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MoneyWeek

MAKE IT, KEEP IT, SPEND IT
15 JULY 2022 | ISSUE 1112

Unfinished business

Britain's towering to-do list
Page 12

BRITAIN'S BEST-SELLING FINANCIAL MAGAZINE

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From the editor-in-chief...

Rishi Sunak says that if he becomes prime minster he will cut taxes as soon as he "has gripped" inflation. That would be nice. Over the past 12 years of Conservative government, middle- and high-income-earning households have become "significantly worse off", says The Times. In 2010, tax freedom day (the day when you have earned enough to pay all your taxes) came on 30 May. This year it came on 8 June. You can thank the government for nine extra days working for the state (with, as far as I can see, no obvious improvement in the public services the state provides in return).

This is mostly about fiscal drag: if the threshold for paying the 40% rate of tax had risen in line with inflation since 2010, it would now be well over £58,000. The fact that it hasn't will have cost those who pay it (an extra three million of them since 2010) £1,653 each. The threshold at which you lose your personal income tax allowance is currently £100,000. If it had gone up with inflation it would be just over £130,000. That bit of drag costs those who pay it more than £6,000.

We're ready to pay a bit less tax, Rishi

©Alamy

"Sunak calls himself a tax cutter, but he has been working hard to suppress his true self"

A growing burden

I could go on. But you get the picture: the UK tax burden is now at a 70-year high, with taxes as a percentage of GDP at 33.8% (the last time that number was higher was in 1951). As the chancellor of the exchequer until just over a week ago, Sunak is very, very far from innocent in all this. He calls himself an instinctive tax cutter. But if that is so, he was clearly working hard to suppress his true self during his time in the Treasury.

Sunak oversaw three big tax rises. He raised corporation tax from 19% to 25% with effect from next April. He increased national insurance (NI) rates by 1.25 percentage points for all (and dividend taxes by the same amount, to catch people who mostly get paid in dividends through their own companies). An NI hike is an effective rise in income tax, whether you want to call it that or not. And he froze all allowances again – with inflation heading for 10% this represents another huge tax hike through fiscal drag.

Collectively, those measures should raise £50bn a year in extra revenue by 2024-2025, Sunak reckons. And the tax burden by then? A depressing 36.6%.

Time to change

There is some reason to hold off on tax cuts right now – and particularly to hold off on slashing corporation tax back to 15% as Sunak's rivals seem to want to (all the chopping and changing is a nightmare for companies). It is a complicated and expensive time. But Sunak needs to be careful about how he looks at the numbers – and at those who pay the taxes his party demands.

He warns that the idea that tax cuts can work for the UK economy right now is nothing more than a "comforting fairy tale". He also tells us that "it is hard to cut taxes when the demands on the state are growing" (public spending is forecast to hit 41.1% by 2026-2027). But we do wonder if it might be better to look at this the other way around – and ask if perhaps taxes are too high because the state tries to do too much. We also wonder if the real fairy tale might be in the idea that the UK's working population will put up with their tax freedom day extending any further into June. We may have our limits.

Merryn Somerset Webb

Merryn Somerset Webb
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Career move of the week

Boris Johnson's departure from Downing Street should help him put his "chaotic finances" in order, says The Times. Being in government has famously been tough on Johnson: in 2019, he made £624,000, thanks to speaking gigs and newspaper columns, but as prime minister he earns £164,080. That's "well below the £300,000 a year he tells friends that he needs to keep his head above water" – hence Tory donors being asked to help pay for renovating his flat, subsidising his food bill and even a nanny for his son. After leaving office, his pay as MP will drop to just £84,144 – but that's unlikely to last long. "If previous prime ministers are anything to go by, Johnson has little to worry about." All since John Major have become multi-millionaires, with Tony Blair's net worth estimated to be £100m. Speaking fees (Theresa May has netted £2.5m so far), books (David Cameron snagged £800,000) and perhaps even a spot on a global TV network surely await.

Cover illustration: Howard McWilliam. Photos: ©Getty Images; Volkswagen

Good week for:

Actor **Tom Cruise** (pictured) is set to earn $100m from *Top Gun: Maverick*, taking his career earnings to over $1bn, says Forbes. The sequel to 1986's *Top Gun* should pass $1.2bn at the global box office this week. Cruise's deal reportedly gave him $12.5m up front plus 10% of "first-dollar gross" (what the studio collects – roughly 50% of cinema sales plus streaming and rental revenue).

Government ministers who resigned from Boris Johnson's cabinet this week will receive a total of more than £420,000 in severance pay, says The Times. Ministers get 25% of their salary on leaving office, no matter how long they serve. Michelle Donelan, who was education secretary for 36 hours, said that she would donate her £16,876.25 to charity.

Bad week for:

Police in Gujarat have busted a **fake Indian cricket league** set up to swindle Russian gamblers, says the BBC. The gang was streaming supposed Indian Premier League games over YouTube and taking bets on Telegram. In reality, the rigged matches were taking place on a farm and involved local workers being paid 400 rupees (£4.20) per game.

Former Formula One boss **Bernie Ecclestone** is to be charged with fraud for allegedly failing to declare more than £400m in overseas assets to the UK tax authorities, says The Guardian. The first hearing in the case will take place in August. Ecclestone built up a £2.5bn fortune over the course of almost 40 years running the world's most lucrative motorsports tournament.

©Getty Images; Alamy

Investors dash into the US dollar

Alex Rankine
Markets editor

The worst geopolitical crisis in Europe since 1945 has helped propel the greenback to a two-decade high against the euro

©Getty Images

"Recession in the eurozone is priced in," say analysts at Japanese banking giant Mizuho. On Tuesday the euro slumped to parity with the US dollar – the lowest the euro has traded against the US currency since 2002. The sell-off followed growing concern that the shutdown of the Nord Stream 1 gas pipeline to Germany for annual maintenance could turn into a more permanent closure.

"The ECB [European Central Bank] is fiddling while the currency burns," Neil Wilson of Markets.com told Julia Kollewe and Graeme Wearden in The Guardian. "Inflation above 8% and interest rates remain negative … it's madness."

The euro's slump could be a foretaste of what is to come if a Russian gas cut does materialise, say Lynn Thomasson and Farah Elbahrawy on Bloomberg. Economists at UBS think that the single currency could hit 90 cents to the dollar in that scenario, with corporate earnings falling by more than 15% and a 20%+ drop in the Stoxx 600 index of pan-European stocks. German equities are already feeling the chill after tumbling 11% since June. Shares in gas giant Uniper, which is seeking a government bailout, are down 77% this year.

Considering the circumstances – "the worst geopolitical crisis in Europe since the World War II" – the euro isn't holding up all that badly, says Ambrose Evans-Pritchard in The Daily Telegraph. This is not so much a story of euro weakness as of the dollar's strength against nearly all other big currencies.

Note that the Japanese yen and the Swedish krona have fared even worse against the greenback this year. The dollar index, which tracks the greenback's value against a basket of six major trading partners' currencies, "has gone mad as the US Federal Reserve engages in frenetic triple-decker rate rises, belatedly scrambling to contain the inflationary blow-off of its own monetary creation, and to rein in the greatest fiscal expansion since Roosevelt's New Deal".

Economic logic

The dollar's rally is a matter of "economic logic", says James Mackintosh in The Wall Street Journal. At a time of soaring global energy prices it makes sense for investors to head for America – a country that is "self-sufficient in energy" because of fracking – rather than Japan or Germany, which need to import oil and gas from elsewhere. At some point the current dollar bull trade will flame out, but "without a trigger – a peace deal in Ukraine [that] might restore cheap gas to Germany, or perhaps a dovish turn by the Fed – it is hard to see what could prompt the dollar to turn".

The dollar looks to be trading somewhere "between 10% and 20% north of fair value" at present, say Themistoklis Fiotakis and Sheryl Dong in a Barclays note. In the medium term that overvaluation should unwind, but don't bet on it happening anytime soon. The dollar's current strength rests on its role as a haven in uncertain times. Another "Covid-19 flare-up in China" or "more disruptions to the flow of Russian natural gas to Europe" could yet drive the greenback even higher.

Base metals in freefall – will growth follow?

Copper prices have just suffered their worst quarter since 2011

©Getty Images

"Copper is flashing a recession warning," says Myra Saefong in Barron's. Prices have slumped to their lowest level since November 2020. They slumped by 22% in the second quarter, the metal's worst quarterly performance since 2011. Considered an "economic bellwether" because of its role in everything from electronics to construction, copper's tumble suggests a "sour outlook" for the world economy.

It's not just copper, says Albert Edwards in a Société Générale note. Other "industrial commodity prices are in virtual freefall", with aluminium and nickel down 19.6% and 28.5% respectively since their May peaks. "This is not so much a canary in the coal mine as… the recessionary gorilla charging towards us out of the mist."

Metals markets have been rescued in the past by Chinese stimulus, but don't count on it this time, says Bloomberg News. While Beijing is supporting local government spending on infrastructure, the help is not on the scale of the 2008 or 2020 stimulus. The debt-ridden property sector – a key source of demand for metals – remains fragile, while new infrastructure projects in "cloud computing, 5G networks and data centres are less materials-intensive than the… bridges and high-speed railways" that characterised previous stimulus cycles.

Optimists see metals' slide as an early victory over inflation, but the win might not last. The sell-off may reflect financial speculators reining in their bets, rather than a rebalancing of the underlying physical market. JPMorgan Chase reports that "in the week to 1 July about $16bn flowed out of commodity-futures markets, bringing the total for the year so far to a record $145bn". But in the physical market, "commodity stocks remain 19% below historical average at a time of tight production".

New Zealand's housing falters...

As global central banks start to hike interest rates, New Zealand is "the canary in the coal mine", says Sharon Zollner of ANZ Bank. Spared the worst of the pandemic, New Zealand was one of the first developed countries to start tightening monetary policy. Since October last year the Reserve Bank of New Zealand (RBNZ), the central bank, has raised rates from 0.25% to 2%. This week it announced a further hike to 2.5%, with rates forecast to peak at 4% next year.

That makes the RBNZ "the first of its peers to lift its benchmark rate above a neutral level", which it reckons is 2%, say Matthew Brockett and Enda Curran on Bloomberg. That means that rather than stimulating demand, monetary policy should now start to weaken it. Concern is growing that the central bankers are going too fast, says Lucy Craymer on Reuters.

New Zealand's economy shrank 0.2% in the first quarter and may have entered recession in the second. "One survey showed business confidence has fallen to its lowest level since the start of the Covid-19 pandemic." The housing market is down 9% since a peak last November.

The falls do little to improve affordability, say Nic Fildes and Nick Peterson in the Financial Times. The median home in New Zealand is worth ten times the median annual income. Data from consultancy Sense Partners shows that the median New Zealand house price has jumped by 43% in two years.

... as global property bubble bursts

"Central bankers giveth and central bankers taketh away," says Neil Shearing of Capital Economics. After fuelling a two-year long worldwide boom in house prices with ultra-low interest rates, monetary policy is now tightening and starting to weigh on global property.

By the last quarter of 2021 prices across the 38 members of the OECD (a club of developed countries) had risen 16% in two years, says Valentina Romei in the Financial Times. "That is the fastest pace since records began 50 years ago."

Now rising mortgage rates are reversing the boom. In America average rates on new mortgages have leapt from 2.9% at the start of the year to 5.9% now, says Shearing. That has caused US mortgage applications to tumble 28% from their peak, with new home sales down 17%. Trouble in the US mortgage market brings back nasty memories of the 2008 crisis, but there is "less leverage in today's housing market". Stricter lending standards and more robust bank balance sheets should prevent a repeat of the Great Recession.

©Alamy

House prices in Toronto have slumped by almost 9% since February

The countries at risk

Instead, the situation in neighbouring Canada – where prices have more than tripled since the millennium (compared with a 60% gain in the US) – is more concerning, says The Economist. Canada's long housing boom has rested on a shortage of inventory in big cities like Toronto and a steady "influx of immigrants". Yet in April the government banned foreign investors from buying Canadian homes for two years, and a construction boom should see 2.35 million homes added this decade, more than will be needed to satisfy new household formation.

Prices in Toronto have plunged almost 9% since February, says Enda Curran on Bloomberg. Canada ranks fifth on a Bloomberg index of OECD members facing the greatest "risk of a price correction". The index is based on factors such as price-to-income ratios and credit growth. New Zealand (see column), the Czech Republic, Hungary and Australia round out the top five. The UK comes in mid-table at number 15. Last week Halifax reported annual UK house-price growth of 13%, the highest level since 2004, says Martin Strydom in The Times. While strong employment and the pandemic savings cushion should prevent a big crash, the UK property market appears to be heading for a softer period now that "households are facing the biggest annual drop in disposable income since the 1950s."

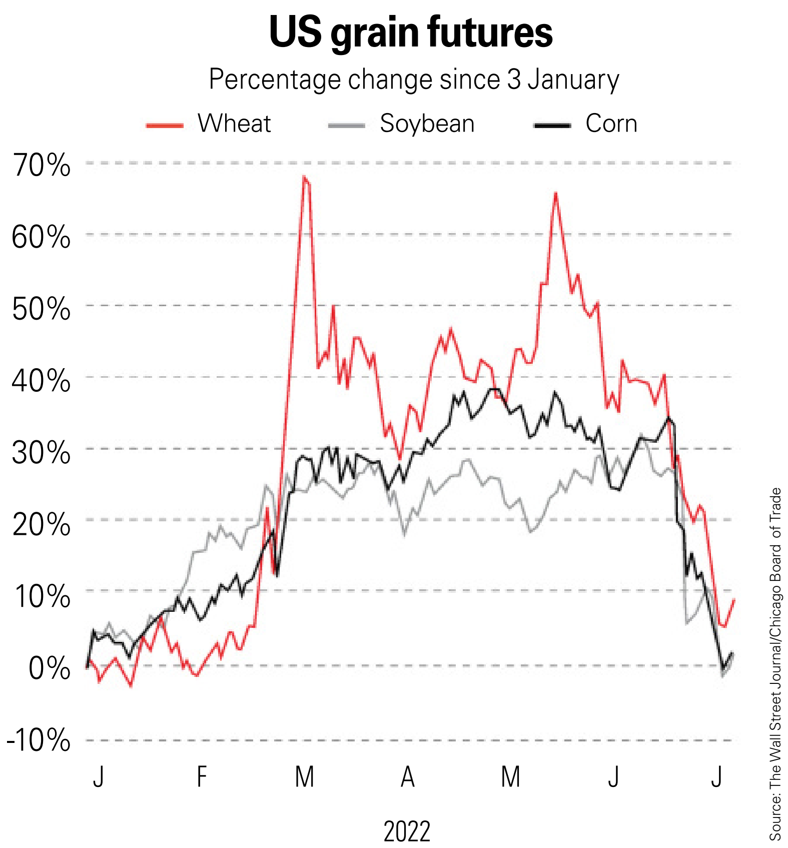
Property is still bubbly in some places. Prices in Portugal jumped 13% in the first quarter of 2022, reports Sónia Santos Pereira in Diário de Notícias. That comes on the back of a 27.5% gain between March 2020 and January 2022, a European record. Attracted by relatively cheap prices and "golden visas", foreign investors are driving the boom.

Viewpoint

"Twitter is a toxic environment for impressionable investors. The people taking the biggest losses [on cryptocurrencies] today are among the most extremely online people in our society. Stay out of rabbit holes. Most of them do not contain a treasure chest at the bottom. The more time you spend exposed to the firehose of opinion, misinformation, promotion and grift on Twitter, the more susceptible you become. Stick around long enough and you can convince of anything. The algorithm is designed that way. I know people whose brains have become scrambled or rewired by it. Can't even have a conversation with them anymore. When you ask: 'How could an otherwise normal middle-aged man who works a 40-hour week and raises a family end up on the steps of the [US] Capitol building swinging a hockey stick at police officers?', the answer is The Internet."

Joshua Brown, The Reformed Broker

■ High prices are the best cure for high prices



The global food crisis is starting to ease. Prices of key crops soared after Russia's invasion of Ukraine, says Michelle Cheng for Quartz. "The two countries together export about 30% of the world's wheat", and the war has also disrupted fertiliser supplies. However, those post-invasion gains have since been undone, with soy and corn prices flat since the start of the year and US wheat futures down 35% since their 7 March peak. That partly reflects hopes for favourable weather for US corn and soybean harvests. Demand has also slid as higher prices cause consumers to eat less meat (which reduces the demand for animal feed) and use less fuel (corn is a key source of biofuel). As ever, the best cure for high prices is high prices.

Musk turns back on Twitter

The billionaire investor has withdrawn his bid for the social-media platform, triggering a legal imbroglio. Matthew Partridge reports

After a “dramatic few weeks of speculation that his deal to take over the company was falling apart”, Elon Musk decided last week to withdraw his $44bn bid for Twitter, says The Guardian. After he agreed to buy the group for $54.20 a share in April, the deal took a “sour turn” when Musk “accused Twitter of withholding information about the number of “spam” accounts on the platform. He now alleges that Twitter is in “material breach of multiple provisions” of their agreement, and has made “false and misleading representations”.

Musk’s move leaves Twitter with three options – “none of them good”, says Danny Fortson in the Sunday Times. While Twitter could use the law to force him to complete the deal, “the awkwardness of forcing a billionaire with buyer’s remorse to purchase a company that he says he no longer wants is hard to overstate”. Another option would be to “swallow hard and go back to the negotiating table to agree a new, lower price”. Finally, it could “let Musk walk, take him to court for the $1bn break-up fee, or billions more in shareholder damages, and pursue life as an independent company”.

It looks as if Twitter is going down the first route by hiring a law firm “to enforce the merger agreement”, says Gina Chon on Breakingviews. The battle could certainly get “messy” for all concerned, especially since Musk is likely to hit back by trying to “undermine Twitter’s business model and perhaps even some of its board members”. What’s more, Twitter is unlikely to persuade Musk to change his mind and go through with the deal, especially since his financing “may be getting shaky”. However, the fact that the controversy has caused Tesla’s stock to fall means that Musk may be willing to offer a “massive fee” in order “to get Twitter off his neck”. Most experts agree that Musk faces an “uphill battle” in his quest to walk away from the deal, especially since the agreement contains a “specific performance clause that commits Musk to finish the deal if all other closing conditions are met”, says the Financial Times. While Musk will argue that the fall in tech shares constitutes a “material adverse event” that annuls the deal, Delaware courts have only once accepted such an argument, and have “generally been unimpressed” with “skittish buyers” trying to get out of deals. What’s more, his behaviour gives Musk a “serious credibility problem”.

©Getty Images

Musk alleges that Twitter has breached multiple provisions of their deal

Even if Musk is forced to “write a big cheque”, say Dan Gallagher and Laura Forman in The Wall Street Journal, Twitter’s future looks bleak. Musk’s disputed claims about the number of fake accounts on Twitter highlight the fact that “it is impossible to know just how many real users Twitter’s platform has”. Meanwhile the departure of three key executives since the deal was announced shows that Twitter has become “an unappealing place to work”. While Musk may talk about “adverse effects”, Twitter shareholders may find out that the whole “Musk affair” looks like “the worst effect of all”.

Bill Ackman finds nothing to buy

Having raised $4bn in July 2020, investor and hedge-fund manager Bill Ackman (pictured) is now “winding up the largest-ever special-purpose acquisition company [Spac] after failing to find a target”, says Julie Steinberg in the Wall Street Journal. Regulations state that Spacs, listed shell firms that raise money from outside investors with the aim of merging with a private company, need to do a deal within two years or return their money to investors.

With the deadline close, Ackman decided that Pershing Square Tontine Holdings (PSTH) “couldn’t find a target that met its investment criteria”. PSTH was dealt a major blow last year when its attempts to pull off a “complex and novel transaction with Universal Music Group” fell through, says Ortenca Aliaj in the Financial Times. The deal would have involved Ackman taking a 10% stake in the company without floating it. He was forced to abandon his plan “following a backlash from regulators”. Meanwhile PSTH was hit with a lawsuit from a former commissioner with the US Securities and Exchange Commission, who claimed that Ackman’s Spac operated as “an illegal investment company”.

©Getty Images

Ackman deserves credit for returning investors’ funds, plus interest, rather than pursuing transactions to keep the fund alive, says Chris Bryant on Bloomberg. Still, the fact that PSTH was “the largest ever” Spac means its demise is “a grim milestone for the asset-class”. As Spacs have lost large amounts of money for their shareholders in “ill-conceived” deals, it’s also likely that “plenty more will fold in the coming months”.

Drug giant on a shopping spree

©Getty Images

Not content with buying Acceleron Pharma for $11bn last year, drug giant Merck is now eyeing up biotech firm Seagen, which develops novel cancer therapies, says Michelle F Davis on Bloomberg. There could be an agreement within weeks. If the deal does go ahead, Merck is likely to end up paying as much as $200 a share for Seagen, a roughly 14% premium to its price before the rumours emerged, bringing the total bill to about $37bn.

There are certainly good reasons for Merck to buy Seagen, says the Wall Street Journal. It would “help broaden its line-up of cancer drugs”, which are currently led by the blockbuster immunotherapy Keytruda. While Keytruda generated $17.2bn in sales last year, and is expected to account for 40% of Merck’s revenue in the following few years, it is due to go off patent at the end of the decade, which will vastly reduce its value. Seagram’s range of cancer drugs, known as antibody drug conjugates, some of which have already been approved, could “help offset the sales blow”.

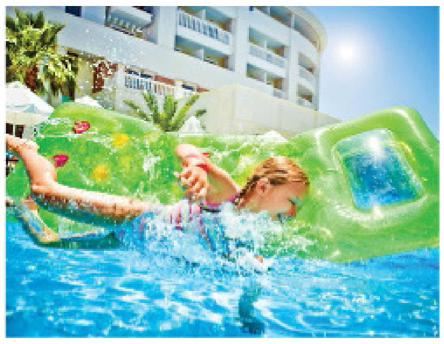
Still, even if the two companies do agree a deal there is no guarantee that it will be allowed, says Lex in the Financial Times. One of the main stumbling blocks is the Federal Trade Commission, the US antitrust watchdog, which has become particularly “aggressive” in blocking mergers. It has already derailed Nvidia’s planned $40bn acquisition of Arm and Lockheed Martin’s $4.4bn agreement to buy Aerojet Rocketdyne.

The fact that both companies have a “strong presence” in the oncology market is likely to make any tie-up particularly problematic: drug prices are an “area of concern” for the White House. As a result, its no wonder that Seagen shares are still “trading well below the reported $200 offer price”.

MoneyWeek's comprehensive guide to this week's share tips

Three to buy

On The Beach
Shares
Suggesting investors buy shares in holidays group On The Beach in the midst of all the travel chaos "might sound mad". But the business is "fundamentally sound" and its long-term prospects look solid. The stock is trading at its lowest valuation in seven years and demand is rising: UK holidaymakers will spend around £7.3bn on package holidays this year, and that will jump to £9bn by 2026. The shares are at 129p, but analysts believe they could jump



to between 400p and 500p within 12 to 18 months, making now the time to buy. *129p*

Rio Tinto
The Sunday Telegraph
Volatile markets provide an opportunity to buy companies such as miner Rio Tinto. Over the last year the stock has dropped by 18%, but the company's solid balance sheet and net cash of £1.3bn will shield it from rising interest rates. The company has an "exceptionally wide" safety margin to fall back on if a turbulent economy hits short-term profits, and over the long term it will benefit from rising demand for iron ore, copper and lithium, all of which are essential for the transition to renewable energy. *4,835p*

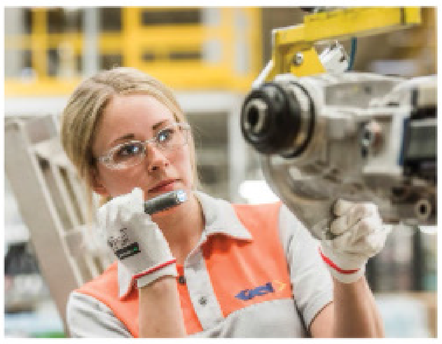
Serabi Gold
The Mail on Sunday
Gold "comes into its own" during economic uncertainty, so now is a good time for gold investors and gold miners. Serabi Gold's mine in Brazil struggled after it opened 20 years ago, but was turned around by "geologist turned mining company doctor" Mike Hodgson. Serabi is developing another two sites, one of which could yield large amounts of copper. That could lead to lucrative deals with big miners keen on the red metal. *39p*

Two to sell

Domino's Pizza
The Times
Until recently franchisees "had Domino's in a headlock". They were dragging their feet on opening stores while insisting on higher marketing and technology expenditure and better profit-share terms. The company reached a "breakthrough agreement" at the end of last year and is now opening 45 new stores. Nonetheless, the outlook is inauspicious. The firm's offerings are good value, but lower-income households are grappling with a significant squeeze on budgets. While promotions might lure customers and bolster overall orders, franchisees already dealing with higher costs, including higher delivery-drivers' salaries and energy bills, may not be inclined to pursue this strategy. It seems investors are already pricing in an uphill struggle. The stock is close to an eight-year low and on a lower rating than in March 2020. Despite a yield of 3.5%, it may not move higher anytime soon. Avoid. *$401*

Inland Homes
Investors' Chronicle
Management at southeast England-focused housebuilder and developer Inland Homes has maintained full-year profit expectations despite a first-half loss of £8.2m on revenue of £80m. First-half results were hit by £10.9m of pre-tax losses on housebuilding. The board has put cost-control measures in place to bolster returns, but the company is now facing cost-inflation pressures and supply-chain problems. Its operational performance "has been far from plain sailing" since the Covid-19 market slump and the share price has yet to recover. Land-buying activity could also slow if the economic backdrop in Britain worsens, so a return to profit could take time. Sell. *39p*

...and the rest



Investors' Chronicle
Eli Lilly's shares look expensive, but the company stands out in the pharmaceutical sector. It is not facing any imminent patent expiries, its pipeline is focused on high-growth areas and its growth rate is eclipsing the sector's average. Buy *($325)*. **Melrose Industries'** takeover of GKN has proved tumultuous, but most of the risky operational challenges have now been addressed. The company, which specialises in automotive and aeronautical engineering, has repaid a large chunk of its debt too. Buy *(153p)*.

The Mail on Sunday
Brazil is the fourth-largest consumer of fertiliser in the world, yet it only produces 4% of the fertiliser it needs. **Harvest Minerals'** Brazilian site is producing pure organic fertiliser and selling directly to farmers. The future looks bright: it has brought in new business and should benefit from "Russia-induced turmoil". Sales and profits should both rise at a steady pace. Brave investors could "take a punt" at current levels. Buy *(13p)*.

The Sunday Times
The Restaurant Group, owner of Wagamama and Frankie & Benny's, is due to struggle from rising costs, but its shares "look a bargain". Investors might have lost their appetite, but the company's meals out "for the masses look set to be our new little luxuries". Buy *(44p)*.

The Times
JD Sport's "stellar" outperformance against the FTSE 100 over the last five years has "sharply reversed" and the shares are now the cheapest they've ever been. Given the company's optimistic outlook and its growth opportunities, now is the time to buy *(123p)*.

A German view

Vossloh is on the right track, says Börse Online. The rail infrastructure group, whose products range from tracks and concrete sleepers to fastening and signalling systems, is set to benefit from a local and global effort to improve rail infrastructure. Germany recently announced a multibillion-euro revamp of the country's tracks and points, while the latest G7 meeting produced a $600bn worldwide infrastructure investment programme, a significant proportion of which will be devoted to railways. Vossloh recently raised its forecasts for 2022, with sales now expected to reach up to €1.5bn; orders are pouring in. A recent dip in the share price and a yield of 3% are further reasons to buy.

IPO watch

Italian manufacturer De Nora has launched the first major initial public offering (IPO) in Europe since the start of the Ukraine war, says CNBC. It floated in Milan last week. De Nora specialises in electrode and water-treatment technology, but is expanding into the production of "green hydrogen" through electrolysis, which it hopes will become increasingly competitive as the price of natural gas rises. The group's confidence in its longer-term strategy helps explain why it made its debut in a volatile market, with the pan-European Eurostoxx 600 down by 14% in the first half of 2022. The shares were priced at €13.50, valuing the group at €2.7bn.

©Domino's; GKN/Melrose Industries; On The Beach

Who will be the next PM?

The race is on to replace Boris Johnson. Who has the right credentials? Emily Hohler reports

On 5 September Britain will know the name of its new prime minister, says George Grylls in The Times. The eight candidates who remained on Wednesday (see picture, top row from left: Penny Mordaunt, Rishi Sunak, Kemi Badenoch and Nadhim Zahawi; bottom row: Jeremy Hunt, Tom Tugendhat, Liz Truss and Suella Braverman) need to secure at least 30 votes to stay in the race. This is the first in a series of secret ballots that will whittle the field down to a final two, almost certainly by next Thursday. Those two will then go forward to a vote by Conservative Party members.


The hopefuls: who has the safest pair of hands?

©Getty Images

"High competence"

At the time of going to press, Rishi Sunak, the 42-year-old former chancellor, was the frontrunner "thanks to first-mover advantage" (his resignation, along with Sajid Javid's, last week, led to an exodus of nearly 60 MPs), a "slick campaign launch video" and the backing of more than 50 MPs, say Sebastian Payne and Martin Stabe in the Financial Times. William Hill puts his odds of being the next PM at 13/8. Penny Mordaunt, trade policy minister and former defence secretary, has the next greatest support amongst MPs, followed in third place by foreign secretary Liz Truss.

In a blow to Sunak, however, a Wednesday YouGov poll of 800 party members suggests that Mordaunt would beat every other candidate including Sunak by a "wide margin", says Oliver Wright in The Times. Despite her relative lack of top-level experience – she is not even in the current cabinet – she has consistently polled as a leading choice among Tory party members and was also the top pick in a poll this week by the Conservative Home website.

The 49-year-old, a reservist in the Royal Navy and one of the party's "more colourful MPs", has "played on her outsider status to appeal to MPs and activists from different wings of the party," say Sebastian Payne and George Parker in the FT. Much of her support comes from the 2019 intake of MPs who "see Johnson's departure as a chance to make a break from the past". David Davis, the former Brexit secretary, described her as a "woman of incredible integrity" and "high competence". Unlike other candidates, she is "not trying to appeal to an urban electorate"; one ally describes her as very "Middle England". She has said she does not want her leadership pitch to be about personality, and, in an article for The Daily Telegraph, pledged to cut taxes with a fiscal rule "that debt as a percentage of GDP should fall over time". She has also said fuel duty would be cut and income-tax thresholds for low- and middle-income earners would be raised.

Voters need a break from the past, says Madeleine Grant in The Daily Telegraph. Truss risks being labelled as the "continuity Boris" candidate. Sunak, though clever and decent, is also closely associated with Johnson and partygate, however unfairly, and "has been captured by groupthink on the economy". Labour would "make hay with his family wealth". Sunak's rise has been "bruised by misjudgments", but such matters are in the past and the "raw fact" is that he remains the only candidate with a "record of sustained competence in one of the toughest offices of state", says Simon Jenkins in The Guardian.

Truss has "shown herself startlingly lightweight in her public pronouncements. Her attempt to portray herself as a new Thatcher and as the beacon of the party's right wing (she was a "vocal Remainer" in 2016, notes Henry Zeffman in The Times) is "ludicrous".

What Britain needs at this time is a "calm intelligence applied to the task of steering it through" an extremely disruptive period. Most polls show Sunak is favoured by the wider British public. The 200,000-odd Tory party members "must stand proxy" for them. As the New Statesman's Oliver Eagleton puts it, Britain's next PM should "forgo ambitious policies and focus on good governance. No grand designs are needed; just a safer pair of hands".


Will his nightmare come true?

©Getty Images

Who Keir Starmer should be praying for

Kemi Badenoch as Tory party leader would be Labour's "worst nightmare", says Madeleine Grant in The Daily Telegraph. "Intelligent, straight-talking, young, black, female, a first-generation immigrant", she has the potential to "disarm the Opposition" and rob them of their "most potent lines of attack". She has "properly conservative instincts" and has "ruled out unfunded tax cuts, insisting that any reductions be accompanied by institutional reform and a permanent shrinking of the state". She has a "coherent philosophy" which the Tories "sorely need".

Rishi Sunak is a much more likely choice and Labour will be "praying for the Tories" not to vote for him, says Simon Jenkins in The Guardian. His final days at the Treasury and fight against Johnson's "plea for tax cuts" saw him strong in his resolve to "balance the needs of public spending against the dangers of a budget deficit and soaring indebtedness".

If Sunak or Penny Mordaunt wins the contest, both major parties will be led by "conservative, managerial types – proudly bereft of ideas – whose main function is to banish the memory of their populist predecessors", says Oliver Eagleton in the New Statesman. If the new PM can "stay scandal-free, then Keir Starmer's electoral strategy – presenting himself as the law-abiding antidote to Tory sleaze – will come undone".

Mordaunt "stands the best chance of giving Labour a run for their money" at the next election", says Tom Harris in The Daily Telegraph. She appeals to both left and right. "She's a Brexiteer, but it doesn't define her." She represents a chance for the country to heal the divisions caused by the referendum. And crucially, she is "innocent of the charge" of either treachery against or complicity with Boris Johnson. If the Tories "are serious about holding back the Labour tide", they will opt for Mordaunt.

Shinzo Abe's legacy

The murder of Japan's former PM may spark reform. Matthew Partridge reports

Abe: a consequential if polarising figure

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Japan's former prime minister Shinzo Abe was shot and killed by a gunman while out campaigning last week. The murder was a "tragic coda to the life of one of the most consequential politicians of modern Japan", says The Economist. Abe was a "polarising" figure, but won acclaim for his "three arrows" economic policy – loose monetary policy, expansionary fiscal policy and structural reform – which is credited with pulling Japan out of its "long deflationary doldrums" and boosting stockmarkets. He also changed Japan's legal framework to allow its armed forces to play a more active role globally.

Exploiting nationalist feeling

The latter change was controversial, says Jeff Kingston in The Guardian. Critics worried that the move "greatly expanded what Japan could do militarily in support of the US" and undermined its pacifist post-war constitution. Dissenters from his economic policies claimed that they amounted to "little more than a branding strategy to generate a buzz rather than a blueprint for economic revitalisation". And Abe failed to deal with Japan's mounting challenges, not least "the demographic time bomb of a rapidly ageing society". His time in office was also associated with "allegations of cronyism and a lack of transparency".

Abe undoubtedly did a lot to "solidify Japan's liberal international standing", but he wasn't averse to exploiting nationalism to "boost his popularity and strengthen his leadership", says Saori Shibata in The Conversation. This sometimes backfired – Abe mired Japan in diplomatic disputes that damaged relations with South Korea over Japan's use of sex slaves during World War II, and with China over the mass rape of Chinese women. At home he faced criticism for the "considerable control and influence" he exercised over the media and was accused of orchestrating the removal of controversial television presenters who "dared to voice criticism of his domestic and foreign policies".

A life-long ambition may finally be realised

Abe's murder has gifted the Japanese government with "a historic opportunity to revise the country's pacifist constitution", which was one of Abe's "life-long ambitions", say Kana Inagaki and Antoni Slodkowski in the Financial Times. The Liberal Democratic Party won a "landslide victory" in elections to the upper house on Sunday on the back of revulsion against the assassination, and its allies now have the two-thirds majority needed to put changes to the constitution – which was written by US occupying forces after the war – to a public vote.

A "number of issues" still stand in the way of such changes, however, say Will Fee and Kanako Takahara in The Japan Times. First among them is that, although the murder puts current PM Fumio Kishida under pressure at least to "go through the motions" on moving forward with the constitutional changes, Abe's death removes "the leader and unifying force of pro-revision and conservative politics in general". Kishida may well decide to "prioritise economic reforms and redistribution" instead.

Putin cuts off the gas to Europe


Putin: exploiting Europe's vulnerability

Russia closed the Nord Stream 1 pipeline, the major source of gas to the EU, on Monday, raising fears in European capitals of a "supply crunch that could freeze whole sectors of the bloc's economy", says Politico. The stoppage was part of a planned ten-day outage for maintenance, with production expected to resume, but there are mounting fears that Russia could shut it down for good as part of president Vladimir Putin's plan to divide Europe over policy on his war in Ukraine.

Putin has reassured Berlin that Russia is "ready to fulfil its obligations" by resuming transport as soon as possible, says Oliver Moody in The Times. But Berlin is taking the threat of disruption so seriously that it has persuaded Canada to override sanctions and return an impounded turbine previously destined for the pipeline. Germany is right to be worried: if the pipeline isn't turned back on, the results could be catastrophic, causing a collapse of nearly 13% in the German economy, sparking what would be the country's worst recession since World War II.

Even if the Russian leader is willing to grant Europe a "reprieve" for now, however, he will be "delighted" by the response he has had, says The Economist. The row between Germany and Canada makes sanctions look "counterproductive" and Europe's vulnerability will encourage Putin to "use the gas weapon" at a moment of "maximum leverage", most likely in the winter. The EU as a whole needs to do more collectively to enhance energy security by further boosting gas-storage levels, diversifying energy sources and encouraging cuts in demand.

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Betting on politics

The Conservatives are voting this week in successive rounds each day to narrow the list of candidates down to a final two who will then face the party membership (see previous page). This means the prices available will have changed considerably by the time you read this column, so it makes sense to wait until next week before I make a recommendation. Instead, I'll focus on the various markets on the US mid-term elections, which are now less than four months away. Bookmakers and betting exchanges have added additional markets over the past few weeks.

One contest worth betting on is the gubernatorial race in Michigan, where the Democrat incumbent Gretchen Whitmer (pictured) is facing re-election. The Republican candidate

©Getty Images

will be decided by a primary at the start of next month: businesswoman Tudor Dixon and congressman Ryan Kelley are the two frontrunners. With £1,131 matched on Smarkets, the Democrats are favourites to win the contest at 1.31 (76.3%), with the Republicans out at 3.8 (26.3%).

This should be a tough contest for Whitmer as Michigan only narrowly voted for Joe Biden two years ago, with barely more than a third of residents thinking he is doing a good job. But Whitmer seems popular, with nearly half of people approving of her, giving her a net approval rating that's in positive territory. She also has strong poll leads over Kelley and Dixon in head-to-heads. I suggest you bet on the Democrats to win this contest.

London

GSK heads for break up: Shareholders have overwhelmingly voted to break up pharmaceuticals giant GlaxoSmithKline (GSK) through the demerger and listing of its consumer healthcare business, Haleon, later this month, says Alex Ralph in The Times. At the general meeting last week, 99.8% of investors approved the plans. Glaxo Wellcome merged with Smith Kline Beecham in 2000 to form GSK, today one of Britain's two leading drug companies, producing vaccines, pharmaceuticals and consumer healthcare products. It will continue to focus its investment on the pipeline of its remaining biopharma business under a strategy begun in 2018 to turn around GSK's long-running underperformance, according to chief executive Emma Walmsley (pictured). She took over as CEO the previous year.

Haleon is expected to be the largest listing in Europe in over a decade, but it will "immediately be saddled with billions in debt", says Calum Muirhead in the Daily Mail. The company will have a debt load of around £10.3bn when it lists, equivalent to four times its estimated earnings for 2022, say analysts at Barclays. Haleon is expected to be valued at £38bn to £45bn, although GSK had previously rejected a £50bn offer for Haleon from consumer goods giant Unilever, saying it undervalued the business. Swiss giant Nestlé also considered making a bid in what would have been its biggest-ever deal, before backing out earlier this year. Walmsley expects the demerger to return GSK to "really competitive growth".

New York

PepsiCo fizzes: Purse strings have continued to tighten owing to rising consumer prices but shoppers are still buying fizzy drinks and crisps, says Alex Harring in The Wall Street Journal. PepsiCo reported a 5.2% increase in revenue in the latest quarter from a year earlier despite an average rise in prices of 12%. The company increased prices to help offset increased costs in packaging, transportation and ingredients; year-on-year prices were up 10% in the first quarter of this year and 7% on the fourth quarter of last year. CEO Ramon Laguarta welcomed the results, but warned that a recession is probable. The company is preparing plans for a reduction in capital spending, an increase in automation and a shift in investments from growth to productivity. The results make sense, says Ian King on Sky News. Retail spending has certainly taken a hit in Britain, but consumer spending is "actually holding up". Analysts at bank Jefferies noted non-essential spending rose for the 13th consecutive month. Compared with the pre-pandemic era, spending on takeaways and fast food in May was up 82%, with spending in bars, pubs and clubs up by a "comparable amount". Profits at Pepsi fell from \$2.4bn to \$1.4bn year-on-year for the quarter, but "on the whole… these were stronger results". Whether it can continue growing sales at this pace remains to be seen due to rows with stockists over pricing. In March, its Frito-Lay crisps briefly disappeared from Canada's biggest retail grocer's shelves.

Paris

EDF nationalisation: Shares in energy utility Électricité de France (EDF) surged on news the French government is preparing to pay around €8bn to buy the 16% of the company that it doesn't already own. A tender offer to minority shareholders avoids steering a nationalisation bill through Parliament, and it is "shaping up as the swiftest and most viable plan", say Sarah White and Leila Abboud in the Financial Times. The government of president Emmanuel Macron (pictured) says the move will "bolster" the group's finances as it prepares for expensive investments in nuclear reactors and it will help France to gain greater control of electricity prices as Europe is "rocked by an energy crisis". There are fears that Russia will not restart gas supplies to Europe after maintenance work on the Nord Stream 1 gas pipeline is completed later this month, says Alex Lawson in The Guardian. Last year, EDF's nuclear production accounted for 69% of France's electricity supplies, but this is likely to fall steeply this year because of maintenance, refuelling and repairs at 12 reactors. The firm is building Hinkley Point C nuclear power station in Somerset, but this is not expected to be operative until 2027 due to construction delays.

The way we live now... the rise of the Gentleminions

Minions: popular on TikTok

©Universal Pictures

Cinemas have paid out thousands of pounds to customers who say their enjoyment of watching *Despicable Me* spin-off *Minions: The Rise of Gru* has been spoiled by "Gentleminions" – teenagers dressing up in suits in imitation of the central character, says The Times. The trend took off on video-streaming platform TikTok when well-dressed users filmed themselves watching the film, prompting others to do the same, while cheering and clapping. Vue Cinema in Worcester issued £1,300 in refunds in a single day.

Minions made \$128m in its opening weekend in the US and Australia. Besides, Gentleminions could be the saviours of cinema, says Stuart Heritage in The Guardian. Fans, who have grown into teenagers in the five years since the release of the last sequel, *Despicable Me 3*, may be exhibiting "genuine joy". But they are probably being ironic. If so that could prove lucrative just as *The Room*, a giant flop, became a favourite with fans. If cinemas start hosting dedicated screenings of *Minions*, it could still be in cinemas come Christmas.

Moscow

Miner collapses: London-listed Russian gold miner Petropavlovsk is filing for administration after it struggled to refinance its debts and secure a buyer for its mines in eastern Russia, says Neil Hume in the Financial Times. The company, one of the few Russia-focused firms still trading in London, requested trading in its shares be suspended on Tuesday. The company's appointment of Opus Business Advisory Group as its administrator is the "latest twist" for what was once the London Stock Exchange's biggest gold miner. Following years of boardroom turmoil, it was ultimately brought down by the war in Ukraine after Britain placed sanctions on Gazprombank, Petropavolvsk's main lender. Petropavlovsk had borrowings and gold sale agreements with "the offshoot of the state-controlled Russian gas group", including a $200m loan and an $86.7m credit line. The bank demanded Petropavlovsk repay its loans immediately in April, but, Petropavlovsk has said it is unlikely to be able to refinance in the near term.


Petropavlovsk is in a hole

Zhengzhou

Protests quelled: Authorities in the central province of Henan, China, have agreed to start repaying most of the victims of the country's biggest bank scam, following weeks of angry protests, and clashes with what are thought to be plainclothes police officers, says Bloomberg. An official probe found that Henan Xincaifu Group Investment Holding, a private investment firm with stakes in five rural lenders, colluded with bank employees to transfer deposits and balances from financial products by fabricating lending agreements. Accounts were frozen during the investigation, which is still ongoing, leading to protests in the provincial capital of Zhengzhou from depositors unable to access their savings. Individuals with deposits of up to ¥50,000 (£6,250) will be repaid first. Those with bigger deposits may not be repaid in full. Tens of billions of yuan are thought to have been siphoned off in the suspected scam.

"China's small-bank crisis is far from over," says Yawen Chen on Breakingviews. While China's 1,600-odd village banks are too small to pose a systemic risk, they nevertheless play an important role in providing financing to local businesses. The regional pain is "already being felt".

Milan

Benetton deal: The billionaire Benetton family, through its Edizione holding company, has agreed to sell its majority stake in motorway restaurants operator Autogrill to Swiss-based duty free firm Dufry, creating a $6bn player in the travel retail market. In return, they will become the biggest investor in Dufry, with a stake of up to 25%. Dufry will then make a bid for the rest of the Italian holding company. Other Autogrill investors will receive a new Dufry share, or €6.33 for each share they own, valuing Autogrill at €2.4bn. New boss Alessandro Benetton (pictured), who took over from his father, the group's co-founder Luciano, earlier this year, has continued the shake-up of €11bn Edizione that began in 2018, in the wake of the deadly bridge collapse in Genoa, on a section of road managed by the group's Autostrade per l'Italia company. Edizione later sold Autostrade. For Autogrill's shareholders, the "meal deal… arrived cold", says Chris Hughes on Bloomberg. The "ungenerous" offer deprives investors of the takeover premium "they were clearly expecting" and the shares fell by almost 10% in Milan on the news. But the logic for Edizione is "clear" – "diversification and exposure to a larger travel market for food and retail".

Sri Lanka

President flees: Sri Lanka's prime minister, Ranil Wickremesinghe, declared a state of emergency on Wednesday after president Gotabaya Rajapaksa fled to the Maldives on a military jet just hours before his resignation was due, says Hannah Ellis-Petersen in The Guardian. Wickremesinghe subsequently assumed the powers of acting president. Rajapaksa had faced weeks of protestors' calls for him to be prosecuted over allegations of corruption and human rights violations. The Parliament's speaker confirmed the president would make arrangements to send his official letter of resignation, which would allow the government to trigger a succession plan and allow an interim president to step in and organise an election. "Citizens and creditors alike… face a long road to recovery," says Una Galani on Breakingviews. The latest wave of protests came after the prime minister declared the country bankrupt "and petrol pumps ran dry". Citizens are facing a food and medication shortage, and inflation in Colombo is running at 55% year-on-year. Political parties look set to create a unity government that might make it easier to accept the sweeping reforms required by the International Monetary Fund (IMF) for a $3bn rescue package. But that would require cutting the country's public-debt ratio by at least a third. It stands at 120% of GDP.

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Britain's towering in-tray

Our economic problems are piling up rapidly following the last few years of drift and chaos. What should we do first? Simon Wilson reports

Boris Johnson's administration failed to work hand in glove with business

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What's happened?

The candidates for the Conservative leadership have been spraying around promises of tens of billions in tax cuts. In response, Conservative ex-chancellors and other grandees lined up to give the would-be new PMs a telling-off. Former chancellor Norman Lamont attacked the "Dutch auction" of unaffordable tax cuts. And William Hague said the promises would undermine the party's "priceless reputation for disciplined economic management" – and were doubly dangerous in a prolonged period of "high inflation, a recession, or both".

Is the UK facing a recession?

The country, and its new prime minister, are facing multiple serious economic challenges. Inflation is at a 40-year high and moving higher. The UK tax burden is rising from 33% of national income to a planned 36.3% in 2026-2027, according to the Office for Budget Responsibility's spring forecasts – the highest level since the late 1940s. The public debt-to-GDP ratio is close to its highest level since the 1960s: 95%. Consumer confidence has slumped to a 50-year low amid the income squeeze. And there's no sign of a solution to the UK's productivity puzzle. "Productivity growth in the years since the financial crisis has been weaker than at any time since the dawn of the industrial revolution," notes David Smith in The Sunday Times. In the 30 years after 1945, it expanded by 3.6% a year, but has since slowed to 0.2%. Low business investment, poor infrastructure, low skills and overcentralisation are key reasons. The last problem was supposed to be partly rectified by "levelling up" the regions to make the UK less London-centric, but there has been scant movement on that front. Meanwhile, the OECD, an association of developed countries, expects Britain to have the slowest growth and highest inflation of any major economy next year (zero and 7.3%).

> *"Productivity growth hasn't been this weak since before the industrial revolution"*

Why so grim?

Much of the developed world is suffering from higher inflation and slowing growth, with higher energy prices, supply-chain problems and labour shortages colliding with the post-pandemic surge in demand. Meanwhile, our exit from the EU's single market has hampered trade, while inconsistent policymaking and the recent political chaos are also weighing on the pound. Sterling has fallen from $1.39 to $1.19 over the past year, despite four interest rate rises since December. In the short term, Nomura forecasts sterling at $1.10 by September, the weakest level in more than 30 years, with currency strategist Jordan Rochester even mooting sterling parity for the first time, due to the UK's heavy reliance on dollar-denominated energy imports.

Why does that matter?

A weaker currency could help exporters, but it reflects investors' worries about the long-term structural weakness of the UK economy. And for a country so famously dependent on the "kindness of strangers" to service our ballooning current-account deficit, a weak currency makes us even more vulnerable if sentiment changes rapidly. The overarching task for whoever replaces Johnson – the man who responded "f**k business" when challenged over concerns about Brexit – is to offer stability, competence, and to start rebuilding trust, said Ben Wright in The Daily Telegraph. "The tragic irony of Johnson's premiership is that so many of his big policies were only going to work if his administration worked hand in glove with business." Private enterprise should have been at the heart of levelling up, investing in renewable energy, creating a scientific powerhouse and forging new trade deals. Instead, it has been traduced, mocked and ignored. The most urgent job for the new PM will be to identify "the areas in which the UK economy lacks the skills it needs, work out how to train British workers in them and issue fixed-term visas to foreign workers" to fill gaps.

Do lower taxes boost the tax take?

If fiscal policy were so magically easy, the tax rate could get ever closer to nil and the Treasury's coffers would be overflowing. Rishi Sunak is right that "tax cuts do not pay for themselves – at least, in the short run", says Roger Bootle in The Daily Telegraph. But they will pay off in the long run if they give an incentive to "both businesses and individuals to base themselves here and to strive for success". Moreover, tax cuts are only modestly inflationary, and for all the damage that sharply rising prices cause, the current bout of higher inflation can do the new PM fiscal favours: it will boost government revenues more than proportionately (especially via ex-chancellor Sunak's frozen income-tax thresholds) and will reduce real spending. The Treasury could easily hand back this unexpected windfall without threatening fiscal stability.

So tax cuts would be a good idea?

Contrary to much media coverage, tax cuts are not some "weird Tory fixation, utterly divorced from the real-world concerns of the British people", says Robert Colvile on CapX. The country's number-one political issue is the cost-of-living crisis – and tackling it might just involve letting us keep more of own money. In particular, taxes on business and investment have the worst impact on long-term growth. The planned rise in corporation tax due next spring is a huge mistake (see page 14). Whoever wins, it should be scrapped. Indeed, the UK is actually an exception in tightening fiscal policy in the face of the current crisis, says economist Julian Jessop in his Charter for Tax Cuts. A looser fiscal policy (tax cuts) could actually help control inflation, both directly (for example, by cutting VAT) and indirectly (by taking some of the pressure off wage demands). Easing fiscal policy should be pursued with a tighter monetary policy: higher interest rates would help support sterling, thereby also helping to keep a lid on inflation. (See also page 3.)

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The tax cut that would do most good

Tory leadership candidates are promising tax cuts. This is the one that the winner should prioritise

Matthew Lynn
City columnist

With the unfortunate exception of Rishi Sunak, who is boxed in by his record as chancellor, every candidate to take over from Boris Johnson as prime minister is promising spectacular cuts in tax. It is a little hard to work out what they have all been doing for the last couple of years while taxes were being raised to peacetime records, given how much they dislike them. But still, cynicism aside, it is refreshing to see that the Conservative Party still has some interest in lower taxes.

The trouble is, with an economy heading into recession and with huge demand for better public services, it does not sound very credible. We can't cut national insurance, corporation tax, VAT, fuel duty or inheritance tax at the same time as spending record amounts of money. With a recession looming, tax revenues will soon be going down and welfare spending up, putting even more pressure on the public finances. A winning candidate should choose one tax cut – and mean it. Halting the planned rise in corporation tax to 25% scheduled for next year is the best bet, for three reasons.

Hobbled competitiveness

First, it makes the UK uncompetitive globally. Corporation taxes have been steadily coming down around the world for the last decade, and the UK was quite rightly in the vanguard of that. In 1980, the average corporate tax rate was around 40%, according to figures from the Tax Foundation. By this year, it had fallen to 23%, and it is still coming down. In the US, Donald Trump slashed corporate rates, and his successor has only partially reversed that. Sweden, Belgium and even France have

Sunak: boxed in by his record

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all made significant cuts to their rates over the last few years. Over the last decade, the UK cut the rate by ten percentage points, and was set to bring it down even further, giving it one of the most competitive systems among the major developed countries. Having left the EU and the single market, it was important to keep driving that down. After all, we need to make ourselves more attractive to global business, not less so. This is the worst possible moment to raise the tax rate businesses have to pay – and we will quickly pay a price for that as fewer companies decide to base themselves here.

Next, it will reduce investment. Firms don't have many options when it comes to finding the money to pay for new product launches, extra manufacturing capacity, or setting up whole new units. They can try borrowing from the bank, although the answer is usually no, or they can raise capital from outside investors, although that is a lot of work. Usually they invest through retained earnings. If those are taxed more heavily, there will be less investment. Sunak did include a tax break for investment, but allowances are fiddly and hard to claim. They rarely work as well as the chancellor expects. The net result? Investment will be much lower than it otherwise would be – especially among small businesses.

The worst mistake

Finally, the Treasury gets the money anyway. Although it might come as a surprise to the people who constantly clamour for higher corporate taxes as if it were free money, companies don't actually hold onto any cash. It all gets used one way or another, either to pay higher dividends to the shareholders or else higher wages to the directors or staff (and even if it is deposited in the bank, it will be lent out to someone else). When it is paid out, it will be taxed, and usually at a higher rate as well. One way or another the money finds its way into the economy and gets taxed. It just depends at what point, and at what rate.

The Johnson-Sunak government made lots of mistakes on tax policy. It was too quick to put taxes up, it didn't put any serious thought into what to do with the money and it showed no real interest in controlling public spending. But of all of them the rise in corporation tax was by far the worst. It was too sudden a jump, taking the tax rate up by a third in a single step, it hit the sector we most need to grow, and it made the UK less competitive against its key rivals. The Tory leadership candidates are all keen on tax cuts. Make it that one.

City talk

● "Another outing for the Heathrow hot-air balloon," says Alistair Osborne in The Times. CEO John Holland-Kaye's "latest excuse for the chaos at the airport" is an uptick in passengers, with apparently an extra 20 million since February. Holland-Kaye claims the airport has experienced "the equivalent of 40 years of growth in just four months" and that the increase in passengers is 'exponential'. Yet these numbers are still well below pre-pandemic levels, and far from "unprecedented". Perhaps the real reason why it's having to axe flights is due to 600 of its 4,000 security staff being newbies who can't clear passengers on time, or other issues under its control, such as problems with the baggage system. "Maybe things would be better, too, if the airport had a boss less focused on lobbying for its billionaire owners or concocting meaningless soundbites."

● "Welcome to the 90% club, AO World," says Nils Pratley in The Guardian. The online appliance retailer is now in that select group of companies "whose share prices have crashed by nine-tenths from their peak", after tumbling from a high of 429p in 2021. CEO and founder John Roberts has announced a £40m cash-call at a price of 43p to repair the firm's stretched balance sheet. He's calling the decision "a sensible piece of financial housekeeping given the short-term macroeconomic uncertainty", but that still means a 20% increase in the number of shares in issue. "Investors who climbed aboard at the top – when Roberts was proclaiming that the pandemic had permanently improved AO's prospects and pan-European expansion was ready for lift-off – may not be amused".

● "Fintech is an area where Britain is a leader. It is unfortunate that many of the stars in this bright firmament are losing their dazzle," says Alex Brummer in the Daily Mail. Take buy now, pay later champion Klarna, which has "suffered a calamitous decline in its worth". The firm has been valued at just £6bn in its latest funding round, a huge drop from £38bn last year. Klarna "rode the ecommerce bubble in the pandemic", but now it's struggling due to a decline in discretionary spending amid the cost-of-living squeeze. The fact that it can still raise funds suggests its model remains viable, but CEO Sebastian Siemiatkowski's claim that the latest round is a "testament" to the firm's strength should be taken with a hefty pinch of salt. "Confidence that it is going to be the Amazon or Apple of finance is fading fast. Its best future may well prove to be as a cyber-banking arm of a Silicon Valley player or a consumer bank."

Are markets cheap yet?

We're always telling you to buy when assets are cheap. So are any global markets looking appealing yet?

John Stepek
Executive editor

At MoneyWeek, we're always telling you to buy assets when they're cheap. Over the past six months or so, the majority of markets have fallen a great deal, with plenty sitting in bear-market territory (down 20% or more). So the obvious question now is: are there any bargains?

Clearly, a fall in price alone does not mean a market is cheap. If a fast-growing stock suddenly warns that its growth has fallen off a cliff, it's share price will fall. But that doesn't mean it has become cheaper – it merely reflects the company's diminished prospects. So you need to look at valuations. Conveniently enough, fund manager Meb Faber of Cambria Investment Management has just put out his latest update on cyclically adjusted price/earnings ratios (CAPE) for global equity markets. CAPE is one of our favourite long-term valuation measures. It's explained below, but in short, the lower the number, the cheaper the market.

One thing is clear – most markets have indeed got a lot cheaper since the start of 2022. The median average CAPE was 18 in January. Now it's 15. The median CAPE on the quartile of least expensive markets has fallen from 14 to 10, while the quartile of most overpriced markets are looking more reasonable, with January's median CAPE of 32 falling to 25 now.

Which markets look cheap now?

In terms of the markets likely to be of most interest, the UK was already relatively cheap in January on a CAPE of 15.9. It has held up somewhat better than many of its peers but is now even cheaper at 14.6. The US by contrast,

Russia was cheap for a reason

©Alamy

while considerably cheaper than it was, remains one of the world's most expensive markets, with its CAPE falling from 38.8 to 28 (only India and Denmark are comparably expensive).

At the "cheap" end of the scale, three markets trade on a CAPE of less than 10: Poland, Egypt and Turkey. All three were also among the cheapest markets in January. Other notable cheap markets include Singapore, Chile, Brazil and Spain. You can use exchange-traded funds (ETFs) to get access to most of these markets, such as the **iShares MSCI Poland UCITS ETF (LSE: SPOL)**. The strategy is to buy a mix of the cheapest markets on the principle of "reversion to the mean" – the idea that historically cheap markets will return to more "normal" valuations.

"A market might be cheap, but it can still get cheaper"

Of course, just because a market is cheap doesn't mean it can't get cheaper. The cheapest market in January, on a CAPE of 8.1, was Russia. The latest update doesn't list Russia because it's uninvestable. This is why diversification is critical – it's an example to bear in mind before putting money into Turkey or Egypt, say.

I wish I knew what the CAPE ratio was, but I'm too embarrassed to ask

The price/earnings (p/e) ratio is a popular measure for assessing whether a share is cheap. It's simple to calculate – you just divide the share price by earnings per share. A low number (eg, below ten) suggests that you aren't paying much for each £1 of earnings, while a high number indicates a stock may be expensive (unless it's growing rapidly).

The p/e ratio has one obvious weakness. Using just one year of profits means a stock – particularly one in a cyclical business, such as mining – can look cheap because profits happen to be peaking at that point and are set to plunge when the business turns back down in line with the economic cycle. An analyst looking at a single company may be able to assess whether current earnings are cyclically high or low, but that's more difficult when considering the valuation of the overall stockmarket. The cyclically adjusted price/earnings (CAPE) ratio tries to compensate for this by using average inflation-adjusted earnings over the past ten years, smoothing the effects of the economic cycle.

A 1988 paper by John Young Campbell of Princeton and Robert Shiller of Yale University concluded that the level of the CAPE ratio was strongly negatively correlated with long-term returns: when it is high, future returns are lower. (The ratio is also known as the Shiller p/e due to Shiller's role in popularising it.) The CAPE ratio later indicated that the US market was very expensive ahead of the dotcom bust in 2000, which helped it gain a name for itself, even though Shiller did point out that it is not a short-term forecasting tool.

It also signalled that stocks had become cheap during the 2008-2009 crisis, but did not fall as low as it had in past crises. This suggests that care is needed when comparing a CAPE ratio with its long-term history – in part because accounting standards and the composition of an index change over time.

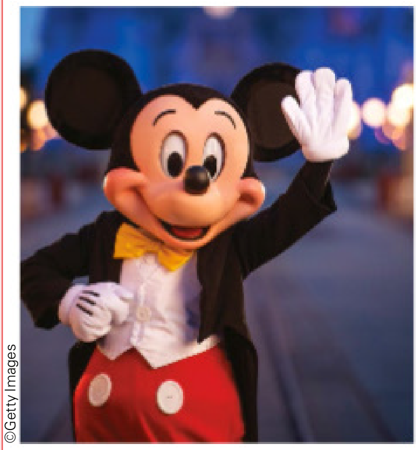
Guru watch

Rob Arnott, founder and chairman, Research Affiliates

©Research Affiliates

"Recessions are usually created – they don't happen naturally," Rob Arnott, founder and chairman of asset management group Research Affiliates, tells Bloomberg. "Economic expansions don't die of old age – they're murdered by the [Federal Reserve]. And we're seeing that happen again now."

In a paper written with colleague Campbell Harvey, Arnott notes that the US central bank ignored inflation for too long, and is now "late to the game". That means there is a greater risk



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that it will overreact by raising interest rates too far and too fast now. Many of the drivers of inflation today – such as disrupted supply chains – cannot be fixed by the Fed. And yet, "to a person with a hammer, everything looks like a nail".

Given the risks, it makes sense to be prepared. Companies might want to hit pause on any big investment plans. "If you're spending money that you don't need to spend, you might give some serious thought to stopping it for a little while." As for consumers, "maybe it isn't the time to take that trip to Disney and use your credit card to finance it".

Equity investors, on the other hand, can act earlier, Arnott tells Bloomberg. "We're probably not at peak fear – the bear market probably isn't over – but you could do worse than starting to average back in if you were smart enough to lighten up before this." Arnott favours non-US "value" stocks because US stocks still look expensive (see main story) whereas emerging markets are "abnormally cheap".

Europe's thriving unicorns

Editorial
The Economist

European tech firms suffered more than their US counterparts after the 2008 financial crisis, but there's a chance that the continent's 150-odd unicorns (private firms worth more than $1bn) will "weather the storm" better this time around, says The Economist. Last year was a "smasher" in Europe, with venture-capital (VC) investments exceeding €100bn. Success breeds success. The structure of the European tech ecosystem is "more robust", European entrepreneurs are more experienced, and capital is being accumulated. If the crisis "drags on", European funds are sitting on nearly €50bn of VC cash that has yet to be deployed. Meanwhile, the number of "angels" (successful entrepreneurs who invest in other start-ups) is growing and executives "lower down the food chain" increasingly have skin in the game as stock options gain "cultural acceptance". European firms also "boast certain comparative advantages that will come in handy": their "relative thriftiness" and the fact that they are thematically diverse and less geographically concentrated than in the US, which means they often rapidly expand abroad. In a crisis, diversification "is a boon". If the coming months are "certain to be tougher", so are Europe's tech firms.

A simply bonkers fees payout

Patrick Hosking
The Times

Fury over the £117m fee that Jupiter Fund Management extracted last year from Chrysalis, an investment trust specialising in "unicorn" companies, is understandable, says Patrick Hosking. By its year-end on 30 September, Chrysalis boasted a market value of more than £1bn and its share price was up 84%. But growth company valuations have since dived. One of its "gems", Klarna, which Jupiter valued at $49.2bn in September, is now trying to raise capital in a deal that would value it at $6.5bn. Other valuations were similarly fantastical. Chrysalis now concedes that its fee structure was "flawed". "Paying fees for unrealised gains was bonkers, especially in hard-to-value, illiquid assets in bubble conditions." Handing Jupiter responsibility for valuing those assets was "more bonkers still". But if the two Jupiter managers at least took their spoils (belatedly) in Chrysalis shares, Jupiter has pocketed its £56.5m share in "hard cash". The firm, whose shares are now languishing at an "all-time low", has lost billions' worth of client business in recent years, but new CEO Matthew Beesley appears unrepentant. If such complacency continues, the industry should not be surprised if the shift to low-cost trackers continues unabated.

Sustainable profits trump ESG

Andy Kessler
The Wall Street Journal

Environmental, social and governance (ESG) funds are "big business", but who do they benefit? asks Andy Kessler. In June the US financial regulator announced an investigation into Goldman Sachs for claiming some funds were ESG "when they really weren't". In May, Tesla was dropped from the S&P 500 ESG index. "Exxon is still in." In response, Tesla's CEO Elon Musk tweeted, "ESG is a scam. It has been weaponised by phoney social-justice warriors". Does he have a point? Lifting the lid on BlackRock's ESG Aware MSCI USA ETF reveals it has almost the same top holdings as the S&P 500 ETF, yet costs five times more – and has performed worse. Sanjai Bhagat of the University of Colorado makes some "important points" in the Harvard Business Review. 1) ESG funds have underperformed; 2) firms flaunting ESG credentials have "worse compliance records for labour and environmental rules"; 3) ESG scores of companies that signed the UN Principles for Responsible Investment not only didn't improve but had lower returns; 4) firms "embrace ESG as a cover for poor business performance", driving overinvestment just as "their financials turn south". So "skip ESG – it just gives someone else sustainable profits".

Is the US about to fall apart?

Rana Foroohar
Financial Times

Secession used to be joked about in the US, says Rana Foroohar. No longer. Recent Supreme Court rulings have deepened "fissures" dating back to the financial crisis of 2008. Thanks to policy decisions, including bank bailouts and big corporate tax cuts, trust in institutions is at a record low. New curbs on "the ability of federal agencies to act at a national level will weaken and divide the country further". All this comes against a backdrop of "rampant inflation", a rise in mass shootings and congressional hearings about the Capitol Hill attacks. According to Mark Rosenberg, founder of GeoQuant, the US now ranks the highest of any developed country in terms of political risk. More worrying, in terms of social and government instability, political violence "and even the risk to democracy", the US now looks more like an emerging market. Rosenberg calls this the "EM-fication" of US politics, where institutions are "too weak to clearly define or enforce the rules". The economy may be outperforming, the dollar strong, but trust, which is built on consistent adherence to the rule of law, is needed over the long-term. What might happen if states have "wildly different frameworks for everything from taxation to the environment?". "We are about to find out."

Money talks

"My true understanding of whether I love tennis would be: if I love tennis, I would go out there and play tennis, whether I got paid for it or not… I have not gotten to that point where I haven't been paid for it. So I don't know the answer."
John McEnroe (pictured) reflects on what motivates him to play tennis in a new documentary film about his life, quoted in The Guardian

"Unlike some of my girlfriends, I came out worse from my marriages than I went in."
Former Conservative MP Anna Soubry says that the worst investment she ever made was getting married, quoted in The Sunday Times

"To pay my rent and keep a roof over my head and [schnauzer-poodle] Ruby's head, so she is comfortable and I am safe. There's no point having expensive things if you are not content where you're living."
Gemma Oaten, former *Emmerdale* actress, on her financial priorities, quoted on This is Money

"Artists have continually chased their dues and still do. That's why musicians gave testimony to Parliament about how iniquitous the payment to musicians and songwriters is in the digital age. Companies have always been one step ahead of artists in fleecing them. The cake should be divvied up in a series of copyright reforms."
Musician Phil Manzanera, formerly of Roxy Music, quoted in The Telegraph

"It was recognised [during the pandemic] that the railways needed to run, for food on shelves and to get key workers to work. We need that now and for the next 20 years… There is no loss or cost to the economy in running your railways properly."
Mick Whelan, head of train drivers' union Aslef, quoted in The Guardian

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The crypto craze is over

coindesk.com

As alternative digital currencies collapse, sceptics are calling it "the end of crypto", says Frances Coppola. We've seen this kind of correction before, of course. Bitcoin crashed in 2014 when the Mt. Gox exchange collapsed. In 2018, bitcoin again "crashed and burned". The market has always recovered and prices hit new highs. This time, though, "it's different".

The pruning begins

Driven by war and pandemic, a new macroeconomic paradigm is forming (see also story below). High inflation is back, and with it much tighter monetary policy. Interest rates are rising and central banks around the world are "burning money" (quantitative tightening). "The era of plentiful dollars is coming to an end. And that will mean persistently lower prices for cyrptocurrencies."

Ever since the financial crisis of 2008, central banks have been printing money at unprecedented rates. The money taps opened even wider during the pandemic. Much of that money found its way into crypto markets, raising prices and fuelling the rapid growth of debt and complex derivatives. "The crypto industry's luxuriant growth since bitcoin emerged from the ashes of the financial crisis – and particularly since March 2020 – can be directly attributed to the copious monetary fertiliser central banks have been pouring into financial markets." Now that trend is going into reverse and central banks are removing the fertiliser and "getting out the pruning sheers".

You might wonder why people aren't piling into bitcoin as inflation rises. The original idea, after all, was to provide a safe haven from the predicted inflationary collapse of the dollar. But most of those invested in cryptocurrency now don't want to replace the dollar at all. "All they want is to get rich in dollar terms." Crypto prices are typically quoted in dollars, most transactions are pegged to dollars, and dollar-pegged stablecoins are widely used as safe collateral for crypto lending. "The crypto ecosystem has tethered itself firmly to the traditional financial system" and the dollar dominates just as it does in other markets.

The crypto crack-up will not be mended

©Alamy

Yet the dollars aren't real. There aren't enough dollar-backed assets to enable everyone to cash out – crypto is essentially a fractional reserve system – and there's now a race on to "exchange cryptocurrencies for the few real dollars available". "Illusory riches are now giving way to real losses" and "the law of the jungle applies". And if tighter money is here to stay, as many expect, then "continuing dollar scarcity will make it impossible for crypto to rise again as it has before".

A new paradigm takes hold

project-syndicate.org

You know a new economic paradigm has taken hold when even purported opponents start to see the world through its lense, says Dani Rodrik. At its height, the Keynesian welfare state received as much support from conservative politicians as from those on the left, for example. Thatcher and Reagan's neoliberalism was internalised by the centre-left leaders who came after them. Now, we might be in the midst of another transition. A "new bipartisan consensus" is starting to form around the idea of "productivism". This emphasises the spread of productive economic opportunities through all regions and segments of the labour force, puts less faith in markets, envisions a large role for governments and civil society, is suspicious of large corporations, and emphasises production and investment over finance, revitalising local communities over globalisation. It expresses greater scepticism of technocrats and is less hostile to "economic populism". The thinking behind it has been championed by libertarian think tanks on the right and yet has been embraced by Joe Biden's administration on the left. It therefore holds out the promise of transcending political schism. "Productivism might just develop into a new policy model that captures the imaginations of even the most polarised of political opponents."

Fun no longer mandatory

bbc.com/worklife

A school outing might have been fun when you were a child, says Kate Morgan. As an adult, the equivalent team-building exercises and morale-boosting parties and so on feel more like "forced fun". The pandemic-induced shake-up of office culture has, thankfully, largely put an end to such things as more people work from home, at least part of the time, and have learnt to value time at home with their families more than after-hours laser tag.

Companies have for years been trying to make the office more "fun", largely by turning them into nurseries, with bean bags and arcade games and ping-pong tables. But this was always more about getting people to not mind staying in the office longer. And if you objected to hanging out for the extra "happy hour", you were vilified for not being a "team player".

Be a team player and join in

©Getty Images

The pandemic helped us to realise that we don't need all these "bells and whistles" to work effectively. It made us a little angrier and less willing to put up with things we find annoying. Now, we are connecting in ways we actually find truly enjoyable. The "inane office 'fun' of yesteryear" may be a thing of the past.

WFH puts a lid on inflation

bloomberg.com/opinion

Why has inflation-adjusted wage growth in the US been so disappointing in the past year? The rise of "working from home" may explain it, says Jonathan Levin. New research from economists Jose Maria Barrero and Nicholas Bloom shows that part of the 3% decline in real average hourly earnings in the past year may reflect "the hidden cost of flexibility". Workers spend less time commuting and grooming themselves for the office, and benefit from more time to spend with the kids, and so on, and this is being counted as a benefit in lieu of a pay rise, much like a company car or office gym.

This is welcome news for policymakers concerned with keeping a lid on inflation. But workers missing out on wage rises now may yet want to play "catch up" later and the new relationship keeping a lid on expectations will only hold as long as jobs stay remote and is likely to "play out as a one-time effect". As inflation continues to run near a four-decade high, the "ability to skip the commute and work at home in sweatpants won't offset disappointing wages forever".

Income and reliability in biotech

The BioPharma Credit investment trust lends to promising small drug developers

David Stevenson
Investment columnist

Over the next few months I plan to highlight several defensive funds that should escape the worst the markets have to throw at them. Let's start with **BioPharma Credit (LSE: BPCR)**.

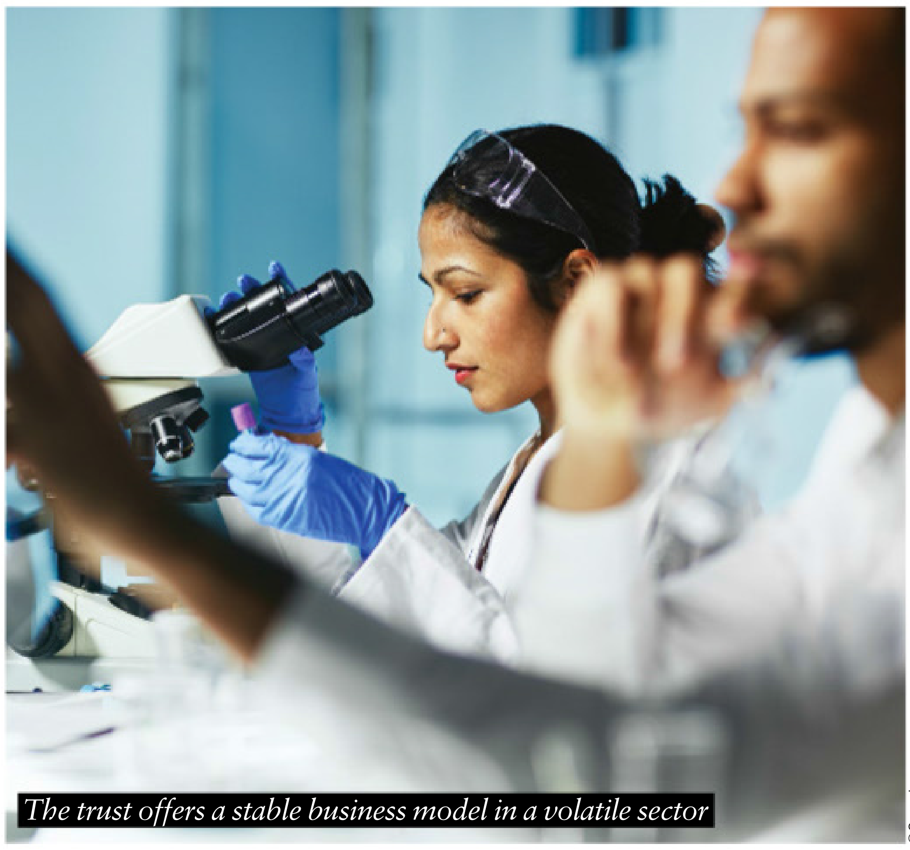
With a few exceptions, the listed lending funds that have emerged over the past few years have not proved very successful. BioPharma provides credit through loans or royalty payments to cash-strapped biotech and pharmaceutical companies.

You'd be forgiven for having a few heart palpations as the biotech and healthcare sector has crashed over the last year, slashing the share price of some of the companies it invested in.

Nevertheless, the BioPharma team is experienced and interested in life-science businesses that have actual revenues from real-life drugs but lack the cash to boost production, scale up sales and achieve critical mass. So they turn to debt to fuel growth.

BioPharma charges set-up fees for its loans, but it also charges fees if the underlying business is sold before the loan term is up. Of the $1.3m invested in senior secured loans, 58% is in floating-rate loans and 42% in fixed-rate ones.

That means rising interest rates boost the bottom line. The average yield across the 11 loans is 10.3%, with an average loan life remaining of 3.8 years. The portfolio is 91% invested in senior secured loans and 9% in purchase payments, which are equivalent to royalty payments.



The trust offers a stable business model in a volatile sector

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The obvious risk here is default, but to date the fund has avoided this. The bigger challenge has been that a handful of borrowers have paid up early, triggering break fees and leaving the fund with excess cash that needs to be reinvested. BioPharma's latest deal sums up this challenge.

In November 2019 the fund, alongside other private funds run by the manager, lent $110m to cancer treatment developer Epizyme. The loan was due to mature in November 2024, but Epizyme's share price collapsed in recent months and it was taken over by leading pharmaceutical company Ipsen. This triggered a payment back to BioPharma, which included a $3m-$7m pre-payment on top of the fees due alongside the loan repayment set for September.

Concentrated portfolio

Note that the fund is highly concentrated on a few big loans to businesses: roughly 55% of the portfolio is lent to just three companies, Sarepta (23.4%), Collegium (21.7%) and LumiraDx (10.0%).

These three businesses could struggle, but the loans are secured against revenue-producing assets, so it seems there is some protection in place.

BioPharma Credit delivers a $0.07 annual dividend, which with the share price at $0.95 for the dollar class (and 77.5p for the sterling class) equates to a dividend yield of around 7.4%. The shares have slipped recently, with the dollar class peaking at $1.04 and trading down to the current $0.95.

At that price the fund is trading at a 5% discount to net asset value (NAV), which might trigger a share buyback – there is a buyback facility in place which could involve buying up to 14.95% of the shares.

The buyback is triggered once the discount averages 5% over a three-month rolling period, with the aim to bring the discount back up to 1%. The average discount for the past 12 months is running at around 1% to 1.5%.

So although BioPharma Credit has not been immune to market turbulence, the upshot is that the trust is conservatively structured and looks an appealing income play for volatile markets.

Sceptics might worry that the doldrums in life sciences could undermine the group's prospects, but one could argue the opposite: because equity investors are scared of biotech firms, funding for late-stage, revenue-producing businesses might be elusive. That could allow BioPharma to lend out more cash at higher returns.

Activist watch

Paul Pindar, chairman of online estate agency Purplebricks, has been urged to resign. Lecram Holdings, a vehicle run by investor Adam Smith, built a 4% stake in the firm in the last month, and wants Pindar to step down after overseeing an 85% crash in the group's share price since it floated on Aim in 2015. That reduced the firm's market value from £240m to £45m. The drop in the stock was caused by profit warnings and operational blunders. Mistakes dealing with tenants in its lettings business cost it £3.6m, for instance. In a letter to the CEO, Lecram outlined the need to address "continuing cash burn" and operating performance under new leadership. An investor with a 5% stake can ask the board to call an extraordinary general meeting.

Short positions... a new index tracking hedge funds

■ **"Abrdn is bringing index investing to the $5trn hedge-fund universe," says The Wall Street Journal. Eclipse, the asset manager's new platform, will be the first to give institutional investors passive exposure to hedge-fund strategies by tracking indices, the firm claims. The Hedge Fund Research Inc (HFRI) 500 includes an equal-weighted tracker of 500 hedge funds with different strategies. The platform will invest in the funds in HFR's indices and will be run by abrdn's alternative investment strategies team, which currently oversees roughly $14bn in assets. Hedge funds are supposed to thrive when stocks and bonds tumble, but their performance can vary widely. In the first six months of the year there was a 67% difference between the best- and worst-performing funds in the HFRI. The average hedge fund charges investors 1.36% of their net asset value and 16.1% of profits. Abrdn will charge an extra 0.2%.**

■ Mounting fears of recession have prompted investors to dump oil at one of the fastest rates since the pandemic struck, says Reuters. Hedge funds and money managers sold 110 million barrels in the six most important oil-related future and option contracts for the week to 5 July, taking the total to 201 million barrels in the past four weeks. Last week's sell-off stemmed largely from the liquidation of previously bullish long positions instead of the creation of new bearish shorter ones. The sector's "bullish bias" is dissipating owing to growing fears that growth is moving down a gear. Investors are now expecting a mid-cycle slowdown or a recession, which should ease current oil shortages and rebuild depleted reserves over the next 12 months.

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Invest in the car market – it's charging ahead

The vehicle sector suffered badly in the pandemic, and has since been buffeted by supply-chain problems, inflation and recession fears, says David J. Stevenson. But electric cars are thriving

Car registrations are a key leading indicator. They provide a preview of how the economy will perform in future. In the aftermath of the 2008-2009 financial crisis, world car sales turned into a steadily climbing one-way street. From just over 60 million units in 2009, the global number of passenger vehicles sold grew to around 92 million by 2017, according to the International Energy Agency (IEA). This figure remained unchanged in 2018, however, and declined slightly in 2019 to 88 million.

In 2020, global car sales collapsed to 73 million, says the IEA. Covid-19, along with the resultant government restrictions, caused a speedy and savage recession. It was a very painful period for the world's car manufacturers.

As normality gradually returned in mid 2021, with fear receding and lockdowns easing, world registrations recovered well. For last year as a whole they were up by roughly 5%, according to data from Statista, despite various supply-chain problems. Indeed, the sales rebound was so strong it outstripped car-manufacturing capacity, which was curbed by a global semiconductor shortage.

"Most cars contain between 300 and 3,000 computer chips to help keep drivers safe"

Most modern cars are equipped with between 300 and 3,000 computer chips that "are crucial to infotainment systems and creature comforts – as well as many of the advanced driver-assistance aids that have become mandatory for five-star safety scores", notes Joshua Dowling of Drive. As we examine later, inadequate supplies of chips created a damaging car-supply crunch as manufacturers couldn't meet their production targets, let alone booming demand.

The shortage of new vehicles saw the prices of second-hand cars soar to crazy levels. In the US, the Bureau of Labour Statistics reported that the consumer-price index for both used cars and trucks rose by 41% from January 2021 to January 2022. The average cost of a used American car climbed by about 50%, according to data from car-pricing site Black Book.

Another slowdown

However, global car sales have since broken down once again. From January to May 2022, total registrations of new passenger cars in the EU were 13.7% lower than in the same period the previous year. Sales decreased in Italy by 24.3%, in France by 16.9%, in Spain by 11.5% and in Germany by 9.3%, according to the European Automobile Manufacturers' Association.

In parallel, June 2022 sales volumes in the US were down by 13.5% from their level of 12 months ago, notes Thomas Feltmate, senior economist at TD Economics. The US has experienced similar difficulties to Europe. Again, the registration decline suggests that a recession could be around the corner, even if the present problems still appear to be caused by supply-chain constraints rather than declining interest from consumers.

Granted, car sales in China – now the world's largest auto market – rose by almost 23% in June from a year earlier as production recovered in lockdown-hit Shanghai to meet pent-up demand. But government cash incentives stimulated purchases, notes the Wall Street Journal. So the data can't be taken at face value, and a more realistic assessment of China's car sales can only be made when those incentives expire.

The British position, meanwhile, has been particularly grim. June 2022 new car sales plummeted by a dire 24.3% compared with the same month in 2021. Just 140,958 new cars left showrooms, according to official figures. That made last month

©Hyundai

Three of Hyundai's brands are among the ten most popular electric vehicles in the US, including the Ioniq 5 the worst June for car sales since 1996. Again, British car showrooms have experienced similar problems to Europe and the US. While demand has held up so far, the semiconductor shortage has continued to bite and inflation concerns have overshadowed the market.

Supply-chain crises

What is really concerning, however, is how automakers' problems are now stacking up, partly in ways that weren't immediately obvious when Russia began its invasion of Ukraine.

Take neon gas. It's vital to the lasers that are used in manufacturing semiconductors. Prior to Russia's military activities, Ukraine purified neon that was a "by-product of Russian steel manufacturing" and exported it, says Automotive News.

Indeed, Ukraine probably supplied between 50% and 70% of the world's neon gas. Now the Russian government has "reportedly restricted the export of noble gases including neon", says Global Times, in response to the EU's fifth sanctions round.

So not only have Russian neon exports been curbed, Ukraine's gas purification capacity has also been compromised by the war. This is causing ongoing restrictions in semiconductor output. While chip makers will eventually secure new neon sources, the process will take time. In other words, the semiconductor supply-chain shortage is set to worsen before it improves.

Another factor creating supply-chain disruption has been China's zero-tolerance approach to curbing Covid-19. Bottlenecks at Chinese ports are taking a long time to resolve. Labour negotiations at US ports are causing further problems. And global consumer confidence has been hit by the Ukraine conflict, while retail-price inflation has started to soar.

The latter has two main effects. It raises new car prices and it hits buyers' pockets. So far "carmakers have managed to make up for lost volume by charging higher prices, though it's unclear how much higher they can go", says Bloomberg. Meanwhile, the rising cost of living is eroding consumers' real (inflation-adjusted) incomes. In other words, they have less cash to splash on new vehicles.

Having cut its forecast for Western European passenger car sales in each of the past four months, industry analyst LMC Automotive now expects annual deliveries to dip by 6% this year to less than ten million units. That's a massive downgrade from its forecast in January, when LMC was expecting nearly 9% growth.

Global auto sales will shrink by 5% in 2022, Germany's Centre for Automotive Research (CAR) told Neil Winton in Forbes. "The global car market will have thus fallen below the level of the first Corona year 2020 and will reach its lowest level in ten years," says CAR director Ferdinand Dudenhoeffer.

"Global car sales are expected to shrink by 5% to a ten-year low in 2022"

The one bright spot

Yet there is one bright spot amid the gloom. Sales of zero-carbon, battery electric vehicles (BEVs) are booming – though this doesn't apply to 'hybrids', which have internal combustion engines as well as electric motors, whose sales are struggling.

In the US, BEV sales increased by 60% year on year to 158,689 in the first quarter of 2022, according to car registration data from Experian, reaching a new record market share of 4.6%.

Continued on page 22

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Continued from page 21

Among the top ten all-electric cars in the US, four were Tesla models and three were from Hyundai, according to trade magazine InsideEVs – including the Korean carmaker's Ioniq 5 (pictured on page 20).

The only other cars in the top ten were the Ford Mustang Mach-E, the Nissan LEAF and the Volkswagen ID.4 (pictured right). Hyundai sold 15,414 units, including 8,450 cars under the Kia badge (one-third owned by Hyundai) and 6,964 vehicles under its own name. The company's total sales in the period were twice those of Ford.

UK BEV registrations in June 2022 were 22,737, up 15% year on year, says sales company heycar. This means there are now an estimated 477,000 electric cars on the road in Britain. Their market share has reached 16.1%, up from 10.7% in 2021.

So the future for all-electric cars is looking even more promising than before, says the IEA. "Despite strains along global supply chains, sales kept rising strongly into 2022", it notes, "with two million electric cars sold worldwide in the first quarter, up by three-quarters from the same period a year earlier".

Certainly, soaring prices of key materials for making batteries – essential for all electric cars – are a concern. Russia provides 20% of global battery-grade nickel, so there are supply worries following the Ukraine invasion. Meanwhile China has a stranglehold over lithium-ion battery manufacture: it has 70% of the production capacity for cathodes and 85% for anodes, again both vital components.

Other impediments, such as the UK cutting its electric-car grant scheme a year earlier than expected – may appear. But the IEA also notes that "a growing number of countries have ambitious vehicle electrification targets for the coming decades, and many carmakers have plans to electrify their fleets that go beyond policy targets".

"Move over, gasoline-powered cars," say Lisa Martine Jenkins in Protocol. "More electric vehicles are set to take the road, and adoption might be even faster than previous analyses have forecast.

"Just one year ago, the consultancy BCG projected that battery-electric vehicles would make up 11% of global new light vehicle sales in 2025 and 45% in 2035. Now, the group's latest analysis found that battery-powered EVs will amount to 20% of global sales by 2025 and 59% in 2035. They are projected to be the most popular type of light vehicle sold by 2028, three years earlier than they found in 2021."

The best carmakers to buy

History shows that car manufacturing is not a particularly appealing area for investors. Researching and developing new vehicles is very expensive.

This means that auto makers are very capital-intensive and can suffer significant balance-sheet strains. What's more, the business can be highly cyclical. Vehicle makers may find that their very expensive product launches coincide with recessions that crush sales just when these car companies need a strong tailwind.

Looking for suitable investments in the sector, therefore, can prove difficult. Chinese electric auto maker BYD has a stratospheric valuation. Meanwhile Tesla is the clear choice from the above list of popular all-electric cars in the US. But despite dropping by 40% from their November 2021 peak, the shares still look very expensive.

Tesla has a current market capitalisation of $760bn. Yet it only delivered just over a quarter of a million vehicles in this year's second quarter. Japanese giant Toyota, by contrast, has a market value of $214bn and sold 514,100 vehicles in the US alone over the same three-month period – despite having to recall more than 2,000 all-electric SUVs over problems that could cause the wheels or axles to fall off.

Volkswagen's ID.4 is also a US bestseller

©Volkswagen

Even as far out as 2024, Tesla stands on a forecast price/earnings (p/e) ratio of a whopping 39, according to the average of analysts' estimates compiled by MarketWatch. And this assumes a near 75% jump in earnings over the next two years, which seems doubtful as the US economy teeters on the brink of recession.

Hyundai (LSE: HYUD) is the next most popular maker of all-electric cars in the US, even though BEVs currently account for just 5% of total sales. In sharp contrast to Tesla, however, Hyundai's shares still look very cheap.

You can buy into the company via its GDR (global depository receipt): each represents half an ordinary share. Net debt is high at 90% of shareholders' funds. However the shares stand on a forward p/e of a mere 4.2, according to analysts' forecasts compiled by Barron's, and yield 6.2%.

While carmakers tend to sell on below-average p/es, by all measures Hyundai is on a very low valuation. After declining by more than a third over the past eight years, this stock looks like one to tuck away.

Meanwhile, despite all-electric vehicle sales accounting for only 5.2% of total 2022 first-quarter turnover, German carmaker **Volkswagen (Frankfurt: VOW)** is optimistic about the prospects for BEVs.

While semiconductors still represent a supply bottleneck, this is likely to change soon, VW CEO Herbert Diess told CNBC. "We will see an alleviation through the next weeks... we are ramping up production… five assembly plants are coming into production now."

So delivery times for EVs should shorten as the year progresses. "The outlook is very good, we have [a] very good order intake in Asia," continues Deiss. "There's high demand in Europe and also in the US."

By 2030 VW says that it is aiming to derive at least 70% of its European revenue from electric cars. In China and North America, the company's goal is to generate at least 50% of turnover from BEVs.

Down by 45% from their April 2021 highs, VW shares currently sell on a prospective p/e of just 5.5, according to the average of analysts' estimates compiled by MarketWatch. Further, the historic dividend yield is 5.5%.

Admittedly, net debt is higher than equity and there's a risk that the pay-out to shareholders may be trimmed this year. But VW is a cheap share that could benefit from a long-run re-rating as its all-electric vehicle sales increase.

"Battery-electric vehicles could make up 59% of global car sales by 2035"

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The curious case of Adler

The story behind the struggling German property group is tangled, but one lesson is simple, says Bruce Packard

To Sherlock Holmes she was always "the woman". Irene Adler, the antagonist in Sir Arthur Conan Doyle's short story *A Scandal in Bohemia*, was one of the few characters to outwit Holmes. Adler Group, on the other hand, is a German property company that is caught up in its own, rather less Bohemian scandal. Adler's shares are down 83% in the past year, its auditors have bailed out, and its future is uncertain. Its rapid rise and fall is a fine case study in how investors turn a blind eye to red flags in every boom and the perils of doing so.

The background to Adler's situation is complicated, to the point where it would tax even Holmes. In brief, however, over the past decade an obscure real-estate firm called Adler Real Estate became a major player in residential property, owning about 70,000 apartments across Germany at its peak. This growth was funded through debt rather than issuing equity, and as the real-estate market boomed, Adler Real Estate's shares rose from around €0.50 to a peak just above €15.5 by 2018.

In 2019, Adler Real Estate acquired a 33% stake in a better-capitalised German real estate company called ADO Properties, using a bridging loan. ADO then went on to buy Adler Real Estate and a third company, Consus Real Estate, in all-share deals, before being renamed as Adler Group. This transaction makes little sense on the face of it – borrowing to acquire shares in a rival, and then persuade the rival to make a bid for your own shares and a third company (Consus) – and many minority investors in ADO were unhappy.

Then in October 2021, a short-seller – Fraser Perring at Viceroy Research – published allegations about Adler. These claimed that an Austrian investor called Cevdet Caner was closely involved in key decisions at the group (Caner had previously presided over one of Germany's biggest real-estate bankruptcies. He was acquitted of fraud in 2020 after a decade-long criminal case in Austria). They also alleged that Adler had engaged in a series of related-party transactions that benefited investors with links to Caner, and that the value of its assets was significantly inflated.

Shares in Adler Group tumbled. Adler denied the allegations (as did Caner, who has filed a lawsuit against Perring and Viceroy) and it hired KPMG, its auditor to investigate the allegations. It later postponed its results, due in January, until the investigation was complete. KPMG's report was published at the end of April: it concluded that Adler's rental portfolio was fairly valued, but that there was a risk of writedowns on the property-development portfolio. KPMG also said that it could neither confirm nor refute some of the allegations, in part because Adler had withheld around 800,000 emails, but noted governance issues and found evidence that Caner was involved in making decisions. It also set out some questionable transactions, including a 2017 sale where full payment has still not been made and where KPMG argued that the remaining €60m should be written down. (The buyer has done multiple deals with Adler and owed it €249m as at mid-2021.)

The following week, KPMG declined to sign off on the annual results, saying that management had "denied us access to certain information" and so it could not "obtain sufficient appropriate audit evidence". Adler published the results anyway, which showed a net loss of €1.2bn, mostly due to around €1bn of writedowns on Consus' property-development portfolio. The board members who were in office in 2021 offered to resign, with four standing down immediately and three staying on until the annual general meeting (AGM) at end June.

"Adler had bought flats supposedly below market price and immediately written the value up"

Attempts to raise rents in Germany have led to protests

In mid-May, KPMG said that it was dropping Adler as a client, just hours after Adler's chair said that it was planning to reappoint the firm for 2022. Ratings agency S&P downgraded Adler's credit rating from B- to CCC with a negative outlook. BaFin, Germany's financial regulator, has begun looking into Adler Real Estate's accounts, while prosecutors in Frankfurt have opened an investigation, reportedly into the sale of a building in 2019.

Vonovia tries to take control

A key outcome of the Adler/ADO/Consus merger was that an investment holding company called Aggregate, controlled by Günther Walcher, a friend of Caner, became the largest shareholder in the enlarged Adler Group, by dint of having a controlling stake in Consus. (Adler, in turn, owned bonds issued by Aggregate – something covered in the KPMG report. These are now trading at around a third of their face value.)

However, that position has now unravelled in a way that has left Vonovia – another residential landlord and Germany's largest property company with total assets greater than €100bn – owning just over 20% of Adler Group's shares. Vonovia came by this shareholding because last year it lent €250m to Aggregate to refinance a margin loan that Aggregate had with a group of banks. This loan was secured against Aggregate's Adler shares. When Adler's share price

"German landlords will struggle to raise rents in line with inflation"

dropped at the end of January and Aggregate failed to meet a cash collateral call, Vonovia seized €250m of shares. It appears that Vonovia was considering bidding for Adler (the loan terms also granted it an 18-month option on half Aggregate's stake), but the continued fall in Adler's share price means the value of the seized shares is now less than €100m, so it's not obvious that it got a good deal. In any case, Vonovia is now Adler's largest shareholder, while Cevdet Caner's wife Gerda holds 7.4% and Aggregate retains 6.1%. And in a twist that nobody saw coming, Aggregate last week appointed Cevdet Caner as chief executive.

How all this resolves is anybody's guess, although it seems likely that banks and property companies will want to avoid a forced liquidation and the associated systemic risks. The former finance director of Vonovia, Stefan Kirsten, was appointed chair of Adler in February; he presumably hopes he can turn all this around. At the AGM at the end of June, the accounts were approved by shareholders despite the lack of an auditor. The three board members who had resigned in April were reappointed until 2025. The group is selling assets to pay down debt; its rental portfolio has shrunk to under 30,000 apartments. Still, the headwind in the market is increasing and share prices are signalling broader concerns in the whole sector. Vonovia's shares are down 39% in the past year. Grand City Properties, another big residential landlord that has not been associated with Adler's problems, is down 43%.

In the UK, we tend to assume residential property can protect owners from inflation. In reality, property price rises have been driven by the decades-long trend of falling government bond yields and banks' willingness to lend. This is even more true in Germany where tenants are well protected by long-term contracts and rent controls have been in place since the 1980s. Local authorities compile an index of rents, which is supposed to serve as a benchmark for rents on new tenancies (a system called the *Mietspiegel* or rent mirror). Despite these controls, attempts to raise rents have led to protests. In a September 2021 referendum of Berliners, 56% voted in favour of expropriating large landlords with more than 3,000 properties. The referendum was non-binding, but it appears that German landlords will struggle to raise rents to keep up with inflation.

A slump in the market will also hurt banks. Before the financial crisis German banks funded Irish and Icelandic banks in the wholesale markets, bought Greek government bonds and snapped up subprime mortgage securities from US investment banks. Chastened by those losses, this time they have been focused more on domestic lending, including lending to the likes of Adler, Vonovia and Grand City Properties. Until recently this has been perceived as lower risk. Now even the European Central Bank has already taken a hit. It had bought Adler's 2024 bond as part of its quantitative easing programme, but last month it took the rare step of selling, saying that the bond no longer meets its collateral framework criteria (the ECB bought near par and the bond now trades at 66 cents on the euro, so it's sitting on a decent loss). Given all the focus on the risk of propping up the bonds of Mediterranean countries, it is slightly embarrassing that the ECB has managed to lose money in a German corporate bond.

Beware mark-to-model accounting

Obviously, this is a costly mess for investors. Yet while most concerns only emerged recently, there were signs well before the ADO deal that Adler was a risky bet.

I first looked at Adler Real Estate in 2014. At the time, it had 21,500 flats, which were worth over €1bn. Back then, its largest shareholder was a Luxembourg entity called Mezzanine IX Investors and there was no way of knowing who the beneficial owner of Mezzanine IX was. It was only in 2019 that rule changes by Luxembourg prompted the disclosure that Gerda Caner had a stake in Mezzanine IX.

Still, one could look at the accounting policies. In 2014, 69% of the company's accounting book value was a "fair value" write up. That is, Adler had supposedly bought flats at below the market price, and had immediately written up the value using "mark-to-model" accounting. My concerns were not allayed when Adler bought Estavis, a Berlin-based property company with a similar strategy. The purchase price was at a 41% discount to the acquired company's accounting book value. Estavis had issued a one-year bond paying 11%. The high cost of debt and the discounted price that the shares traded at suggested that some participants in financial markets felt that all was not well at Estavis. Yet Adler immediately wrote up the "fair value" for Estavis to reported book value, rather than the 41% discount price that it had paid to buy it.

As it happens, with long bond yields falling (pushing up the value of assets priced relative to bonds, such as real estate) and increased occupancy from Syrian refugees, the value of residential properties in Germany rose in subsequent years. Thus Adler could claim that it was always correct – the market was wrong and that real estate had gone the way it expected. Still, the accounting was clearly not conservative at the time.

Fair value accounting involves judgement on management's part. In the BBC adaptation of *A Scandal in Bohemia*, Irene Adler tells Holmes that "the big problem with a disguise is that however hard you try, it's always a self-portrait". The main lesson from the Adler saga is that the choice to write up valuations can be as revealing as the figures themselves.

Maximise holiday money

Foreign holidays are making a comeback now that restrictions have gone. Ensure that your pound stretches as far as it can while you're abroad

Ruth Jackson-Kirby
Money columnist

Summer is here and many of us are about to embark on our first post-pandemic foreign trip. If this applies to you, follow these steps to make sure you don't get stung by any unexpected costs.

Let's start with where to pick up your holiday money. Opt to get it at the airport and you could pay more than you need to. Airport currency stands know they have a captive audience, so they charge over the odds for converting your pounds into foreign cash. This can be easily avoided, however. Use MoneySavingExpert's Travel Money Max in advance to find the best price for your currency and you can get it delivered to your door. We found the best rate we could get for €1,000 was £855.43 from TravelFX. By contrast, Post Office would have charged £15 more.

A cheaper option is to use a debit card to withdraw your holiday money from a cash machine when you reach your destination, but don't assume that using your everyday debit card will do. Many card providers will charge you a mark-up on the foreign exchange rate, an ATM charge if you withdraw money and a spending charge every time you buy something on your card. That can all add a substantial amount to your overseas spending. For example, a TSB debit card – one of the worst offenders – has a 2.99% charge on top of the exchange rate plus a £1 per purchase spending charge and a 1.5% ATM charge.

Chase and Starling Bank use Mastercard's conversion rate – which is as close to the interbank exchange rate as a private individual can get – and they don't charge you any extra for using an ATM abroad. So, €1,000 will cost you £847.75. But withdrawing €1,000 with the TSB card mentioned above would cost you £872.89. To add to the appeal, Chase will pay you 1% cashback on your foreign spending for the first 12 months too.

Stay on top of your credit card balance

You should also tread carefully when it comes to using credit cards abroad. Take the wrong one and you'll pay extra every time you spend. The average credit card has a 3% non-sterling exchange fee, so you will be charged £3 for every £100 you put on your card when you're abroad. Some will also charge you a fee to withdraw money. Avoid this with a specialist credit card – just make sure you pay off the balance in full each month to avoid any interest charges.

The Barclaycard Rewards Visa card charges no fees or interest on foreign spending or cash withdrawals – provided you pay off your balance in full. The unusual thing here is not paying interest on cash withdrawals. Most credit -card providers charge interest from the minute the money leaves the ATM as it is treated as a cash advance rather than normal spending. To top if off, you'll also get 0.25% cashback on your spending.

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Foreign exchange facilities at airports are a rip-off

Dealing with lost luggage

Airport travel chaos means many people are being separated from their hold luggage when they travel. Earlier this month photos of the entire arrivals hall at Heathrow Airport full of lost luggage unnerved even seasoned travellers. The airport has received 2,000 complaints relating to luggage since problems first began in March.

You may eventually be reunited with your lost luggage but think twice about what you pack in it. Medication is best packed into your hand luggage. Take your prescription with you in case there are any questions at airport security.

Also consider the value of your luggage. Most travel insurance has lost-baggage cover, but it doesn't always apply to luggage in transit that has been checked in with an airline. The airline should compensate you, but this is limited to around £1,000 per bag. The safest option is to travel with valuables in your carry-on luggage to keep them safe.

If you do need to make a claim with an airline for delayed or lost luggage (it is classed as lost after 21 days) do so immediately. Head to the baggage claims hall and keep a copy of the "property irregularity form" (PIR). If you didn't report it at the airport, contact the airline as soon as you can.

Keep hold of your boarding card, luggage tags (the bits stuck to the back of your passport or boarding card) and the PIR. Once you've received your bags you can make a claim for compensation.

Pocket money... don't fall for scammers' latest wheeze

- Paying your car insurance annually rather than monthly could save you nearly £60 a year, says The Sunday Times. Research by Compare the Market found that the average car insurance policy quote between January and April was £752 if you paid monthly and £693 if you paid upfront. Monthly payments are higher as most insurers require a 20% deposit, and the interest of 15% to 35% gets added to the remaining 11 payments.

- A record-breaking 8.6 million parking tickets were issued by private car parks over the last year, according to the DVLA. There has been a 50% rise in tickets over the past four years. The government has announced a private parking code of practice to crack down on overcharging, misleading signs and aggressive tactics but the new rules are currently on hold. If you get a ticket in a private car park, take the time to appeal. Only one in four drivers appeal their ticket, but two in five who do succeed.

- Criminals are now pretending to be distressed relatives to get you to send them money. TSB has revealed that 14% of impersonation frauds suffered by its customers were scammers pretending to be family or friends, says The Times. Cases of impersonation fraud are up 39% from 2020, with victims losing a total of £77.5m last year. "Telltale signs... include a plea not to call the number the messages are being sent from" – they may say the phone speaker is broken, for example – and requests for money to be sent to accounts with names you don't recognise.

- Students graduate with average debt of £45,000. Now research by job search engine Adzuna has revealed the universities most likely to lead to the highest salaries, says The Daily Telegraph.

  Specialist business school Bayes, part of the University of London, came top with graduates earning an average £52,167 five years after graduation. Second place went to Oxford University with earnings after five years of £47,618 a year. Imperial Collage came third with average earnings of £45,741.Graduates from Aberystwyth University earn the least at just £25,129 five years after graduation.

How to avoid a wage spiral

Demands for higher pay are spreading. How should small firms react?

David Prosser
Business columnist

But how much can your employer afford?

©Getty Images

Demands for pay rises may be the last thing small businesses feeling the squeeze want to grapple with. But just as their own costs are soaring – research from the Federation of Small Businesses shows that 82% are worried about inflation – so too are those of their staff. Employees facing a cost-of-living crisis will naturally hope that their employers will be generous.

The danger of a confrontation is very real, as the growing number of wage disputes across the public sector underlines. And while many employers may not need to think about pay rises until later in the year – if salaries work on a calendar-year basis, say – they should be prepared; inflation is forecast to remain high for the foreseeable future.

So you will need to consider carefully what your business can realistically afford to offer staff, given your forecasts for costs and revenues over the next couple of years, and what staff will be looking for.

Inflation is expected to average around 7.5% over the course of 2022, falling to around 4.5% in 2023, so this gives you something of a base level. If you offer staff less than this, you're effectively asking them to take a pay cut. You may feel you have no choice but to do that, but if so, you will need to manage the situation carefully.

One useful thing to do straight away is a pay-benchmarking exercise. Using resources such as Glassdoor and LinkedIn, analyse whether what you currently pay at different levels of the business is competitive compared with other employers in your sector. That at least gives you an idea of whether staff are already losing out financially. If so, below-inflation pay increases may be even more difficult to justify.

It is vital that you are as open and transparent as possible with staff about what the business is in a position to offer. If your company's finances don't provide the headroom to deliver the pay increases staff are hoping for, explain why.

That doesn't have to mean opening the books for all employees to inspect, but there will be information you can share. And in smaller businesses, it can sometimes be easier to brief employees on the pressures facing the company.

Equally, employers are going to have to accept that with employment levels at an all-time high, many unhappy staff will find it easy to find new jobs elsewhere.

"Perks such as childcare can persuade staff to stay"

If you can't finance inflation-beating pay rises, is there something more affordable you can offer instead? That could be more flexible working practices, for example, or additional holiday. Indeed, growing numbers of employers now offer flexible benefits packages, enabling staff to swap pay for perks such as help with childcare or a gym membership. These can be valuable staff-retention tools.

In fact, this is a potentially important opportunity to think more broadly about what staff at your business value. If you're now panicking at the thought of staff leaving en masse, or taking industrial action because you can't afford the pay rises they want this year, there may be something wrong with your employee-value proposition.

Most research suggests that salary is not the be-all and end-all for most employees. They want to work for organisations whose values they share and where they feel they have opportunities to develop and progress. Offering that kind of culture is important at any time, but this year, when people are focusing on pay, it could be the difference between keeping staff and losing them.

Battling your energy bills

It's not just households struggling with high energy bills. Many smaller companies are also facing cost increases they can't manage, and they're not entitled to the government support announced for hard-pressed families.

Still, there are some things you can do if your business is finding it difficult to pay its energy bills. Talk to your energy supplier as quickly as possible about your options.

It may be able to offer a more realistic payment plan, payment breaks and reductions, and an extended period over which to settle your debt. Most suppliers also offer hardship schemes, which small businesses may be able to access.

Reducing your bills for the long term should also be a priority now, which makes it sensible to explore energy-efficiency measures. Here too there is help available. Many energy companies offer grants to help small businesses with the cost of upfront investment in efficiency measures.

There is also free advice available to struggling businesses. The Money Advice Trust, for example, operates a free Business Debtline, while Citizens Advice can also offer support.

Finally, know your rights. Do you run a microbusiness (a company with fewer than ten employees and a yearly turnover of less than €2m)? In these circumstances, your energy supplier can't usually bill you for energy you used more than 12 months ago.

Petty cash... fraud crackdown hits R&D

● Loss-making companies claiming tax credits for their investment in research and development (R&D) could lose out as the government tries to crack down on fraud. Ministers have imposed new caps on the value of tax credits available for R&D, which could see some firms missing out on benefits worth tens of thousands of pounds. The measures apply only to loss-making firms – profitable firms are entitled to R&D relief through reduced corporation tax bills – but will hit some hard.

● A sharp increase in the number of company directors struck off by the Insolvency Service is closely linked to concerns about abuse of Covid-19 support schemes, new data shows. More than a third of all directors struck off during April and May were cases where the Insolvency Service investigated claims that Covid loan schemes and job support packages had been abused.

● Small businesses are losing £19bn a year because poor mobile-phone reception is hitting the productivity of staff, new research claims. The figure reflects a lack of support for small-business customers from the mobile-phone industry, according to mobile-network provider Three. This mirrors data from the Federation of Small Businesses showing that 45% of small businesses experience unreliable voice connectivity.

Ashtead's solid foundations

The building-equipment rental firm's prospects are auspicious

Matthew Partridge
Shares editor

In the immediate aftermath of the first wave of the pandemic there was much talk about the need to "build back better" by spending more on infrastructure. The idea was that this would not only jumpstart the major economies by putting people to work, but also make up for decades of underinvestment that had led to severe deficiencies, something that was increasingly acknowledged as a problem even before 2020.

Throw in a housing boom, and it's no surprise that the shares of firms involved in the manufacture and rental of construction and industrial equipment surged for most of last year.

However, over the last nine months this boom has started to unravel. There are several reasons for this. Firstly, central banks have started to raise interest rates in order to temper inflation, making it more expensive to finance infrastructure projects and raising fears that house prices may decline.

The rising price of energy and food are also starting to squeeze people's incomes, raising fears of recession. Finally, governments are also looking at ways to cut spending in order to tackle the huge fiscal costs imposed by the pandemic.

Benefiting from diversification

One company that has been caught up in this downturn is equipment-rental specialist **Ashtead Group (LSE: AHT)**. The stock has fallen by over 40% since last November. The fall looks overdone. Firstly, there is little sign that the slowdown in demand is affecting its core construction business, now mainly focused on the US.

The company recently reported that it continues to benefit from supply-chain problems with manufacturers that have resulted in an overall shortage of equipment. It also believes that there is a longer-term shift to companies renting equipment rather than buying it outright.

Another reason why a construction downturn won't affect Ashtead as much as some experts think is that it has been putting a lot of effort over the past fifteen years into diversifying its business. As a result, it now receives a rising proportion of its money from other sectors, such as the film industry and "mega projects". These projects, such as carmakers building new facilities to manufacture electric cars, are particularly important, as they not only bring in large amounts of revenue, but are also relatively immune to economic downturns.

The film industry now accounts for a growing proportion of sales

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Ashtead has a strong growth record: sales rose by 60% between 2017 and 2021, while profits increased by a similar amount. At the same time it continues to earn a very strong return on capital expenditure (a key gauge of profitability) of between 12%-15% a year, allowing it to keep increasing the dividend. Yet it trades at only 12.5 times 2023 earnings, a very modest valuation compared with both the US and UK markets. In addition to the group's strong fundamentals, there is evidence that the shares may have bottomed out over the past few weeks. They are now trading above their 50-day moving average. I recommend going long at the current price of 3,785p at 50p per £1. With a stop-loss of 2,005p, this would give you a total downside of £890.

"There is scant sign that the jitters have affected the group's core US business"

Trading techniques... transfers of power

After last week's resignation, Boris Johnson's days in office as prime minister are numbered. The question is what (if any) impact the change of leader will have on the stockmarket. One view is that the entry of a new prime minister into Downing Street is usually bad for the market, as it usually coincides with political and economic turmoil; alternatively, it can be viewed as an opportunity for a fresh start.

Analysis by Russ Mould, investment director of online broker AJ Bell, suggests that the market is more likely to react negatively to a new PM. In the last 50 years, five prime ministers have entered office between elections (James Callaghan in 1976, John Major in 1990, Gordon Brown in 2007, Theresa May in 2016 and Johnson himself in 2019). In the case of Callaghan, Brown and Johnson the FTSE All-Share index had fallen within three months, and with Brown and Johnson it had produced sharply negative returns within a year.

On average the FTSE tends to go up by only 1.9% within three months of a new PM, and 1.5% within six months, well below the long-run average. Indeed, after a year the FTSE had fallen in price by 1.9% on average. But Major's arrival showed that change at the top isn't always bad. The FTSE not only shot up by 11.5% within three months, but also increased 13.9% in price in his first year in office.

Of course, the small number of cases means that it is hard to draw any general conclusions: the economic backdrop, notably the financial crisis of 2008 and the outbreak of Covid-19 in 2020, clearly weighed far more on investors' minds than who was in Downing Street.

How my tips have fared

In the past month my open long tips have put in a mixed performance, with three out of the four rising. Supermarket J Sainsbury rose from 204p to 214p, telecommunications firm Airtel Africa climbed from 142p to 146p and fast food chain Domino's Pizza increased from 375p to 398p. However, coach operator National Express fell from 224p to 174p.

Pending tips ASOS, JD Sports, Pets at Home and Hays Recruitment all remain below the price at which you should start going long. Overall, my long tips are making combined profits of £1,042, down from £1,102. Five of my six short tips rose. Cinema chain AMC increased from \$11.48 to \$14.95, remote-medicine firm Teladoc advanced from \$29.20 to \$39.59, online-marketing firm HubSpot went up from \$291 to \$295 and KE Holdings climbed from \$14.41 to \$15.10. Digital currency exchange Coinbase also rose – from \$52 to \$54. However, DWAC, the holding company for Donald Trump's social media venture moved in my favour, falling from \$38 to \$29.45. My short tips are making a combined profit of £6,543, slightly down from £6,808 a month ago.

My short and long tips are making an overall profit of £7,585, compared with £7,910 previously. I suggest that you close the loss-making positions on J Sainsbury and National Express, both of which I've held for well over six months. This leaves nine open tips: long Airtel Africa, Domino's Pizza and Ashtead Group; and short AMC, Teladoc, HubSpot, KE Holdings, DWAC and Coinbase. I also suggest that you raise the stop losses on Airtel Africa to 125p (from 100p) and Domino's Pizza to 300p (from 240p). Cut the level at which you cover KE Holdings to \$20 (from \$30) and, for HubSpot, to \$325 (from \$350).

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These companies will conquer the competition

A professional investor tells us where he'd put his money. This week: James Harries of the Securities Trust of Scotland picks three long-term investments

The Securities Trust of Scotland invests in a portfolio of high-quality and resilient businesses that we expect to compound free cash flow reliably over the long term. This should provide a growing income stream that forms part of the balance of income and capital growth. The aim is to produce an above-average return with below-average volatility. With this approach we hope to establish the trust as the high-quality, conservatively managed global equity income trust in the sector.

In a further effort to protect investors from undue volatility, especially those who have irreplaceable capital and a need for income, we have a discount-control mechanism in place. This keeps the share price close to net asset value (NAV) and provides liquidity for shareholders.

At Troy Asset Management we concentrate our portfolios in sectors that can sustain high returns on capital employed (a key gauge of profitability) owing to the competitive advantages that some companies enjoy. With low turnover and correspondingly long holding periods we want to invest in businesses that we can leave to compound over ten years or more. Three such sectors are consumer staples, exchanges and information technology.

A crowd favourite

Consumer-staples companies are excellent businesses. Strong brands, scale, depth of distribution and longevity all breed familiarity and make for powerful competitive advantages. While best known for its eponymous carbonated soft-drink brand, **PepsiCo (Nasdaq: PEP)** is actually predominantly a snack business.

With a dominant position in the US and growth opportunities overseas it is a wonderful company. Most of its products are impulse buys at checkouts, which allows the company to raise prices without affecting demand – especially useful in these more inflationary times.

"PepsiCo, best known for its cola, is predominantly a snack business"

A hedge against inflation

Formally called the Chicago Mercantile Exchange, **CME (Nasdaq: CME)** owns and trades some of the most important and liquid futures contracts in the world, including those on interest rates, Treasuries and commodities.

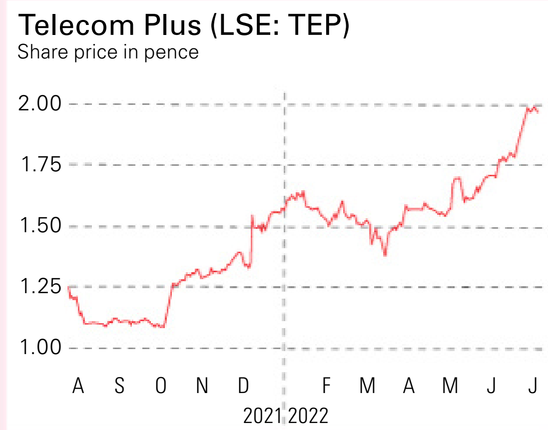
Investors' need to hedge the risks associated with inflation and rising interest rates has benefited the company. Greater volatility in commodity markets also drives activity across the exchange. Limited capital requirements allow CME to pay an attractive and growing dividend. It is very well placed for the uncertain times in which we currently live.

The profits in payrolls

Within information technology (IT) we have exposure to enterprise IT expenditure, which we expect to be more resilient and predictable than household spending in this area. **Paychex (Nasdaq: PAYX)** was originally a payroll firm, but is now a leading provider of payroll, human capital management and insurance serving US small and medium-sized enterprises.

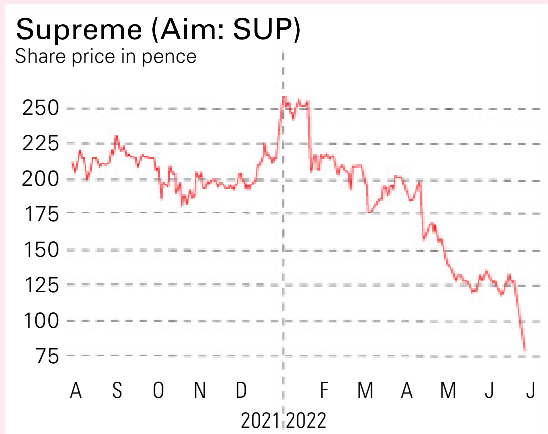
It boasts 710,000 clients and pays one in 12 private sector workers in the US. Despite its scale, the opportunity to penetrate this market further means the company has plenty of future growth potential. The attractive economics Paychex enjoys allow it to pay a decent and growing dividend, which we think it can sustain for years to come.

If only you'd invested in...

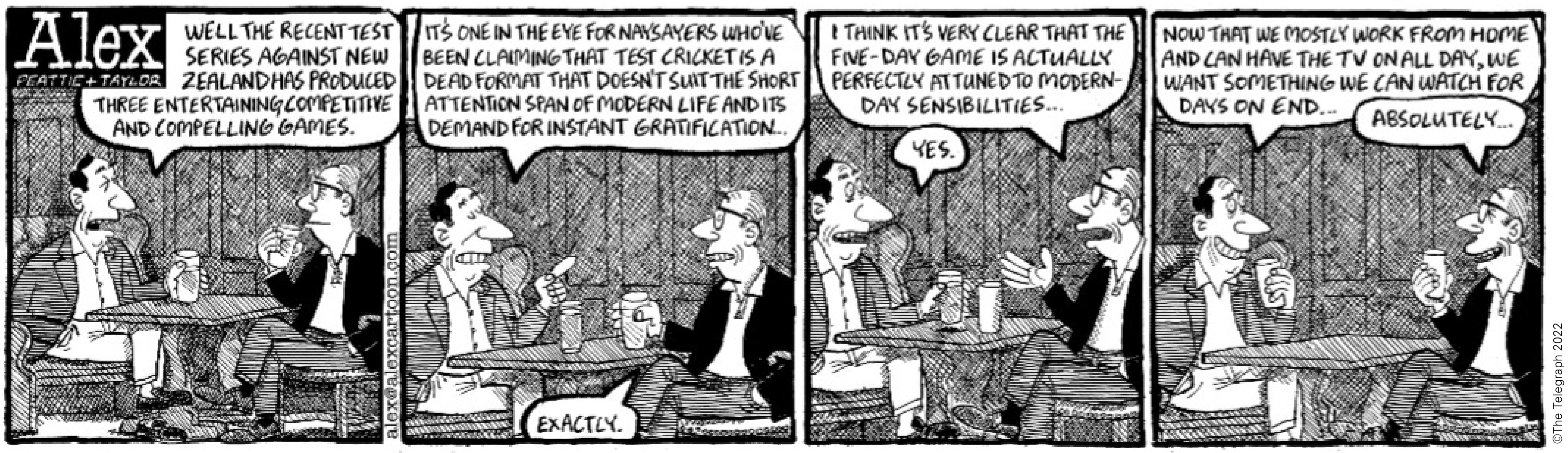


The energy crisis has boosted **Telecom Plus' (LSE: TEP)** earnings, says the Financial Times. The British FTSE 250 group expects adjusted profits to rise by a fifth to £75m in 2023, with similar growth in customer numbers. Telecom Plus owns Utility Warehouse, which offers discounts of up to 5% on the national energy-price cap if customers purchase bundles, whereby electricity and gas are combined with mobile, broadband or insurance services. Bundling is booming as consumers increasingly try to save as much money as possible. The stock is up 78% over the last year.

Be glad you didn't buy...



Shares in **Supreme (Aim: SUP)**, which makes and distributes batteries, lighting, vaping and sports-nutrition products, fell sharply last week after it warned that sales and profits would dip in 2023, says Shares magazine. The company enjoyed a 25% jump in pre-tax profits last year and a 7% increase in sales, but the cost of raw materials has been rising, while consumers overstocked during the pandemic. The warning sent the shares down 28% in a single day, leaving them trading 30% below their February 2021 flotation price. The stock has lost 55% over the last 12 months.



The Theranos saga's final chapter

Elizabeth Holmes's former lover and business partner, Sunny Balwani, has been convicted for his role in the building of a multibillion-dollar fraud. Jane Lewis reports

Nearly eight years after serious concerns were raised about Theranos's blood-testing technology, the final chapter of the legal saga has closed. Following a 13-week trial, founder Elizabeth Holmes' former lover and business partner, Sunny Balwani, has been convicted on all 12 fraud charges brought against him (compared with Holmes's four counts) – including a charge of "defrauding patients" that Holmes escaped when convicted in January. "Defence attorneys depicted Balwani as a loyal soldier" who had "tried to save the company," which, at its height, was worth $9bn, says The Guardian. The jury was having none of it.

©Getty Images

"Balwani was an ambitious, canny and street-smart man, eager to make his mark"

A clear vision

The Theranos scandal isn't just the story of a company whose false claim to have revolutionised medicine gulled everyone from former secretaries of state George Shultz and Henry Kissinger (who leant their weight to the board) to big-name investors such as Rupert Murdoch and tech mogul Larry Ellison. It also charts the course of an ultimately toxic love affair. According to *Bad Blood* – the account of the saga by John Carreyrou, the Wall Street Journal reporter who first broke the story – Holmes and Balwani met in 2002, when she was 18 and he was 37, during a summer trip to Beijing organised by Stanford University's Mandarin programme. She had been bullied by other students. "Sunny, the lone adult among a group of college kids, had stepped in and come to her aid." The two became fast friends and, a year after Holmes dropped out of Stanford to found Theranos in 2004, began living together. In 2009, Balwani joined the company as its president and COO, sealing a relationship that went from platonic, to romantic, to strategic within a few short years.

Balwani once told Fortune he had been attracted by Holmes's "clear vision" for the company, based on a fingerstick device that could purportedly detect hundreds of diseases from a few drops of blood. She, in turn, was impressed by his CV – and perhaps his cash, says Vanity Fair. "I understood that he'd been a really successful business person, that he worked with Bill Gates in the early days of Microsoft," she said at her trial. Born to a Hindu family in Pakistan, and raised in India, Sunny enrolled at the University of Texas in 1986 after his family moved to the US. After stints as a software engineer at Lotus and Microsoft, he successfully rode the dotcom boom – co-founding CommerceBid.com (which aided companies trading over the internet), "cashing out for nearly $40m" before the company went bust.

"We will transcend!"

Holmes and Balwani "went to elaborate lengths" to keep their 12-year relationship a secret while running Theranos, says Vanity Fair. It wasn't the "largest lie" they told in "their troublesome quest" to build a multibillion-dollar business, but would certainly have been flagged up as a conflict of interest by investors. Many employees weren't fooled, says Yahoo News. Carreyrou relates that one of his early sources at the company "painted the portrait of this fraud being run by a couple". That source also alleged that Balwani was an uncomfortably controlling boss, allegedly "terrorising everyone" by keeping track of them through security footage. A later HBO documentary showed leaked footage of him leading employees in a "F*** you" chant, aimed at Theranos's enemies and competitors.

We will never know the full truth about the pair's relationship, says The Information. But recent interviews with those who knew Balwani shed light on "an ambitious, canny and street-smart man… eager to leave a big mark in America, and convinced that his destiny, and that of Holmes, were spiritually ordained". As he once wrote to her, "We will transcend!" Both now face a possible 20 years in jail.

The best trades in history... a punt on the kiwi

©Getty Images

Andy Krieger was born in 1956 and grew up in Wilmington, Delaware, before going on to study Sanskrit and Vedanta philosophy at the University of Pennsylvania. He then did an MBA at Wharton Business School before getting a job at Salomon Brothers in 1984. Two years later he would move to rival investment bank Bankers Trust. There he won a reputation as a successful and aggressive currency trader and the bank allowed him to risk sums of up to $700m, roughly a quarter of its capital.

What was the trade?

Krieger (pictured) specialised in trading short-term currency options, which give you the right (but not the obligation) to buy at some point in the future. In the aftermath of the 1987 stockmarket crash, with the Dow Jones Industrial Average falling by 22.6% at one point, the value of the US dollar plunged. Krieger believed this meant that some currencies seen as safe havens, such as the New Zealand dollar (the "kiwi"), were overvalued. He started buying options that would go up in value if the kiwi fell against the dollar.

What happened?

Krieger's instinct proved to be correct, as the US dollar did indeed rally against the kiwi, especially after the stockmarket bottomed out and started to recover. Krieger's highly leveraged short position was worth hundreds of millions of dollars and his sell orders were said to exceed the entire money supply of the country. The selling pressure combined with the lack of currency in circulation caused the kiwi to drop sharply while Krieger made millions for his employers. Legend has it that the New Zealand authorities, panicked by the collapse of their currency, got on the phone to Krieger's bosses, yelling at them to "get the f*** off our currency!". Krieger left Bankers Trust a few months later, said to be unhappy with his $3m bonus.

Lessons for investors

Krieger's trading in the kiwi was initially estimated to have made around $338m in profits for Bankers Trust in the final months of 1987, though this was revised down by $80m when his positions were unwound following his departure. Krieger went on to work for George Soros, who famously repeated Krieger's trick with sterling in 1992. Such trades can be highly lucrative, but are also incredibly risky – retail investors would be well advised to steer clear.

Perfect harmony in Corfu

Blend in with your surroundings at the new Villa Gaia Rock, says Chris Carter


©Chris Carter
Villa Gaia Rock: serenity with nature

Waking up at Villa Gaia Rock, a new luxury villa on the Greek island of Corfu, is a little like waking up between the pages of an interior design magazine. The objets d'art dotted around the master bedroom complement the overall "minimalism meets beach house" look. Outside the French doors, there are a couple of chairs and a little table turned towards the view. And behind those, there is an outdoor shower. But for the moment, the shutters are drawn and the room is dark. I slip on my sandals and wander out into the living room. There, framed by the floor-to-ceiling window and backlit by the blinding light of day, is the magnificent Ionian Sea. It is perfectly still. Even the boats are still, and the whole appears as in a painting.

I head into the galley kitchen, with its new induction hob and oven, grab a coffee from the bean-to-cup machine, and push through the doors onto the outside terrace – not forgetting my sunglasses along the way. There is a dining table, and beyond that a snug covered lounge area with stone-coloured cushions and minimalist rattan chairs arranged around a coffee table. In the corners hang speakers that you can connect to via your phone and listen to music in the warm evenings over coffee, and a chilled glass of the local kumquat liqueur. But for the moment, it is still morning, and the crickets are already up, serenading the arrival of the day and the heat it has brought with it. The cobalt sky heralds another hot day on the island.

Villa Gaia Rock is located close to the village of Nisaki, in the northeast of Corfu, carved out of the side of the hill that runs down to the water. The stone has been reclaimed for the walls of the villa, the sides of the terrace and infinity pool overlooking the olive trees in the Mediterranean garden. The effect is almost chameleon-like. When the sun sets, the sky softens and blends with the water in the pool and the motionless sea, so that only the thin sliver of land that runs passed old Corfu Town, and the hazy outline of the Albanian hills, define the horizon.

A cosy cottage

The property also comes with a cottage, its back wall shared with the outdoor lounge area. Katerina, a furniture and interior designer, who owns the villa with her husband, explains that the idea was to give the property the sense of there being a collection of buildings, as with a village and its cosy spirit of community. The private road outside the cottage winds down the hill towards the shoreline and Villa Gaia Rock's bigger sister property, Villa Gaia Sea, along with the jetty from where boats can be rented. Small beaches lie a couple of minutes' walk in either direction. One is popular with locals and families, with a restaurant and bar. The other is more secluded, lying close to Villa Gaia Rock. Larger parties can rent both properties together, and in the summer months they are catered for.

"When the sun sets, the sky softens and blends with the water in the pool..."

For my two companions and me that meant local chef Marios was on hand to prepare a selection of Greek and Corfiot mezze dishes one evening. There was *nouboulo*, a traditional cured pork from the island, served with melon, a feta mousse with kumquat jam, a mixed-leaf salad in a fermented-fig and ouzo dressing, smoked aubergine and tzatziki dips, followed by a rich red wine and tomato beef *pastitsada*, and a velvety wine and garlic veal *sofrito*. Both of these dishes are so representative of Corfu. For dessert, baklava and an orange pie in filo pastry with ice cream.

Here, at the round wooden table beside the pool, with Albania and the Corfiot coastline settling down for the night, we ate by candlelight, drinking glass after cold glass of Pontiglio white wine made from the local kakotrygis grape. Meanwhile, out in the bay, a pair of dolphins threaded their way through the water.

Chris was a guest of Villa Collective. A week at Villa Gaia Rock, sleeping eight, costs from €6,000 to €18,000. See villacollective.com/villa/Gaia%20Rock


©Villa Collective
Bedrooms have a beach-house feel

A next generation Lotus

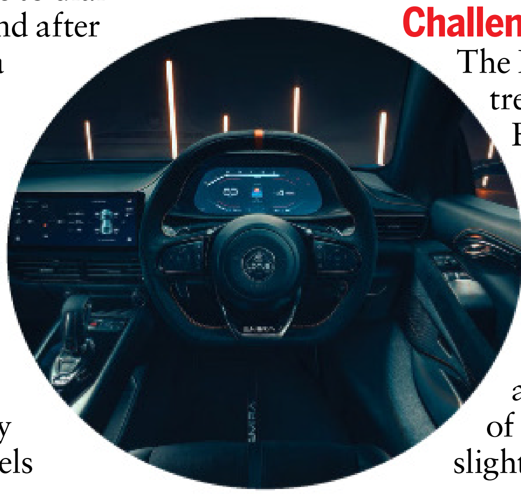
The new Emira is taking on the mighty Porsche 718 Cayman. Jasper Spires reports

Price: from £59,995. Engine: two-litre in-line four-cylinder. Torque: 317 lb-ft. Top speed: 180 mph. 0-60mph: 4.3 seconds.

"The Emira is a massively important car for Lotus and, by and large, it makes a decent fist of being Britain's alternative to the Porsche 718 Cayman," says Steve Sutcliffe in Auto Express. The Emira "goes well, sounds great, looks sensational and has an interior that's miles better in design and quality than any of its predecessors." This is the last hurrah for the marque's internal combustion range and it is a "strong effort". A new era for Lotus has begun.

"It takes very few miles to dial yourself into the Emira and after a couple of hundred extra miles, you don't want to get out," says Stuart Gallagher in Evo. "It feels every inch the next-generation sports car Lotus wants and needs it to be."

It's not the Emira's exceptional speed that stands out, but the quality of its ride. The steering feels connected, and it pours into corners with a linear calmness, settling sweetly and leaning on the rear axle, making it feel "every inch the complete sports car". Indeed, "the resulting handling is close to sublime," says CJ Hubbard for Parkers. "What's more, forward visibility is excellent – the low nose disappears immediately from view, leaving the twin humps of the front wheel arches in your vision in a manner reminiscent of the Porsche 911."



Challenging the Cayman

The Emira is an aesthetic treat too. "While the Evora was never a bad-looking car, the Emira is at another level entirely," says Car magazine. "It's got a proper sense of the exotic about it – all the drama of a supercar… at a slightly smaller scale and much lower cost." Inside, the cabin is just as impressive, with its sensible design leaping out from the moment that you open the door. "Lotus has paid much more attention to comfort, technology and refinement with the Emira," says Will Dron for Sunday Times Driving. "The interior looks polished and high tech", a fully digital driver's display is nicely animated and works "seamlessly" with the infotainment system. Overall, the Lotus Emira gives sports-car enthusiasts another high-class alternative option to the Porsche 718 Cayman, "with similar performance, refinement and versatility".
Lotuscars.com

"It feels every inch the next-generation sports car Lotus wants and needs it to be"

Wine of the week: a hauntingly beautiful Spanish white

2020 Saramusa, Pateiro, Ribeiro, Spain

£21.95, themodestmerchant.com

Matthew Jukes
Wine columnist

I enjoyed a couple of hours at the Wines from Spain annual tasting and focused on wines and wineries I'd never seen before. Alex Percy's table of beauties captured my attention and, as it turns out, this "modest merchant" has a veritable cornucopia of delights in his Spanish collection. All seem to be made by singularly dedicated souls who focus on indigenous varieties, organic viticulture and discreet production levels. I have found five wines for you that impressed me greatly, starting with my featured Saramusa, or Sara the Muse. This beautiful white is a lees-aged treixadura with the most hauntingly beautiful jasmine and green tea flavours I have ever encountered. The same estate is also responsible for 2020 El Patito Feo Treixadura (£26.95), an "ugly duckling" that takes the same grape and elevates it even higher with a gentle kiss of oak. 2020 El Patito Feo Barrica (£26.95) is a thrilling red made from caiño longo, caiño tinto, souson and brancellao (yes, I scratched my head too), and it is a cherry and dark chocolate-scented red with brittle acidity and more crunch than a juggernaut of Fleurie. The 2021 Antxiola Getariako Txakolina (£17.95) is the most nerve-tingling Txakolí I've seen in years, while NV Miguel Galadi Fino Robles (£21.95) is the most unusual style of near-fino. Made from certified organic grapes, which are soft-pressed and left to ferment naturally on their wild yeasts, it's then aged for two years in a solera. The result is a fresh sherry-ish style with juicy pear-skin tones over a tangy, green olive chassis. This is a collection like no other.

Matthew Jukes is a winner of the International Wine & Spirit Competition's Communicator of the Year (MatthewJukes.com).

This week: properties for around £1m – from a Grade II-listed former rectory in Tring, Hertfordshire, to

Gateshaw House, Morebattle, Kelso, Roxburghshire, Scotland. A Georgian house in the Scottish Borders with views over the Cheviot Hills. It has period fireplaces, an open-plan kitchen and family room with an Aga, and landscaped gardens. 8 beds, 7 baths, dressing room, 1-bed cottage, 2.68 acres. £1.1m+ Knight Frank 01896-807013.

Cocks Hill, Perranzabuloe, Penhallow, Cornwall. A restored, Grade II-listed former church dating from 1842 in a village a mile inland from Perran Sands. It has beamed ceilings, wood floors, exposed stone walls and a wood-burning stove in the main living area. 3 beds, 2 baths, open-plan living area, kitchen, gardens. £1m Inigo 020-3687 3071.

Creekside Road, Noss Mayo, South Devon. An 1880s property in need of some updating in an elevated position overlooking a deep-water harbour on the estuary of the River Yealm. It has leaded-light windows, a front garden with a summer house, a rear garden backing onto woodland, and a private stone quay with boat storage and river frontage. 3 beds, 2 baths, 2 receps, kitchen. £925,000 Luscombe Maye 01752-872417.

a Georgian house in Kelso in the Scottish Borders, with views over the Cheviot Hills

The Old Rectory, Wigginton, Tring, Hertfordshire. A restored, Grade II-listed, 17th-century former rectory. It retains its original wide floorboards and ceiling beams and has an inglenook fireplace with a wood-burning stove in the sitting room and a contemporary kitchen with a vaulted ceiling, handcrafted kitchen units and steel doors leading onto the garden. 3 beds, bath, 2 receps, study, dining kitchen, garage. £975,000 Nash Partnership 01442-820420.

West Todholes, Elsdon, Northumberland. A renovated, 1700s stone farmhouse in the Northumberland National Park. It has period fireplaces, a modern kitchen, a one-bedroom cottage with a vaulted, beamed ceiling and further outbuildings. 5 beds, 3 baths, 2 receps, 13.2 acres. £1m+ Finest Properties 01434-622234.

Petersham Road, Richmond, Surrey. A semi-detached period cottage with a brick façade with stucco rendering, and south-west facing gardens close to Ham Common. It retains its sash windows and period fireplaces, and the modernised interiors include a bathroom with underfloor heating and a large dining kitchen that leads onto a terraced garden. 2 beds, bath, 2 receps, front and rear gardens, off-road parking. £900,000 Savills 020-8614 9100.

Circus Street, London SE10. A renovated Georgian house in West Greenwich village, just moments from Greenwich Park. It has period fireplaces in the sitting room and in two of the bedrooms, chevron parquet floors, and a contemporary fitted kitchen with marble floors, Miele appliances and French doors leading onto a courtyard garden. 3 beds, bath, recep, orangery, attic. £940,000 Hamptons 020-3151 7294.

Middle Glebe, Winsford, Minehead, Somerset. This property is created from the principal part of a former manor house and is situated near a village in Exmoor National Park, an Area of Outstanding Natural Beauty. It has a large reception room with panoramic windows and French doors leading onto the garden, and a kitchen with a lantern skylight, range cooker and wood-burning stove. 5 beds, 3 baths, recep, workshop, greenhouse, 0.75 acres. £950,000 Strutt & Parker 01392-215631.

Collectors step on the gas

Prices in classic-car markets are starting to look frothy. Chris Carter reports

Stocks have had a rotten time of late. Collectables, on the other hand, have soldiered on. Sales results from the big three auction houses (Sotheby's, Christie's and Phillips) have thus far been robust. The same is true for classic-car auctions. Several cars fetched six-figure sums at Bonhams's Goodwood Festival of Speed sale at the end of June. The auction house followed that at the start of July with its first sale at the Gstaad Palace hotel in the Swiss Alps in 14 years, successfully selling 89% of lots for a total of CHF7.5m (£6.4m). Top billing went to a rare 1991 Ferrari F40, which fetched just shy of CHF2m (£1.7m). Next month, RM Sotheby's holds its annual Monterey sale in California. With a number of cars valued in the millions of dollars, including a 1924 Hispano-Suiza H6C Torpedo, with a chassis made from tulip wood and a high estimate of $12m, it will be a key test of market sentiment.

Even ordinary models are fetching high prices. Last month, an iconic Ford Capri, built in 1972, sold for £74,250, setting a new record for the model. To be fair, it wasn't any old Capri for sale at Classic Car Auction's Summer Sale in Warwickshire. It was a one-of-a-kind "prototype" model for the RS3100 Capri, the blueprint for a production run of 249 RS3100s made the following year and the basis for the popular coupé. The seller bought the car from Ford in 1975 for £1,500 – around £21,000 in today's money, "showing just how much the modest Capri has appreciated in half a century", says Rob Hull on This Is Money.

"A 1955 Mercedes-Benz 300 SLR Uhlenhaut Coupé fetched $142m at auction in May"

It's harder to make money

Collectors are now finding it increasingly hard to pick up models cheap enough to make them viable investments, due to a flattening of the "depreciation curve", as Rob Sass notes in The New York Times. High-end sports cars shed a large percentage of their values the moment they drive off the forecourt. "From there, it was a long slog to the bottom of the depreciation curve, where cars would often languish for years, sometimes decades, before nostalgia-driven interest drove values up again." A car would gain the attention of collectors only once its value regained its original sale price. But around the middle of the last decade, that curve became more shallow, meaning fewer bargains for collectors looking to make money down the line.

Perhaps the surest sign that the market is getting toppy is the $142m paid for a 1955 Mercedes-Benz 300 SLR Uhlenhaut Coupé (pictured) at an auction in Stuttgart, in May. That figure blew apart the previous auction record, set by a 1962 Ferrari 250 GTO when it sold for $48.4m in 2018. "The buyer has never once asked me what I think the car might be worth in the future," Simon Kidston, who placed the winning bid on behalf of a client, tells Hannah Elliott on Bloomberg. At that price, it's surely just as well.

Auctions

Going... An original Stormtrooper helmet used in the 1977 film retroactively titled *Star Wars: Episode IV – A New Hope* is up for sale with California-based Julien's Auctions on Monday. It is believed to be one of the original six surviving "Sandtrooper" helmets made for the first instalment of the Star Wars series, in which the imperial shock troops are introduced in a scene that takes place on the desert planet of Tatooine. The helmet for sale is thought to have been worn by one of the stormtroopers escorting Princess Leia to meet Darth Vader aboard the captured Rebel Blockade Runner spacecraft. Each of the helmets, designed by Andrew Ainsworth, is unique because the method of manufacture required them to be hand-finished. It is expected to fetch up to $300,000.

Gone... An original miniature model of the Red Leader X-wing Fighter, used in the making of *Star Wars*: *A New Hope*, sold with Prop Store Auction last month. In the film, the fighter is piloted by Squadron Leader Garven Dreis, played by the late Drewe Henley. The model, made by visual effects company Industrial Light & Magic, is extremely rare as most were blown up in the filming of the climactic battle sequence at the Death Star. Despite sustaining scratches when a pyrotechnic was set off to simulate an explosion to the spacecraft's engine, the model was offered in "excellent condition". The scratches and airbrush marks to the paintwork were used to authenticate the model using behind-the-scenes photographs taken in 1976. It fetched almost $2.4m.

©Getty Images; Mercedes Benz; Prop Store

Time's up for Rolex

It's not only classic cars that may have peaked (see left), second-hand luxury watches may have too. "After reaching record highs earlier this year, prices for the most desirable watches on the secondary market, including the coveted Rolex, have now fallen," says Andrea Felsted on Bloomberg. A heady mixture of crypto-asset appreciation, stockmarket gains, stimulus cash and speculation helped fuel the market bubble in 2021. And when financial markets began to "whipsaw earlier this year, some investors were keen to put their money into more tangible stores of value", such as collectable timepieces. Younger traders joined long-time collectors. Together, they chased "the holy trinity of the most-hyped watches" – the Rolex Daytona (pictured), the Patek Philippe Nautilus and the Audemars Piguet Royal Oak. All were trading

for several times their retail prices. That demand "is now evaporating".

Prices for all three of these models are estimated to be a quarter below their peaks, says Felsted. For now, though, the broader market does appear to be holding up. There is also still a lively interest among collectors in "genuinely rare pieces" and demand for new models often continues to outstrip supply in shops. However, according to Jefferies, an investment bank, "crypto wealth" accounted for up to 30% of growth in US luxury sales last year, and the recent collapse in the crypto-currencies leaves luxury goods – from high-end handbags to jewellery – vulnerable. Add to that a possible recession and the outlook for second-hand luxury watches becomes yet more uncertain. "For the bling behemoths, as in the watch market, time may be running out."

Bridge by Andrew Robson

Dentistry

Cashing top cards to extract cards in defenders' hands before exiting is known as the Dentist's Coup – because of the card extraction, like teeth. How should the play and defence go on this week's interesting Four Hearts?

Dealer West — Neither side vulnerable

North: ♠5 ♥QJ65 ♦AKQJ3 ♣AQ6

West: ♠QJ92 ♥AK10 ♦95 ♣K1083

East: ♠A8764 ♥9 ♦10762 ♣952

South: ♠K103 ♥87432 ♦84 ♣J74

The bidding

South	West	North	East
	1NT	double*	2♠
pass	3♠	double**	pass
4♥	pass	pass	pass

* Penalty.
** Take-out.

West led the Queen of Spades to East's Ace, and East, keen to keep declarer from his hand, returned the nine of clubs, which ran to the Queen. At the table, declarer led dummy's Queen of Hearts. No good – West won the King and exited with the nine of Diamonds. Declarer won dummy's Knave, but was unable to reach his hand to lead a second Trump towards dummy. He tried ruffing a third Diamond, but West overruffed with the ten and cashed the Ace. Down one.

After winning dummy's Queen of Clubs, declarer should seek to extract West's Diamonds, should he have the dangerous doubleton holding (declarer has no problem if West has three Diamonds, as declarer is able to ruff a third round in his hand). He cashes two top Diamonds (key plays), and only then exits with the Queen of Hearts.

West wins the King, but cannot now lock declarer in dummy. A Club return can be run to declarer's Knave, a Spade run to his King-ten, while a second Heart prevents West from scoring a third Heart trick. Game made.

For Andrew's four daily BridgeCasts, go to andrewrobsonbridgecast.com

Sudoku 1112

4				8				9
	5							
1	3		4		5		2	
			9		7	3		
8		7			6			
	1		2		3		5	6
	8						4	
3				7				1

To complete MoneyWeek's Sudoku, fill in the squares in the grid so that every row and column and each of the nine 3x3 squares contain all the digits from one to nine. The answer to last week's puzzle is below.

4	6	1	8	3	7	9	5	2
9	5	7	4	2	6	3	8	1
2	8	3	1	9	5	6	4	7
3	1	2	9	5	4	7	6	8
7	9	8	3	6	2	5	1	4
5	4	6	7	8	1	2	9	3
6	3	4	5	7	8	1	2	9
8	2	9	6	1	3	4	7	5
1	7	5	2	4	9	8	3	6

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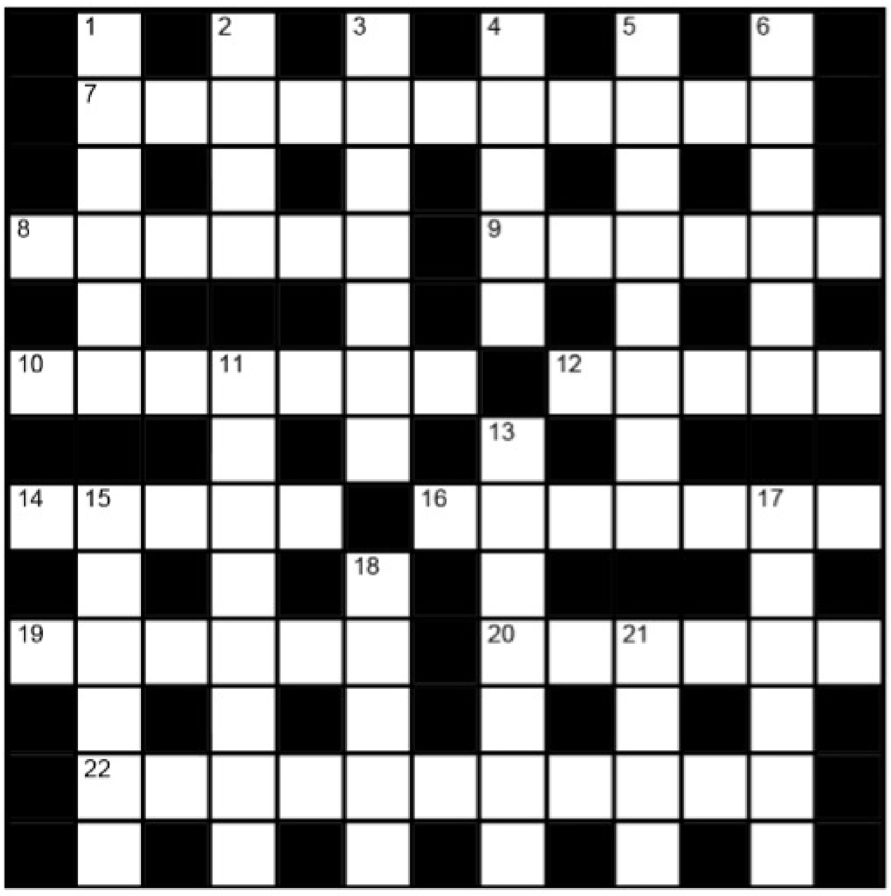
Tim Moorey's Quick Crossword No.1112

A bottle of Taylor's Late Bottled Vintage will be given to the sender of the first correct solution opened on 25 July 2022. By post: send to MoneyWeek's Quick Crossword No.1112, 121-141 Westbourne Terrace, Paddington, London W2 6JR. By email: scan or photograph completed solution and coupon and email to: crossword@moneyweek.com with MoneyWeek Crossword No.1112 in the subject field.



All clues are mildly cryptic

ACROSS

7 Repaired item is not on launch (3, 2, 6)
8 You could count on this once (6)
9 Believe a little criticism surrounding editor (6)
10 Erudite King facing hooligan (7)
12 Pole comes from taxi with hesitation (5)
14 Not enough time given to survey (5)
16 Various waterbirds on end of groyne (7)
19 Heavenly to eat around four (6)
20 One in business on Devon riverbacked (6)
22 Funny name for ship! (3, 8)

DOWN

1 American expert operational (6)
2 Notice internally concerning a listener (4)
3 Diet in King's Head? That's a little alien (7)
4 Some suggest Oscar for an opera (5)
5 Broadcast story not starting – it's a dog! (8)
6 Individual protecting tree that's in flames (2, 4)
11 Most lustful Andrew's in the right (8)
13 Very little meat in troubled Far East country (7)
15 Pretentious couple of Greek characters (6)
17 Partying Swede drinking tons gets drunk (6)
18 West African republic, Benjamin's home (5)
21 Overturned car in the river (4)

Name ....

Address ....

....

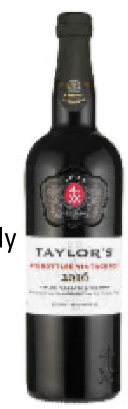
email ....

Solutions to 1110

Across 7 Leave it to me *IT inside leave tome* **8** Tea set *tease + t* **9** Sleigh *homophone* **10** Measure *a inside me sure* **12** Ravel *(t)ravel* 14 Iliad *I + anagram of laid* **16** Pattern *patter + n* **19** Egoist *anagram of I get so* **20** Thrash *h inside trash* **22** First person *anagram with I being definition*
Down 1 Fleece **2** Jaws **3** Western **4** Stash **5** Forecast **6** Reggae **11** Spaniard **13** Canteen **15** Log off **17** Rising **18** Stats **21** Rose.

The winner of MoneyWeek Quick Crossword No.1110 is: David Hawthorn of Derbyshire

Tim Moorey is author of How To Crack Cryptic Crosswords, published by HarperCollins, and runs crossword workshops (timmoorey.com)



Taylor's is one of the oldest of the founding port houses, family run and entirely dedicated to the production of the highest quality ports. Late Bottled Vintage is matured in wood for four to six years. The ageing process produces a high-quality, immediately drinkable wine with a long, elegant finish; ruby red in colour, with a hint of morello cherries on the nose, and cassis, plums and blackberry to taste. Try it with goat's cheese or a chocolate fondant.

The Powell Staying Put

The usual helping hand from central banks has not yet been proffered

Bill Bonner
Columnist

There's no safe harbour nor even a lifeline for investors in this storm

©Getty Images

Investors are in trouble. The last six months were the worst in the stockmarket since 1970. As for the bond market, they were the worst since George Washington was president. The seas are looking stormy. Almost everywhere you look, sailors cling to wreckage. One is buoyed by a busted up tech stock. Another grabs a cracked-up crypto and holds on for dear life.

The high winds and monster waves have come from three different directions. First, the stockmarket itself. A bear market takes on a life of its own. As investors' boats sink, they need to jettison other things to stay afloat. The good, the bad, the ugly – all end up as flotsam and jetsam. A real bear market typically takes stock prices down about 35%. This one has only off-loaded 20% so far. Much further to go, in other words.

Second, a more general sell-off, which is much more widespread than usual. Mr. Market is taking almost everything down. Copper has slipped below $8,000.Oil prices are below $100 amid recession fears and a strengthening US dollar. And third, the Fed. Jerome Powell is not responding to SOS calls. Or at least, not yet. For the last 30-plus years, investors could count on the Fed to send out lifeboats. There was the Greenspan put, the Bernanke put, the Yellen put… But things have changed. Powell is staying put. He is leaving the poor sailors to weather the tempest as best they can. And it isn't easy, because the whole capital structure – stocks and bonds, credits and debits, NFTs and beer-bottle collections – the whole shebang has been distorted and corrupted by the Fed's fake money.

"This bond correction is far more important than the bear in stocks"

The US Treasury bond was a "safe harbour" for investors for decades. But in recent years, the "risk-free rate" from a T-bond went down, down, down – until it came to rest about 600 basis points below the rate of consumer-price inflation. In other words, all the "return" was underwater. All that was left was risk. And then, the yield on the ten-year T-bond rose nearly six times in the last 24 months, leading to the biggest losses (over the last six months) in 224 years. This bond-market correction is far more important than the bear in stocks. It undermines pensions, insurance, debt and federal finances too. Real estate is next in line. Mortgage rates are linked to Treasury yields. And when mortgage rates go up, property prices generally go in the opposite direction.

Market analyst Nouriel Roubini says that stocks tend to fall by about 35% in typical recessions, but that the one on the horizon could be much worse and deliver losses closer to 50%. Apply that 50% to the whole of household net worth, and a 50% haircut – trimming the values of houses, stocks, private businesses, bonds – would represent more than $70trn in vanished wealth. Will that happen? Who knows. It could be worse.

The bottom line

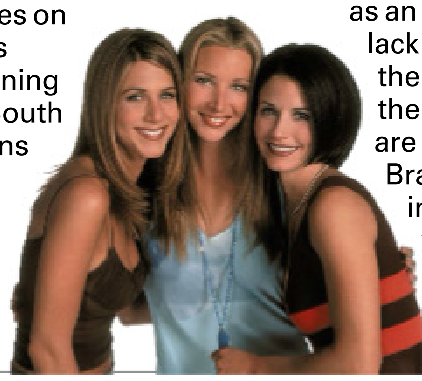
£2.4bn The drop in the value of UK food exports to the EU in the first 15 months following Brexit. Data tracking of exports to the continent since the Brexit transition ended in January 2021 shows a 19% decline to £10.4bn, a fall driven primarily by fewer perishable foods, from British strawberries to cheese, being sent abroad.

€60m The cost of a rust-preventative paint job on France's Eiffel Tower. The Parisian landmark has been at risk of serious corrosive damage since before 2014, when a report revealed 884 defects, 68 of which were structural. The painting won't fix these pre-existing issues, however, and suggestions of a complete overhaul have been made.

HK$9m How much (£896,000) Hong Kong's new leader John Lee spent on political campaigning, despite being the city's only candidate. Unused funds were later donated to a local charity.

$1.4trn The decline in wealth among the planet's wealthiest people in the first six months of 2022. The steepest six-month drop ever for the global billionaire class saw Tesla's CEO Elon Musk lose almost $62bn, Amazon's founder Jeff Bezos shed $63bn, and Meta's chief Mark Zuckerberg's fortune shrink by over half.

£300m The tax-free profits poised to be reaped by Eton College from the construction of over 3,000 homes on fields adjoining the South Downs National Park. The organisation is classed as a charity and so has avoided liability for tax on these investments.



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$4m The value of a donation by Marta Kauffman, co-writer of television hit *Friends*, to her former university as an apology for the lack of diversity in the show (three of the lead actors are pictured). Brandeis University in Massachusetts will receive the cash to support an African Studies scholar.

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