

36 South Views

BY RICHARD "JERRY" HAWORTH



Mike Tyson once said "everybody has a plan until they get punched in the mouth".

Most investors have earned a cum laude degree in complacency as we see growing discontentment with hedging of any sort. The renminbi devaluation has delivered the first solid blow to the head and with that the "plan" has disappeared.

Unwittingly these investors don't know they are part of a cycle of investment that's been going for hundreds of years where a well laid bear trap is eventually sprung, ensuring few people manage to retain any real wealth past three generations.

This bear trap has been thirty five years in the making, postponed by slowly reducing interest rates and adding liquidity every time the bear so much as sneezes.

But, whilst we know that the system is fragile, we don't know which snowflake will eventually cause the avalanche.

In the old days, central bankers like Volker set off mini explosions, causing minor avalanches in a sage attempt to avert really big ones. Today, central bankers effectively ask everyone to keep quiet and not make any sudden turns whilst on the slopes! They know the risk is high and the system is fragile but are too aligned politically to do the right thing.

Greece looked like a mini landslide which had potential to snowball but petered out and left long volatility holders gasping whilst implied volatility plummeted, Chinese equity slump ditto.

The latest move by the People's Bank of China in devaluing their currency is a grey swan rather than a black one. It was always a known possibility but as it had never happened investors came to think it would and could never happen.

We think this is in a response to two factors: firstly the economy is in dire straits and thirst for more capital is reaching epidemic proportions. It is worth nothing that this is occurring at a time when the average Chinese person is trying to move some assets offshore, they have seen what was coming down the road long before we did.

Secondly, the snub by the IMF might give them cause for complaint. They might now feel, "right, you want us to have a free floating currency? Be careful what you wish for my friends." "Think we are not systemically important enough to be included as a reserve currency? Then you won't mind a bit of volatility from a "minor" currency, will you?"

And now Chinese official policy has done a rapid volte-face and investors are scrambling for answers. What does this mean?

China is, as we've said before, the third leg of a three legged stool. If China goes into recession, Europe and US go too. US and Europe cannot do what the old Citroens used to do – that is, keep going if one of the tyres blew – GDP across global economies will crash.

And because for the past 10 years, growth in China has represented 50% to 100% of global consumption increases in most major commodity markets, these markets will crash too (as they have been doing).ⁱ

China has added more than 20 trillion in debt from 2007 to 2014, representing more than one-third of global growth in debt and reaching 282% of GDP. This equates to quadrupling their debt load – and it still didn't stem the flow of blood.ⁱⁱ

DISCLAIMER

36 South Capital Advisors LLP is authorised and regulated by the Financial Conduct Authority (FCA).

This document is for professional investors and qualifying investors only and no other person should rely upon the information contained within it. Prospective investors will be required to certify they are qualified investors upon application and certify their awareness of the risks involved in the investment and, in particular, the inherent risk of losing sums invested. Offering documentation and fund literature is only available upon request and not available on the 36 South Capital Advisors LLP's website. As part of the subscription process the fund administrators check the eligibility of investors.

Unless otherwise stated, the statements, views and opinions expressed in this document are those solely of 36 South Capital Advisors LLP.

An investment with 36 South Capital Advisors LLP will involve a significant degree of risk, which each prospective investor must carefully consider.

Past performance is not necessarily indicative of future results.

ⁱ <http://uk.businessinsider.com/chinas-share-of-global-commodity-consumption-2015-8?r=US&IR=T>

ⁱⁱ http://www.mckinsey.com/insights/economic_studies/debt_and_not_much_deleveraging