Housing Bubbles Reaching Critical Levels in Canada, Australia, and Hong Kong

Retrieved Tuesday 22nd of August 2017 07:34:19 PM

I may have found your black swan. The distant market shock that triggers a local crisis thanks to the long line of dominos reaching around the world and leading to your door. More below.

But first, what did some of our Southbank Investment Research newsletter editors have to say about **yesterday's *Capital %26 Conflict***? I asked them the following question:

Given the stockmarket rally depends on central bank intervention, and we don't know how long that will last, should investors join a potentially doomed rally, or should they wait for a crash and keep their powder dry?

Charlie Morris of *The Fleet Street Letter*, which goes back more than 80 years, argued you should only slightly adjust a sensible asset allocation strategy which holds both investments and cash:

> *Investors should do a bit of both, while avoiding the areas most susceptible* [to **central bank** intervention], *such as **bonds**, and bond-like stocks. Hard assets, banks, insurance and value investments are ok. Emerging markets too.*
>
> *Point is that rates could stay low for ages – and we don't know when they'll go up. Cash is only a short-term investment. Assets are for the long term.*

The key benefit of a balanced asset allocation strategy is that you stand to win from being invested over time. It's too hard to predict the future, but over time investors outperform the overcautious. You can adjust the asset classes you hold a little to reflect the times though.

Charlie also manages a second portfolio within the one newsletter. He calls it the Whisky portfolio. It features his more active and risky bets. Perhaps the two extremes of diversified caution and high-risk selective bets provides the balance you need while avoiding the central bank's control.

Tim Price of *London Investment Alert* argued investors should opt out of the central bank's view of the world and invest based on a different mantra altogether:

I agree that QE [**quantitative easing**] *and ZIRP* [zero interest rate policy] *are probably the primary driver behind most price activity across Western stockmarkets. But it doesn't make sense to try and second guess central banks or make one's investment strategy dependent on what you think they "may" do. This is simply greater fool theory painted on the biggest palette in history.*

To earn superior investment returns, you need an edge. If you do not know what your edge is, or you are simply trying to predict central bank action, you do not have an edge.

The edge that individual investors have over most financial "professionals" is that you do not need to play by their rules.

You do not need to be in the market.

If you are in the market, you do not need to be fully invested.

If you are fully invested, you can invest in whatever you wish – rather than the arbitrary components of some index that everyone else is tracking.

From my perspective, I see attractive value opportunities – bottom-up valuation bargains – along the "road less travelled". That road starts and finishes in Asia, notably in Japan, but also in frontier markets like Vietnam, where there is tremendous potential and yet plenty of cheap stocks.

There are more cheap stocks in Asia than anywhere else in the world. There are pockets of defensive value elsewhere, but most Western markets are expensive. As a sign of just how expensive, the fund managers at GMO expect that investors in the broad US stockmarket – the S%26P 500 index – are likely to lose roughly 4% per annum in real terms over the next seven years, just on the basis of reversion to the mean.

So there's certainly no need to follow everyone else over the cliff. Do something different. If you want to buy stocks, buy cheap stocks on an unconstrained, international basis.

If you are buying Western markets, at least try and be discriminating, and don't pay over the odds just because everyone else is.

QE and ZIRP have effectively destroyed safe havens, and certainly made cash a lot less attractive. So investors today are forced to do something with their money. Electing to do nothing and sheltering in the bank is still a decision.

I recommend genuine asset class diversification – across objectively high quality bonds; defensive value stocks (where they can be found); uncorrelated funds; and real assets, notably the monetary metals, ***gold*** *and silver.*

There may be better ways to protect and grow your scarce and irreplaceable capital over the years to come. But I don't know what they are.

Best,

Tim

For my answer to the question, you'll have to wait for our conference. Tim and Charlie will be speaking too.

Is this the black swan?

The US, Britain, Spain, Ireland and many more saw their housing bubbles burst in 2007. But Canada, Australia and Hong Kong did not.

The answer why is China. China's epic government stimulus saved commodity nations and Hong Kong. It triggered huge debt growth inside China that financed construction with a ravenous appetite for commodities.

But now the Chinese policy has changed to reign in the shadow banking sector. In 2007 the first academic studies of America's own shadow banking sector exposed the problems there too. What happened next is history. Could history repeat itself once more?

The Chinese government has set quotas for lending. Maximums, not minimums. And the lenders are blaring a with lending without realising what this means for the cap. They've used 80% of the annual quota in the first six months of 2017. Which begs the question, what happens for companies needing financing in the last half of the year?

If the Chinese support for commodities ends, the countries relying on it might finally see their housing bubbles burst.

In Canada and Australia, the mainstream media is already on the case. But European and American investors probably have no idea what's at stake.

The Huffington Post reported how Canadians see things:

> *A majority of Canadians say there's a housing bubble, but only a minority believes it will burst in the next year, a new survey has found.*
>
> *The survey from Ipsos, carried out for consumer insolvency firm MNP Ltd., found 67 per cent of Canadians agree that the country is experiencing a housing bubble, but only 43 per cent think it's going to come to an end in the next year.*
>
> *And with the Bank of Canada expected to raise interest rates on Wednesday, a near-majority of Canadians (45 per cent) are worried about what that will mean for their finances.*

If the majority of a nation agrees there's a housing bubble, what does that bode for the economy?

In Australia, the investigative reporting show *4 Corners* exposed Australia's dodgy mortgage system and the size of the burden it's left Australians with. In terms of debt, they're second globally to Switzerland.

Already the housing bubble has burst in some areas of Australia. The foreclosures are exposing remarkable bank practices when it comes to unaffordable lending. That's not a surprise to me given it's the topic of my PhD. You can find my speech about what I've discovered **here.**

But the stockmarket hasn't cottoned on. Australian banks are three times as profitable as their European counterparts and eight times as profitable as UK banks. Australia's big four banks are among the 26 biggest in the world and they dominate the Aussie stockmarket as well as 80% of the Aussie financial system.

In 2012, Australia's financial shares were valued at more than the entire eurozone's in terms of market capitalisation.

The point being that Australia and **Canada's housing bubbles** are big enough to cause a major global disruption and few are considering this possibility. The flow-on effects for the global economy could be enormous.

Until next time,

Nick Hubble
Capital %26 Conflict