Weekly Market Comment

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Source: Reuters, 8 Dec 2017

Progress

The week began with a homemade Brexit debacle and ended with what many commentators saw as real progress towards a constructive future relationship building between the exiting UK and the EU. Despite the Northern Ireland hiccup, we had sensed that, following last week's exit bill compromise, there was a breakthrough in the air. I personally couldn't believe Northern Ireland's luck of being offered the tremendous business opportunity of being allowed to remain member of both the UK and the EU. I was already envisaging Belfast becoming a weightier European financial hub than Dublin! Alas, smaller minded nationalist interests prevailed and put an end to that pipe dream.

In the end, not much appeared to have changed between Monday and Friday, except that it was more explicitly phrased that, in case the UK exits the EU without a comprehensive free-trade agreement, then NI would be permitted to continue to trade with the Republic of Ireland as if it was still part of the EU. The point I am not quite sure how to interpret is that the UK government stated that, in that case all, the entire UK will seemingly be under EU rules, in order for NI not to feel cut-off from mainland UK. Does this mean that, as long as the EU refuses to grant the UK a free trade agreement, then the UK will only ever be able to leave in form, but never in substance?

Whichever way it develops from here, this path towards Brexit looks increasingly like a long drawn out softly, softly framework of a new form of associate EU membership. The UK would continue to be broadly a member of the EU's free trade zone, but operating under an arrangement which allows more exceptions from EU integration than before, at the price of less influence and a lower share of EU common policy benefits.

Without a doubt, a far cry from what 12 months ago Brexiteers were hoping Brexit would bestow on the UK, and what Remainers warned would destroy the UK's prosperity and fabric of society. While I suspect neither side to be particularly happy at the end of this week, it feels as if the compromise formula we seem to be heading towards is more representative of the 52/48 referendum outcome we actually had, than the 70/30 distribution of Brexit interests we seemed to have under the 'Brexit means Brexit' mantra at the beginning of the year. Fingers crossed that the constructive spirit suddenly coming from the negotiating tables will carry over into the coming trade negotiations.

Those who were nervous that the turn of events might lead to a sudden and significant rally in £-Sterling, which could send the UK stock market into freefall (reversal of last year's dynamic), were quickly relieved. The relatively insignificant currency movement at the end of the week, confirms what we had suggested all along: Markets had never believed in a hard Brexit in the first place and the previous fall in the currency merely priced in a less favourable trading position for the UK. Unfortunately, this also tells us that a deterioration from the new Brexit prospect could lead to far bigger capital market disruptions than may have been anticipated. No wonder leaders on both sides were keen to find a compromise for the sake of ongoing economic prosperity, rather than continue to placate emotionally charged electorates on either side.

Had it not been for the Brexit drama, our focus would have been on the rotation from growth to value stocks we first wrote about last week, the US tax reform progress and the further acceleration of the Bitcoin mania. These developments are more likely to affect private investors in the near term than the direction of the Brexit negotiations.

On the style rotation side, it first seemed as if it was taking hold, only to unravel later in the week as realisation set in that the fiscal stimulus potential of Trump's tax reform may be less than anticipated. Furthermore, the prospect of the Russian influence investigation under special investigator Mueller getting ever closer to Trump himself raised the possibility of a further reduction in the Trump administration's ability to bring about any further structural change, or even for the US to suffer a bout of loss of political leadership.

The Bitcoin mania will feel familiar to all those who can remember the Dotcom bubble times of 1999/2000. As we wrote last week, the main danger from the inevitable bubble implosion is that the resulting redistribution of capital between winners and losers can lead to real liquidity stress amongst late party joiners who, in terms of sheer numbers and vulnerability, may be far more substantial than the few who benefit through a lucky timely exit. We therefore welcome the widespread public warnings and contribute ourselves this week with an insight article into the subject matter, for all those who still feel tempted to join the Bitcoin roller-coaster.

US Tax Reform and the anniversary of the 'Trump trade'

Friday is the one-year anniversary of Donald Trump's surprise election win and, to mark the occasion, the wheels appear to be finally turning on his flagship tax reform bill. Last Saturday, the US Senate passed a version of the bill which proposed cutting the corporate tax rate to 20%. This followed the other chamber of Congress, the House of Representatives, passing a version in mid-November which cut the corporate tax rate to the same amount. Given the boost that the reform was expected to bring for US companies, the Senate's vote garnered much attention in the press. Both chambers of congress have now voted and passed their respective bills, so it's plain sailing for the legislation, right?

Not quite. Despite both the House and the Senate passing a tax reform bill, they didn't both pass the same bill. After the resolution initiating the bill was passed by both chambers at the end of October, each chamber made their own amendments to it, before voting on their respective amended versions. And, despite the President's own Republican party controlling both chambers, the bills produced by the respective factions don't line up as neatly as one might expect. This is all part and parcel of the US legislative process, and an agreed bill won't be voted upon until representatives from both chambers meet at an as-yet unscheduled conference.

For investors eagerly awaiting tax cuts, the good news is that Republicans from both factions are optimistic about the chances of passing a compromise bill before Christmas. The devil, however, is in the detail. And, on those details Republicans disagree a great deal. The bills disagree about which tax deductions should be allowed, as well as which previous tax and other legislation should be repealed. Under the Senate's version, the cuts to personal tax aren't even permanent, and the reduction in income tax brackets (one of the main selling points of Trump's original plan) has been scrapped.

Much of the changes to the original plan reflect the priorities of the Republican party's budget hawks, who are loath to see this tax reduction increase the budget deficit. This has resulted in some strange measures agreed on by both chambers, such as the removal of most state and local tax deductions (leading to a hike in effective overall tax in places with high state tax). Similarly, both the House and Senate bills limit the ability of companies to deduct research and development spending from their taxes. This latter measure has been particularly criticised by some economists for its potential dampening effect on productivity growth (which in turn would hamper overall growth).

And yet, despite the scrambling to insert provisions to 'balance the books', the bill is accused of widening the US budget deficit substantially over the coming years. To address this, there is now talk from both sides of raising the corporate tax rate to 22% from the proposed 20%, in order to fund the gap. The original pledge in President Trump's election campaign was a corporate tax rate of 15%.

In the aftermath of Trump's shock victory last November, US equity markets soared on the back of expectations of fiscal stimulus – in particular, this tax reform – and the prospects for growth that it would bring. Hopes of the bill actually passing (in anything like the form promised at least) have taken many hits over the past year, but there is now a clear path to its signing, as well as a clearer picture of what it will actually entail.

However, now that we have a mountain of detail – as well as some unpopular measures included – the question of whether the bill will actually live up to its hype comes to the fore. The President's council of economic advisers has previously said that the bill could boost economic growth by 3-5% a year. But, a report this week from the nonpartisan Tax Policy Centre estimate that the bill will boost US growth by only 0.7% next year. Many prominent economists also dispute that this tax reform will boost growth by as much as the Trump administration claims, with four winners of the Nobel (Memorial) Prize in Economics speaking out against the legislation.

This doesn't mean investors should discount the reform's effects entirely, however. Even if overall economic growth doesn't get as big a boost as promised (though most agree it will still get *some* boost, however small), the reform will still likely have a large effect on equity valuations. Research has found previously that every 5% knocked off of the corporate tax rate adds $5 per share to earnings for US equities, as measured by the S&P500 earnings aggregate (which currently stands at $107.61).

In the face of recent worries over extended valuations in the US, this might provide a welcome underpinning to equity valuation levels, which are currently trading at 18.2 times forecast earnings. The passing of this bill – particularly if it can bring the earnings growth or (even better) economic growth it's purported to – will likely be a real positive for equities going into 2018, even if only by helping sentiment. This is particularly true as we enter potentially choppy waters next year, as growth (potentially) struggles to live up to the high expectations of financial markets.

Ultimately, the reform is unlikely to be as much of a game changer as was implied during the 'Trump trade' a year ago. However, it might still help markets climb the 'wall of worry' as we go into next year.

Brexit Softening on the Horizon?

Last week, we wrote about a breakthrough in the Brexit 'divorce bill' negotiations, and how this could clear the way forward in most other areas. After another – more painful week of negotiations than expected – on Friday the Prime Minister announced that an historic deal had been reached with EU negotiators, where guarantees on Irish border issues and the rights of EU citizens – as well as the divorce bill that made headlines last week – have been secured.

The breakthrough agreement came after a dramatic few days which looked at first like they might derail negotiations. Earlier in the week, a widely pre-briefed breakthrough meeting between PM Theresa May and European Commission President Jean-Claude Juncker ended without a deal, due to internal UK issues concerning the border between Northern Ireland (NI) and the Republic of Ireland (ROI). The UK conceded that there would be no divergence of EU rules throughout the island or Ireland, but Democratic Unionist Party leader Arlene Foster insisted that NI must leave the EU on the same terms as the UK. Meanwhile, Brexit secretary David Davis gave a car-crash appearance in front of the Brexit committee in which he claimed the government had produced no forecasts on the sectoral impact of Brexit, but then also stated that 'regulatory alignment' with the EU attained through a Brexit deal for NI would also apply for the whole country.

Theresa May's reliance on the DUP – with the unionists giving her a parliamentary majority – was one of the reasons why the Irish border proved such a sticky issue, with the Irish unionists blocking a draft deal on Monday due to the appearance of the term "regulatory alignment" in reference to NI and ROI.

Now, however, Mrs Foster's support appears to have been secured through, in her own words, "substantial changes" to the agreement text. There will be no 'hard border' between the two Irelands – something Irish PM Leo Varadkar called an "absolute red line" – while at the same time maintaining the "constitutional and economic integrity of the United Kingdom".

In our view, this agreement significantly improves the short term economic outlook on Brexit, and not just because it clears a roadblock from negotiations. What seems to have gone slightly under the radar in this agreement is the lengths that the government has gone to in order to ensure the deal goes through.

To secure the soft Irish border, May and co agreed to keep NI's regulatory regime in "full alignment" with EU law. However, the government also assured the DUP that there wouldn't be a grand regulatory split between NI and the rest of the UK. This effectively means that, under the agreement, the entire UK will be tethered to EU law even after Brexit and regardless of whether a favourable trade arrangement can be secured or not. After all, if EU law applies in NI, and there is no divergence between the UK and NI, that would mean that EU regulation would apply here too, at least until a more thorough agreement can be reached.

If this proves to be the case, it would amount to a far softer Brexit than almost everyone had anticipated. And, we see this as the culmination of the changing political tide from a hard to a soft Brexit. On Thursday, the cross-party committee of peers in the House of Lords warned that a 'no deal' scenario – where the UK leaves the EU without any prior arrangement – would be the worst Brexit outcome. Meanwhile, the government faces more rebel Tory MPs disagreeing with their stance towards the EU. This time, however, those rebels are on the other side of the argument. Former minister Anna Soubry led calls for MPs to be allowed to delay the official exit if no agreement is reached.

This agreement – and how quickly it was recovered from mid-week setbacks – suggests the government are heeding those calls. In addition to the 'regulatory alignment' mentioned before, the government are now reportedly considering a longer transition period after the official exit date. This would make the actual exit more of a slowly evolving relationship than a sudden divorce.

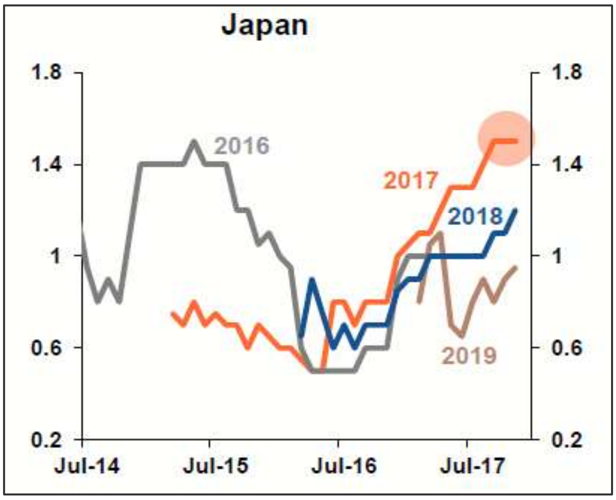
Of course, both sides of the negotiations emphasised that this agreement was far from the end. "We all know breaking up is hard, but breaking up and building a new relationship is harder," said European council president Donald Tusk. If EU leaders formally decide at their summit next week that this agreement represents "sufficient progress", then next will be hashing out the terms of the future relationship.

On this front however, things look more promising. It has long been suspected that the EU's comprehensive trade agreement with Canada would form the blueprint for post-Brexit arrangements, and EU chief negotiator Michel Barnier confirmed this on Friday. "That will be the model we have to work on," he said, adding that talks should begin "immediately" over the nature of the transition period. We would note that the Canadian free trade model would urgently have to be extended to include the service sector, which is desperately missing in this blueprint.

As we mentioned last week, apart from Brexit uncertainties, the UK remains in a competitive position in terms of global trade. Signs that Brexit may be softening, therefore, will help to boost trade and should help to restart business investment. With any luck, the dark clouds of uncertainty may clear away sooner than had been expected.

Japan consensus growth forecast revisions

Our forecasts are not always perfect, as regular readers will attest. Global growth has been stronger, taking global equity markets higher than we thought likely this year. On balance though, we feel we've had good calls than bad. For example, regions we were positive on have gone on to do very well, such as Japan.



Source: Bloomberg Consensus GDP growth Forecasts, SocGen

At the beginning of the year, we looked at Japan in the Weekly, saying then that the economy looked to be in a good position, and that the dynamic should prove relatively positive for Japanese equities.

Our thesis back then was that domestic demand in Japan was likely to be better than foreign investors anticipated, and even better than the Japanese themselves might hope for.

Much of the past 20 years' investor pessimism over Japan has centred on demographics. For a regional economy to have a steady base-line of growth, the population has to produce more than enough to sustain workers and dependents. Japan was faced with a population that did not produce enough youngsters, but was very good at staying alive. As of 2016, the birth rate was 8.07 per 1000 people, which made it the 221st nation out of 223 monitored in the CIA Handbook. Germany (218th) managed only 8.42, while the UK (160th) produced 12.22.

Perhaps more importantly, as a nation that is struggling with its birth rate, it has not been the most welcoming to immigrants, who have elsewhere acted as a counterbalance to falling indigenous population births. The OECD's data, as of 2008, showed that Germany had 13% of its workforce classified as foreign and approved 40% of its asylum seekers. Japan had 2% foreigners in its workforce and approved 0.2% of asylum applications.

Japan's inflow of foreign workers is said to have strengthened recently, but it cannot be significant in economy terms.

So why are we (increasingly) positive on Japan, when seemingly the malaise of the past 20 years carries on?

In October, Prime Minister Abe won his third election. CNBC reported "Abe, 63, took office in December 2012 promising to reboot the stale economy and bolster defence. His Liberal

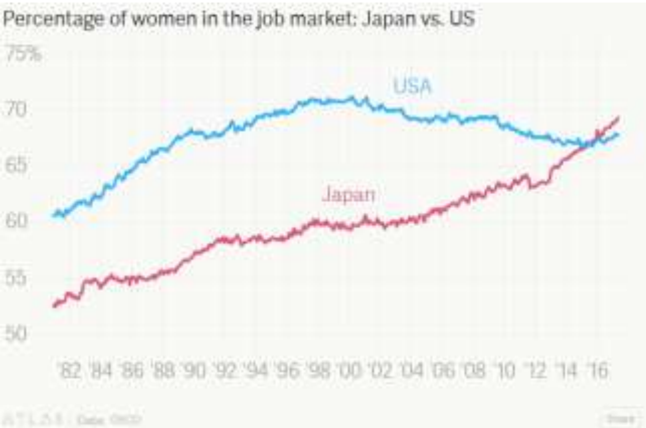
Democratic Party-led coalition retained its two-thirds "super majority" in parliament's lower house in the Oct. 22 election, re-energizing his push to revise the post-war, pacifist constitution."

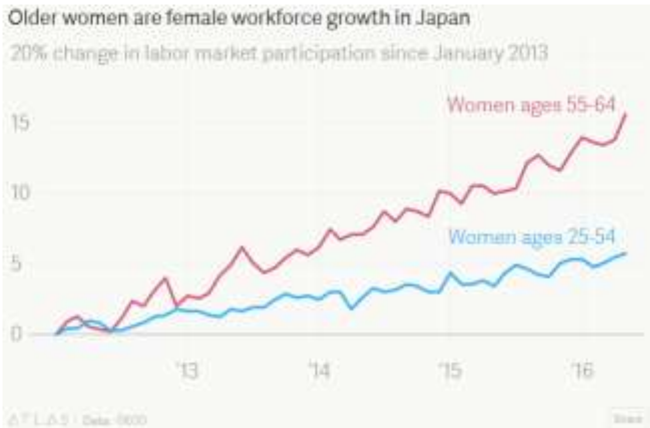
"Abe was expected to reappoint current cabinet ministers and instruct them to compile an extra budget for the year to March 31, 2018 focusing on child care and boosting productivity."

Despite his supposed "unpopularity", he won by a landslide, becoming the post-war period's third longest serving prime minister of Japan. Alain Bokobza of Banque Societe Generale Research noted that one of the things that marks Japan out from some other regions is that the politicians and populace are having grown-up discussions about policy, leading to a greater likelihood of effectiveness.

That seems to be the case. Abe instituted the "three arrows" guidelines of policy; the first is monetary expansion aimed at achieving a 2% inflation target after two decades of deflationary ressures; the second a flexible fiscal policy to act as an economic stimulus in the short term, then achieve a budget surplus; the third, a growth strategy focusing on structural reform and private sector investment to achieve long-term growth.

The third arrow, structural reform, was portrayed by the press as rather ill-defined in its first stages. It seemed to be a set of micro-policies with no cohesion. And yet, as the UK experienced under both Margaret Thatcher and Tony Blair, it's the policies which actually affect people that make the difference.





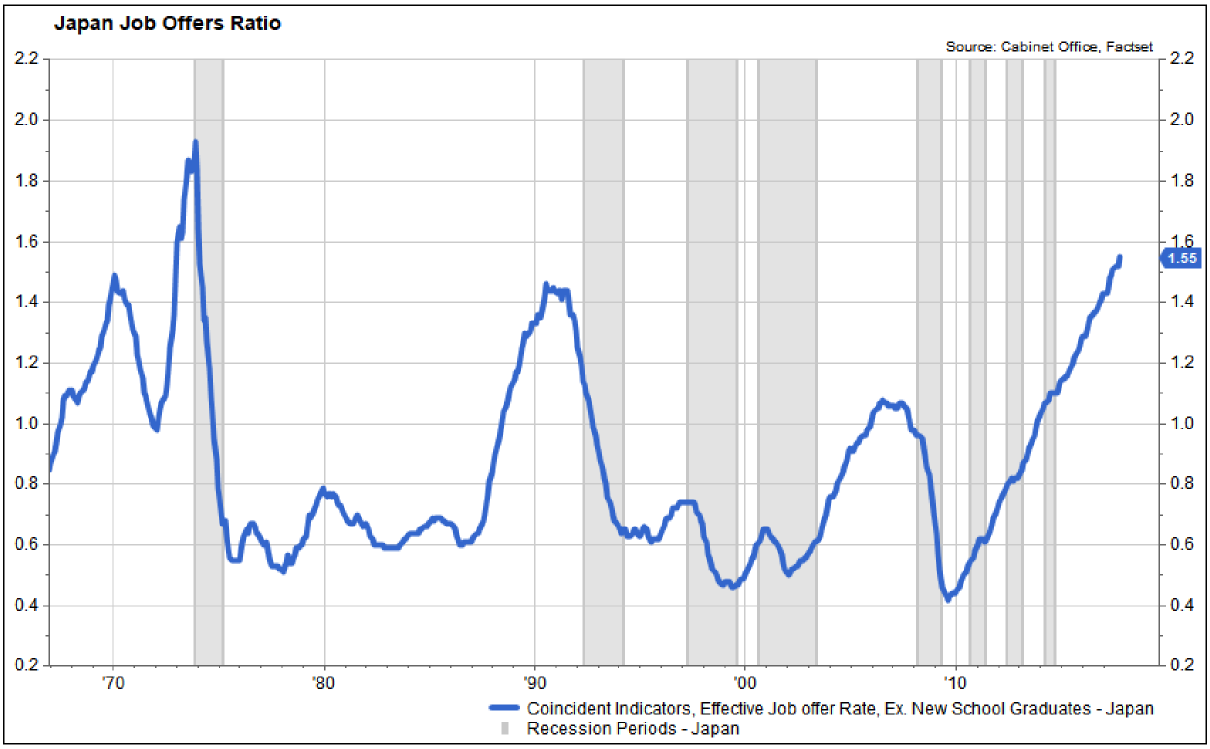
Source: Atlas, OECD

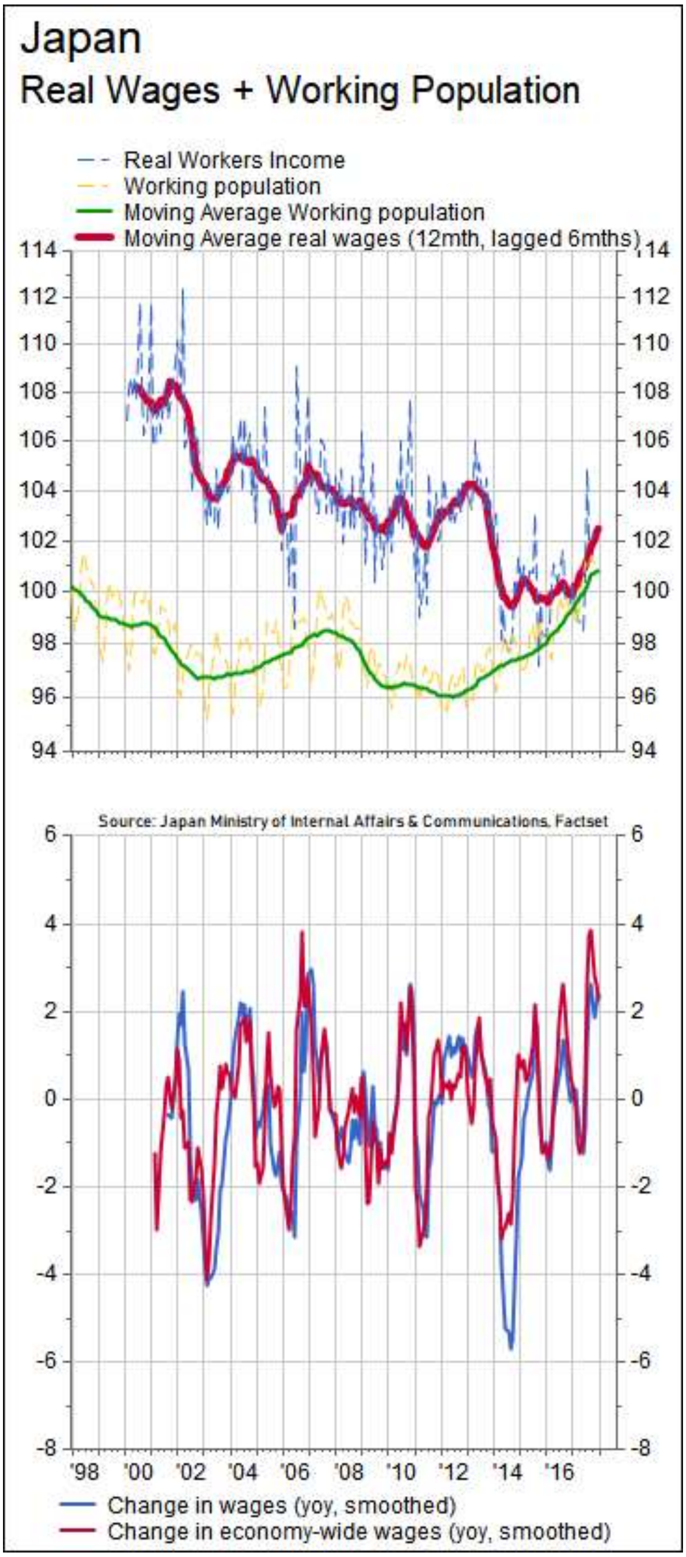
Wikipedia's entry on Abe says *"In September 2013 Abe called for a "society in which all women can shine", setting a target that 30 percent of leadership positions should be held by women by 2020. Abe cited the "womenomics" ideas of Kathy Matsui that greater participation by women in the workforce, which is relatively low in Japan (especially in leadership roles), could improve Japan's GDP and potentially fertility rates, in spite of declining population figures. The Abe cabinet has introduced measures to expand childcare and legislation to force public and private organisations to publish data on the number of women they employ, and what positions they hold."*

If demographics was Japan's problem, unleashing a skilled, motivated group of workers into the economy should solve it. And, remarkably, this seems to have occurred. As the graphs above show, female participation was rising before 2013, but clearly stepped up after its introduction.

This has led to a multiplier dynamic that Japan has not seen since the 1970s (or at least has been a component of it). Often, growth dynamics are debt dynamics. That is, supply doesn't change, it's just that debt growth allows demand to be brought forward. Since 2013, the propensity to consume has decreased in Japan – that means that the proportion of marginal disposable income being spent has fallen. In other words, marginal saving has increased. The extra growth induced by the policy hasn't come from pump-priming, it really has come from a supply shift.

The increase of the work force has not resulted in a fight for jobs. On the contrary, the multiplier has worked to increase jobs at a faster rate than the increase in workers. The chart below shows the ratio of job offers to workers:





So, the unlocking of productive potential has actually created a situation where the influx of new workers is met by wage rises.

The top graph on the left show workers' incomes and the actual working population.

The rise in workers is now being accompanied by a rise in their real wages. That led to a sharp aggregate (economy-wide) boost to wages. The line in red on the lower graph shows a near 4% peak earlier this year. Although data isn't available back that far, it's probable that this hasn't been seen since the 1980s.

Returning to the rise in job offers, this is going hand-in-hand with a rise in business investment. Indeed, most analysts have made more of this aspect than the demographic shift (mainly because they're focussed on the supposed demographic problem). Investment in technological solutions – robots, artificial intelligence, etc. – all boost the productivity of the rising workforce, leading to a second positive supply-side shift. That's likely to continue to feed through over the coming years as well as providing a near-term capex spending boost now.

Worries about the government debt are inevitable, given that it passed 200% of GDP as Abe started his shift in 2012. But, as he has pointed out, the only possible resolution is real growth, brought about by supply-side change. Since 2014, the ratio has started to edge back and is now at a yearly average of 198%, lowered by the growth rate rise, rather than less government spending.

A likely consequence of all this is the strengthening of the Japanese currency, the Yen. Japan's central bank, The Bank of Japan has begun to intimate that monetary policy (more specifically QE policy) might change soon. The subtle change in language in the past days suggests that the commitment to holding 10-year government bond yields at 0.1% could be softened. Rather than a collapse in bond prices, it might cause the Yen to strengthen, especially against the US dollar. In local currency terms, the more globally focused large caps may underperform. However, domestically focused stocks should continue to be the beneficiary of the domestic demand story.

I hope this would explain why we have been increasingly happy holders of (currency) unhedged Japanese equity, and why we think the year ahead looks bright.

Insight article

Bitcoin and Blockchains – what are they?

Source: https://bitcoincharts.com/charts/bitstampUSD#rg2920ztgCzm1g10zm2g2 , 8 Dec 2017

Bitcoin (BTC) have continued their meteoric rise in price this week, smashing through $16,000 per coin just a week after surpassing $10,000 for the first time – and gaining plenty of media attention in the process. This is thought to have accrued on the back of speculation about the impact of a launch of futures contracts for the digital currency. This would increase the availability of investing in Bitcoin for a broader set of the investing public.

It would seem that interest in Bitcoin grows exponentially with prices. Given recent moves, we have received a number of questions on what we think of digital currencies. We believe investors should separate out Bitcoin – the internet based 'crypto 'currency' – from the underlying technology registering their change of ownership – the blockchain. Too often, we get the impression that investors believe they are investing in the future benefits arising from blockchain applications when they buy bitcoins.

It is the technology itself and not the crypto currency that is the true innovation, having particular use in financial services (fund, bond and equity settlement), transportation (shipping records) and health (think fully digitised individual NHS records). In reality, we do not fully know all future uses, but we suspect that nearly every industry's record keeping could be transformed by the blockchain in some way.

Before we dive deeper into the underlying technology, we should review price action over the past week and in 2017 as a whole.

Bitcoin started the year at $997.69 and has since skyrocketed to $16,000, a gain of over 16x as speculative interest in the fledgling currency has grown around the world. In the past 36 hours, prices have moved through $12,000, $13,000, $14,000 and finally breaking $16k in a seemingly relentless near 30% surge.

Each $1,000 psychological increment appears easier to pass as prices rise. Here is the history:

- $0000 - $1000: 1789 days
- $1000- $2000: 1271 days
- $2000- $3000: 23 days
- $3000- $4000: 62 days
- $4000- $5000: 61 days
- $5000- $6000: 8 days
- $6000- $7000: 13 days
- $7000- $8000: 14 days
- $8000- $9000: 9 days
- $9000-$10000: 2 days
- $10000-$11000: 1 day
- $11000-$12000: 6 days
- $12,000-$13,000: 17 hours
- $13,000-$14,000: 4 hours
- $14,000-$15,000: 10 hours
- $15,000-$16,000: 7 hours

In pure market capitalisation terms (number of units x price), Bitcoin is now worth around $250 billion. If it were a company, it would already be nearly as big as Wal-Mart, the 12th largest firm on the S&P500 Index.

What is behind the strong rally?

It would seem that prices are responding to news of the imminent launch of trading in Bitcoin futures. Such a step has the potential to increase not only the ease at which investors can access Bitcoins (financialisation) but also raise levels of demand.

The Chicago Board of Options Exchange (CBOE) will begin trading Bitcoin futures this Sunday (10th December) and rival Chicago Mercantile Exchange (CME) follows a week behind (18 December).

NASDAQ (technology trading) plans to launch its own futures market in the summer of next year, while Japan's Tokyo Financial Exchange may follow suit after that.

Bloomberg even reported that brokerage houses like TD Ameritrade and Ally Invest might offer Bitcoin futures trades to their clients. Even J.P. Morgan Chase may follow suit, despite CEO Jamie Dimon's infamous views on the digital currency (he said he would fire any employee involved in Bitcoin trading).

What is all the fuss about and what is the difference between Bitcoin and the blockchain?

Bitcoin itself could be thought of as a digital code or token that can be used as a person-to-person (called P2P or Peer-to-Peer) version of electronic cash, where 1BTC would be equivalent to say 1GBP.

No middleman is required at any stage of the transaction, so one might question the need for a current account at a bank, or an investment platform to hold their pension or ISA on.

But given how the BTC protocol was set up, it might be better to think of Bitcoin as a digital version of gold. Like gold, Bitcoin supply is 'finite' and limited to 21 million bitcoins. Given the extreme levels of daily volatility in Bitcoin, we would be hard pressed to say it has much utility as a form of cash, or even as a long-term store of value like gold (at least there is a real physical asset with the precious metal).

We think investors should not confuse being able to purchase BTC as the same as being invested in the more promising blockchain technology.

Blockchain can essentially be thought of as a giant electronic database or ledger of digital records (blocks).

The difference is that it is 'distributed' or shared between all relevant users over the internet. The blockchain can only be modified through the consensus of a majority of the users within the system. Once a record has been entered, information cannot be erased, thereby retaining a verifiable record of every single transaction ever made.

When one thinks about the technology in these terms, it becomes much easier to see its value for a multitude of different industries.

Custodian bank State Street believes one early use is likely to be for post-trade confirmations. The firm expects that the blockchain could transform how financial transactions are recorded, reconciled and reported. This could lead to reduced error rates and large cost savings.

This week, the Australian Stock Exchange (ASX) said it would adopt the blockchain to manage the clearing and settlement of equities. While one of the UK's leading mutual fund settlement agents, Calastone, said it would begin migrating fund settlement over to the blockchain method of distributed ledgers in 2019.

However, there are significant uses for the technology in other areas, as any two parties could exchange information within seconds, all without the need for 3rd party verification.

Medical and NHS records, voting and legal documents like land registry could all end up using a blockchain. Any and all digital transaction would leave a 'fingerprint', which would generate a full audit trail for every digital record in history, all without comprising personal privacy.

New digital currencies

Since Satoshi Nakamoto (pseudonym? But no one really knows) released the first white paper (click to follow link to the paper) in 2008 outlining what would later become the blockchain, the digital currency world has expanded well beyond BTC to over 1,000 new variants issued by ICO (Initial Coin Offering – a bit like the IPO of a company on the stock market – a capital raising mechanism).

We would caution investors to think carefully before entering the next 'gold rush' ICO in the hope of it being the next BTC to emerge.

We believe there are a number of linguistic clues or potential red flags people should be aware of.

- Be wary of 'technical innovation' – BTC is essentially software, meaning new innovations are easily copied or assimilated across other coins, leaving any advantage a temporary distortion at best. If an ICO touts such, then purely betting on technological development rarely ends well.
- 'Smart Contracts', from a marketing perspective sound interesting. If an ICO states they will make them usable, easy or accessible, then one has to ask whether this relates to education programmes or a 'breakthrough' that could easily be ignored or lept over with the next such breakthrough.
- Legally enforceable smart contracts: Legal does not really apply to software contracts. Either the software executes a contract or it doesn't – pretty binary, leaving little for lawyers to argue over.
- If ICOs mention 'storage' of things like data, pictures, fingerprints, etc. it suggests that someone lacks any real blockchain network programming experience. It simply costs too much to store data on the blockchain itself and is slow/inefficient compared to something like an SQL database.
- Language around 'decentralised search engines' that might rival Google or Bing is worrying. Search engines by their nature require centralised indexing to efficiently deliver results.
- Blockchain enabled advertising exchanges should raise questions about how they would handle ad auctions, linkages to end websites, payment gateways (and their security) and placement of ads on things like YouTube.
- Use of the term 'micro-payments' suggests someone does not understand the computational and storage requirements to process such transactions, which might mean the processing cost could eventually exceed the payment itself as volume increases.
- Anything touting 'community control' where individuals can vote on aspects of management is by definition not a business but more a social project.
- Mentions of 'distributed computing' should be avoided. Running computing in this manner has not proven to be cost effective, so merging the blockchain with it is problematic, like giving your nightmare a migraine.

Summary

Digital currencies should be seen in their proper context, as a natural extension of the ongoing computing revolution.

The movement of analogue signals to digital formed the genesis of the internet and now the almost pervasive mobile computing platform we use today. We have transformed shopping (Amazon), auctions (eBay), marketing (online adverts, SMS text alerts), healthcare (electronic patient records), news (real-time global coverage), watching TV (instant streaming media from a vast worldwide library) and a whole host of other business innovations that were not possible just a decade ago.

So why are people so surprised that we have reimagined one of the most fundamental things: money?

The blockchain could prove revolutionary to new and existing industries in ways we do not yet understand. Early research suggests that firms are beginning to adopt blockchain technology, and the results look promising in terms of reducing costs and increasing efficiency.

It is no wonder that people are excited for the future of the technology and this may explain some of the exponential rise in prices over the past few years.

This new technology should not be feared, nor should it be blindly embraced under a cloud of flashy buzzwords for the potential to make a quick profit. Investors should seek to separate buying/investing (gambling might be more accurate) in BTC or a cryptocurrency derivative from that of the blockchain.

As for the rise in the value of Bitcoins as presented in the chart at the beginning, we would like to close this article with two observations. Firstly, there is no intrinsic value in Bitcoins as is the case with traditional currencies, which are backed by the taxation power of the issuing nations. Neither is there some form of future income stream which could be discounted to compute a fair present value, as is the case with real world investments. Secondly, the chart displays quite graphically all the hallmarks of an investment mania. Historically, the resulting bubble has always deflated and a quick internet search will generate a myriad of article drawing parallels to previous mania and bubbles like this one: bloom.bg/2kxurBt. In summary, there is very little doubt that this bubble will deflate at some point. When this will be is a different question, but Paddypower's spoof below reminds all of us who were around during the Dotcom mania of 1999/2000 that we have been here before.

PERSONAL FINANCE COMPASS

Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	7396.2	1.3	95.7	↘
FTSE 250	19984.0	0.7	129.6	↘
FTSE AS	4064.5	1.1	45.6	↘
FTSE Small	5743.5	-0.4	-20.7	↘
CAC	5404.1	1.6	87.2	↘
DAX	13165.8	2.4	304.3	↘
Dow	24290.7	0.2	59.1	↗
S&P 500	2644.6	0.1	2.4	↗
Nasdaq	6353.9	0.3	16.1	↗
Nikkei	22811.1	0.0	-7.9	↗

Global Equity Market - Valuations

MARKET	DIV YLD %	LTM PE*	NTM** PE
FTSE 100	4.0	21.4x	14.0x
FTSE 250	2.8	18.5x	14.5x
FTSE AS	3.7	20.5x	14.1x
FTSE Small	3.0	13.9x	-
CAC	2.9	17.2x	14.7x
DAX	2.5	16.8x	13.4x
Dow	2.0	22.0x	18.0x
S&P 500	1.8	21.6x	18.2x
Nasdaq	1.0	24.5x	20.6x
Nikkei	-	-	-

Top 5 Gainers / Top 5 Losers

COMPANY	%	COMPANY	%
INTU PROPERTIES	20.5	PROVIDENT FINANC	-10.2
WHITBREAD	12.4	POLYMETAL INTERN	-5.0
SKY	6.8	BABCOCK INTL G	-4.1
MEDICLINIC INTERNAT	6.5	ST JAMES'S PLACE	-3.3
ASHTEAD GROUP	6.0	ADMIRAL GROUP	-3.1

Currencies / Commodities

PRICE	LAST	%1W	CMDTY	LAST	%1W
USD/GBP	1.34	-0.79	OIL	63.3	-0.7
USD/EUR	1.18	-1.12	GOLD	1248.1	-2.5
JPY/USD	113.57	-1.23	SILVER	15.8	-3.8
GBP/EUR	0.88	0.36	COPPER	297.3	-3.9
CNY/USD	6.62	-0.07	ALUMIN	2010.0	-1.9

Fixed Income

GOVT BOND	%YIELD	% 1W	1 W YIELD
UK 10-Yr	1.3	3.5	0.04
US 10-Yr	2.4	0.8	0.02
French 10-Yr	0.6	3.8	0.02
German 10-Yr	0.3	0.0	0.00
Japanese 10-Yr	0.1	51.4	0.02

UK Mortgage Rates

MORTGAGE BENCHMARK RATES	RATE %
Base Rate Tracker	2.3
2-yr Fixed Rate	1.4
3-yr Fixed Rate	1.4
5-yr Fixed Rate	1.6
Standard Variable	2.0
Nationwide Base Rate	4.5
Halifax Standard Variable	3.99

Sovereign Default Risk

DEVELOPED	CDS	DEVELOPING	CDS
UK	20.2	Brazil	165.9
US	23.8	Russia	130.7
France	16.8	China	56.4
Germany	9.8	South Korea	57.9
Japan	27.9	South Africa	178.9

* LTM = last 12 months' (trailing) earnings; **NTM = Next 12 months' estimated (forward) earnings

For any questions, as always, please ask!

If anybody wants to be added or removed from the distribution list, just send me an email.

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel