



Below is the latest Market Comment from Ian Williams: (05/05/2015)

In the 1990's Roger Bootle wrote a book called "The End of Inflation" which was greeted with much scepticism at the time but turned out to be a remarkably accurate foretaste of the underlying forces affecting the global economy over the last 20 years or so.

One good "market" measure of underlying Inflationary / Deflationary forces are the G7 Government Bond Markets, and with conventional 10 year German Bunds now on negative nominal yields, the key question now becomes, how much more deflation can we expect going forward or are we at a turning point?

The other "market" indicator of underlying Inflationary / Deflationary forces are the commodity markets, which tend to trade inversely to Bonds. As one asset class reacts favourably to Deflationary force, the other reacts favourably to Inflationary forces.

Above is a chart of the Thomson Reuters CRB (Commodity Research Bureau) Index which is the most widely known of the various commodity indices. (Source Bloomberg)

At Charteris we spend a lot of time studying market cycles (as opposed to economic cycles) - in particular the 10, 20 & 40 year cycles & their various sub-divisions & magnifications. We also like to follow what other cycle analysts are saying. Last year a cycle analyst in the USA called Cliff Droke made a call based on the 120 year "Kress cycle" (named after Samuel Kress) that was due to hit its ultimate low in the 4th quarter 2014 (it's Qtr 2015). Droke forecast that this final deflationary climactic end to the mega cycle would cause an implosion of the US Stock market. Well the stock market did not collapse but the commodity markets did (see CRB Index chart) with the well documented sell off in Oil, Iron Ore etc. If this inflationary / deflationary long term cycle analysis is correct then we may have just seen a mega-mega low - in ALL commodity prices.

IF and it is a big IF, as it is still early days, but IF the Inflation/Deflation cycle has bottomed out then the implications for asset allocation are huge. Indeed this is the biggest call facing asset managers for the next decade. Current thinking is that Deflation is with us for the foreseeable future, and as such, investors need a significant exposure to bonds & little or no exposure to commodity markets. However, throughout history, these forces have been proved beyond any reasonable doubt, to be cyclical. We have never had permanent deflation nor have we ever had permanent Inflation.

The famous Russian economist Nikolai Kondratieff found evidence of a 50 - 60 cycle in the price of English wheat going back to the 12th Century (the longest data set available on the planet) .This cycle correlated to general economic conditions and became known as the "Kondratieff wave".

Firstly, what would cause or trigger a new Inflation cycle? The obvious answer is QE. The gargantuan amount of money printed by the world's major Central Banks to try to offset the final phase of the mega deflationary down wave. But QE began in 2009 so why in 2015, is Inflation still low to non-existent? The reason is that most of the newly printed money has been re-lent back to the Central Banks from where it originated as the Commercial Banks cannot lend much, if any, out due to:-

- impaired capital base of the banks - due to bad loan write offs, regulatory fines, PPI awards etc
- New Basel regulations on a Bank's capital to loan ratios.
- Poor quality loan demand - Those to whom the Banks would like to lend (Apple, Google etc) are cash rich with no need to borrow & those who wish to borrow do not have sufficient credit quality
- Real Estate market not yet fully recovered from 2008 crash with borrowers having insufficient equity/cash to satisfy the revised LTV (Loan to Value) criteria.

It is therefore a lack of (Bank) capital, not a lack of Bank liquidity (QE) that is the reason that the newly printed money has not yet found its way into the economy. This however, is not a permanent state of affairs as the Banks will gradually rebuild their Capital Base, and the mortgage business will gradually return to "normal" as property prices increase (especially in the UK) due to a supply/demand imbalance caused by a chronic shortage of property.

Also like all statistics the Year-On-Year Inflation numbers can paint a misleading picture. Take for example the current UK CPI figures. These currently show inflation at zero due mainly to the collapse of the Oil price from \$120 a barrel to a low of \$40 (-66%) a barrel in early January. However, Oil is now back to \$65 a barrel and next January 2016 (when the fall drops out of the Index it will be replaced with a rise of +62%-assuming it stays here - If it say goes up to \$75 a barrel (the lowest price where new shale production can start) the input rise would be 88%. We are also seeing large rises (from very depressed levels) in Iron Ore (up 33% in 2 weeks) as well as other metals such as Silver.

These positive inputs into the CPI are huge and will have a huge effect on the inflation number in a few months' time. Inflation therefore, as measured by Year-On-Year CPI is much closer to a return than most people think. It also shows why "market" indicators of Inflation i.e. commodity prices lead the statistical measures, (which by their nature are lagging indicators and will never be anything else). As such, Commodity prices (& Bond Markets) give the best guide to forward inflation.

So why do we think that the Inflation/Deflation cycle has just turned? Timing is the key here. As the re-appearance of Inflation at some stage is inevitable, Inflation follows deflation as surely as night follows day as proved throughout history- but why is NOW the turning point?

- The 120 year mega low in the Inflation / Deflation cycle referred above - this last bottomed in 1894 & was due to hit its low 4th Qtr. 2014.
- Elliott Wave analysis of the CRB Index - Bear markets split down into 3 waves - the Final climax wave is the "C" wave. When the "C" wave ends the entire bear market is over - see wave count - it could not be easier to identify.
- Many basic commodities trading below their replacement cost- not sustainable for any protracted length of time. Mining companies have reacted to this by cancelling Capex -thus eliminating future supply.
- 40% of EU Government Bonds trading on negative nominal yields - equally not sustainable.
- Sentiment towards Commodity markets very bearish - Sentiment is an inverse indicator.
- Mining Shares are the cheapest in History (last 100 years) whilst Bonds are the most expensive in history.
- World population set to grow from 7 Billion to 10 Billion in the next 20 odd years - this alone guarantees a new bull market in Commodities

The range of Charteris Funds are fully positioned for the outcome outlined above:-

- The new Bond Fund is positioned for a bear market in Bonds
- The Elite Charteris Premium Income Fund (UK top 100) has the maximum allowed weighting in Mining Shares
- The WAY Charteris Gold & Precious Metals Fund is an obvious beneficiary
- As is the FP Charteris Property Fund
- The FP Charteris Global Macro Fund is also positioned to benefit from the above

If you would like any more information on any of the newly launched or existing funds, please contact myself or the team.

Warm regards,
Ian Williams, Charteris CEO and the team.

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