MVAM Newsletter

'Lend it, spend it. We're in the money……' May 2018

"He's never forgotten his humble beginnings.

CartoonStock.com

"We're in the money" sang the Sainsbury's CEO after announcing the merger of Sainsbury's with fellow UK food retailer, Asda. While his singing may have been a little off key his sentiments are being shared by boardrooms across the country. The UK's stock market has witnessed a high level of takeover bids for companies such as Sky, Shire, GKN and Hammerson recently. Even more spectacular were the prices paid. The takeovers were launched respectively at 15%, 60%, 40% and 50% premiums to the share prices of those companies prior to the bid. Are investors really undervaluing companies so much or is there something else going on?

Well, companies will always need to pay a premium to take over another, but arguably these huge premiums reflect something else… the growth illusion caused by the early stages of a "crack up boom".

A crack up boom is probably one of the scariest of economic phenomena. It involves hyper-inflation where prices of goods accelerate so fast that nobody wants to hold on to money that is devaluing so quickly. People think of the post First World War Weimar Republic where money was carried around in wheelbarrows. Normally it doesn't get to this point, although tell that to the populations of Venezuela or, now, Argentina. Argentina put interest rates to 40% and asked for help from the IMF after two years of "printing" money.

Not happening here, you think? But the early stages of a crack up boom creep up on you. Initially prices of goods and services begin to rise. People begin to realise this and start to reduce savings to buy goods before the prices go up further. This gives the illusion of a strong economy, speeds up growth, putting more pressure on the supply of goods, services, employment and therefore prices. Company boards, like us all, see the future expected revenue continuing to rise, and are happy to invest more, pay staff more, bid high prices for competitors, not realising their confidence is false. They fail to realise they are fanning the flames of the bidding war for scare capital (real assets and savings). Entrepreneurs judge they can meet the increased costs of production through increased sales and continue to borrow. Banks assume that the higher rates are enough to compensate for rising prices so continue to loan.

The increased interest in producing does generate a new real wealth. However, the rise in wages and profits intensifies the demand for consumer goods before the capital is in place to provide them. Think why the oil price is rising now? Global demand is at an all-time high, yet there has been little investment over the past 5 years when prices have been low. Your savings are being consumed by this increase in oil price.

When you first start to think about this situation, it seems so unlikely that the central banks could not stop the creation of money. But they continue to tread the well-worn path of erring on the side of caution. So, the increasing revenues and profits that the Sainsbury's CEO sees will keep the "sky sunny" and the stock markets "rolling along" for the time being… until matters get out of hand.

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