just try to go back to history and have a look how history repeats, but you're quite right, we're always… we are… we have to be prepared, we have to be humble enough to know we're going to get a curve ball somewhere. But at the end of the day, it's not going to… in the longer-term picture, longer than a year, it's not going to change the fundamental basics of the cycle. And that is still going to repeat. So that's just what we're trying –

...continued on next page...

AP: – I think what we offer, and I'd say this as, you know, I suppose, to promote ourselves, is that we try and provide a filter to all of the, sort of, sensory and informational overload we get these days. You know, there are so many opinions. And we try to relate it back to fundamental cause and effect. And I think that is relatively unique.

And it's a pattern in the way that economies develop that's been with us since at least 1800. You know, further back in the UK. And we can demonstrate historically that it repeats. And so it will take us quite a significant change in economic arrangements for us to really shift our fundamental view about what's going to happen going forward.

CN: And I should be pointing out, trading the market, you can actually trade the market without knowing the cycle. The charting analysis that you use and has come from Phil, it actually works, regardless of whether you know the cycle or not. So there are opportunities in the markets that don't even have anything to do with the cycle. It doesn't command everything. So if you've got those charting skills and that analysis, there are other opportunities that you'll find out there just by following the market.

PA: The added bonus, of course, is once you get the fundamentals of the real estate cycle, which is what we do on top of it, is then learn how to read a chart. And when you can do that, you find that the stockmarkets themselves actually start singing. They actually start telling you what's coming ahead, certainly six to nine months in advance, because the market reads that. All of the people making buying and selling decisions, the market reads it, and the market starts telling you these sorts of things. So when, for example, a major stockmarket in the world, a major index breaks into all-time new highs so early in the cycle, that's telling you to be bullish – you shouldn't be fearful.

But if, in 2026, the FTSE hits 15,000 or if, in 2026, the Dow hits 40,000 – let's say it's in December 2025 – you have to know then, because you're at the extreme end of the real estate cycle – then you know what to do because history tells you you're at the end. At the moment, we're not at the end. That's the theoretical, the fundamental framework that understanding the economic rent, that's what it gives you.

CN: Yes, absolutely. And look, we're traders. There are opportunities to the downside, you know.

AP: Absolutely.

PA: Absolutely.

CN: Stocks you shouldn't be in or shorting and all sorts of things.

AP: Indeed, yes. Shorts, yes.

CN: And finally, just to tie up, any thoughts on the pound? I know it's at 30-year lows or something. Is that something that you follow?

AP: I do, absolutely. I wish I had converted my pounds to dollars on 23 June. Unfortunately, I didn't. To be fair, I was possibly looking the wrong way in respect to the referendum result. I didn't think they would quite manage to get the votes they needed to leave. Anyway, that being said, I think you tend to find, against the dollar, most currencies

...continued on next page...

depreciate in the first half of the cycle.

So I would be surprised if we have seen the last of the falls in sterling. It may not fall so much against the euro actually, which would be a key, sort of, trading relationship to watch out for. During the second half of the cycle, I think historically, most currencies have appreciated against the dollar, and particularly currencies that are exposed to commodity prices like the Australian dollar and the Canadian dollar, I think, will have a very significant run in the 2020s.

CN: Great. Just to sum up – we've covered a lot of ground today – so you're bullish on UK stocks, you're bullish on… or positive, I should say. Jargon.

AP: I'm just bullish.

CN: Positive on the US.

AP: Yes.

CN: You see positive developments still to come in the UK. I suppose one question that you might get – is it not too late to profit from any of this stuff?

AP: Absolutely not. We've got another ten years of this cycle to play out and there are opportunities all over the place. Whether you're interested in the property market… Okay, you might not want to buy in areas that have already seen, you know, 50% or 60% growth in the last three years; you'd have to look for opportunities and, you know, always consider the fundamentals of a particular decision.

But there are enormous opportunities in the UK in the property market, given the amount of infrastructure expenditure that's going on. Crossrail One, Crossrail Two, the north-south line across London, the high-speed rail link up to Birmingham, which will come onstream later in the cycle, you know, expansions in airports and so on. It's just making the UK a very attractive place to do business, I think. But also, I've talked about stockmarket opportunities as well. You really have to be looking for them.

PA: It's not only that as well; it's a fantastic time to be young again and creating businesses, creating apps, understanding how smartphones work and what you can do with them, understanding the new technology and how they can benefit things in what you can do and how you just… a fantastic time to just be… get creative.

CN: Be alive, yes.

AP: Yes. If you've got a time machine, then we'll try and be young again.

PA: Yes.

CN: Turn back the clock. I just hope, speaking from my own personal experience, once you understand the cycle material, when it comes to stocks, it generates more ideas than you can invest in. It's just… it's just incredible.

PA: It does.

...continued on next page...

AP: It does, yes.

PA: Yes, certainly does.

CN: It's amazing. And especially once you've got some of your charting skills, Akhil, and a bit of money management and how to trade the market, you can really, really clean up. Gentlemen, we've covered a lot today. So thank you for joining me. I hope you've enjoyed it and found it instructive. And thank you for joining us.