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8/F, 2 Exchange Square, 8 Connaught Place, Central, Hong Kong. Tel: 852 3167 4591, Mob 852 9738 0944
Email: afreris@ecognosisadvisory.com Website: www.ecognosisadvisory.com

ECONOTE No. 62: Real assets investment in a disconnected "global" economy 21/7/2017

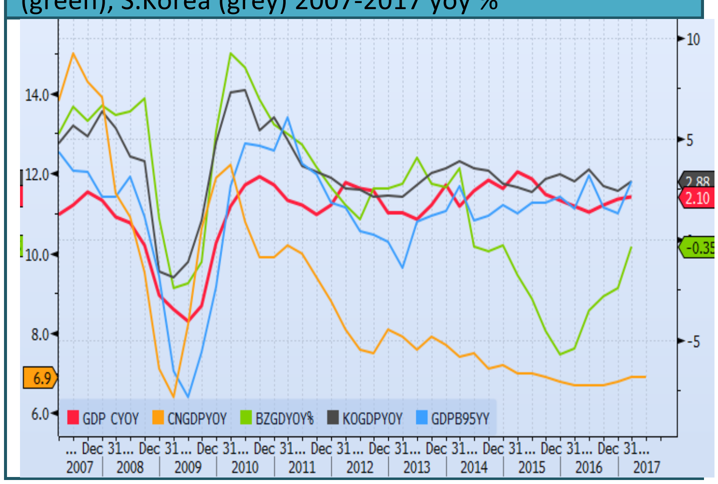
Summary	Investment Conclusions
The attacks on "globalization" have introduced an element of confusion as to what is "global". The globalization attacked arête commercial and investment interlinks between economies, which make them interdependent for the growth of imports and /or exports and hence for output, employment and prices. On the level media publicity level these attacks tend to focus on micro rather than macro links, hence "the destruction of the steel and textile industries in the US" by Chinese imports etc. On the macro level, however, globalization has been interpreted as the process of synchronization of the real and financial cycles of the "interdependent" countries, clearly something not happening now!	The cycles of the G3 are not synchronized in terms of GDP growth, inflation or of fiscal and monetary policies. Asia is not linked to US interest rates and GDP cycles and, similarly, the same for most Latam economies. Within the EU there are major macro differences between Germany and Italy, never mind Greece For some financial cycles, especially equity prices, there are "global" links, such as for Asia, with the S&P 500 but macro trends and equities have not been connected for sometime now, especially in China. Hence investment decisions cannot be based on "global" trends. The alternative is micro choices and sectoral investment approaches.

Staring through the fog

At the risk of overdoing the "historical-cyclical" bit which, in any case, is useless for making money, the 2008-9 **US** crisis (NB emphasis on **US**) and the "globalization" in the media of the US crisis is a crass example of crude US-centricity. Just because the US banking and financial system collapsed and had to be partially nationalized, it did not mean that Japan or Asia's banking systems also collapsed. They most definitely did not, and none of them had to be rescued in the manner that the US financial system had to. Ditto for Latam, except for the local US-unconnected kamikazes, which did it all by themselves and with no outside help, such as Argentina (not now though…), Brazil (domestic corruption with the conspicuous absence of Yankees) and Venezuela (words fail us….). The timings of these events do not coincide with the 2008-9 crises but neither do their antecedents. Back in old Europe, the US crisis did hit the UK, as did some German banks. But the Greeks, Spaniards and Portuguese were hard at work well before the property sector melted in the US. What all this says, is that the 2008-9 crisis showed that the "globalization", however defined or misdefined was already on its way out with everyone else not in synch with the US. The collapse of the US financial system was not accompanied by the collapse of banking systems or economies in Asia and Japan and even in core Europe, where Germany stood well the test, and where the EU crisis was primarily existential (helped by the Greeks) and, hence, political rather than economic.

The existing global trends ,which are neither global nor trends , cannot be reliable guides to asset allocation.Fig 1 is an illustration of the dispersion of growth patterns in major economies.Fig 2 takes this a stage further showing the growing disparities between risk and performance in different equity markets.We prefer individual classes of goods and real assets based sectors, where the "global" influences might be limited or , hopefully,non-existent.

Fig.1 GDP: US (Red), China (yel), Germany (blu), Brazil (green), S.Korea (grey) 2007-2017 yoy %



Source: Bloomberg

Get real !

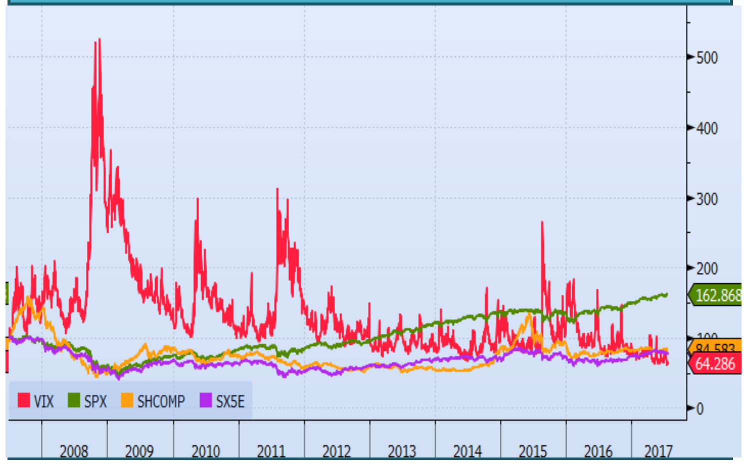
The availability of real asset investment opportunities is as wide as the investors' apetite.The major constraint, however, is the availabiity of skilled managers, and not just paper asset i managers, but of managers with hands -on knowledge of the sector and of the business. An equally important factor is the abiity to supervise the investment while leaving the actual management of the company(ies) in question in the hands of the owners or of the professionals hired to run these companies.A classical illustration of this challenge would be investment in a chain of restaurants, involving the physical ownerhsip of the sites, hence, the real nature of the investment, as well as the mamagement skills necessary to handle the goodwill of the name.A similar example would involve investment in individual units or chains of retirementent accomodation which would involve the ownership of the real estate (the real assets) as well as the the management of estate use and of the tenants.More "exotic" examples of investment in real estate would involve a variation on the self-storage facilities, except here the application of IT would rent not only the space but additional services such as photo fiing and full or partial retrieval of the goods stored though the internet.The next stage in the use of physical space combined with IT will be a form of "cloud storage" of things! Share-a-bike services, with bikes being the real assets, are being combined with IT and GPS, which traces the bikes and discourages theft and provides "macro data" as to the trips and helps improve the use of the inventory. After 2008 the new and second hand markets for private jets collapsed, with only 661 planes delivered in 2016 versus 1313 in 2008.This is a market ripe for uses of the spare capacity, with jets being the real assets backing the investment.

Fact Box: When is a real asset real?

Holdings shares in mining company investors hold claims on physical assets such as the mine infrastructure and the proven mineral deposits.

Ditto for REITS and shares in property companies where the assets are, literally, bricks and mortar. Although it is possible to invest outright in closely specified physical assets, such as a wine or a diamond fund, an investment in a company, which has a specific group of physical assets as a focus of its operations and earnings, brings real asset investment to a different level. This is clearer when compared to holding shares in, say, a major oil company where the assets are oil wells but in a far broader and geographically diversified manner. Several examples of real assets investment are given

Fig.2 VIX, S&P 500,SX5E SHCOMP, 2007=100



Source : Bloomberg

And the more exotics at the end……

Press advertising has taken a huge beating by the digital media.But not all advertising is done via iPhones.The use of outdoor space,whether plots of land or outdoor surfaces such as the sides of buidlings, the sides of buses , bus shelters and the lamp posts of public streets, all offer desirable areas of physical assets being rented out to unexpected uses as well as for ads.And talking of iphones, the companies providing carrier services do not necessarily own the aerials which diffuse the signal.There is an interesting niche area in IT on the onwership and renting of spaces to place aerials, whether this is small plots of land in the countryside, or in the middle of nowhere, or on the rooftops of buidlings.The next step of course is to own the aerials as well as the real estate where they are placed !That is investing in real assets twice over, the real estate and the electronic parts !

The following is hardly an investment suggestions as it does not involve companies or even specific assets, but in my own private property, a flat in Montevideo Uruguay, the rental of the rooftop of the block where the flat is located, to a mobile company to place its aerials, nearly pays for most of the common expenses of the buidling ! Mind you, some of the owners claim that after a few years living next to the aerials, they are now themselves, and their pets, glowing gently in the dark.For that I can not vouch, nor whether the rental yield is adjusted for such a risk!

Andrew Freris (writing finished on 21/7/2017)