UPDATE

Knightsbridge Wealth

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The Knightsbridge Wealth magazine for international clients

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The new economic superpower

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A welcome note from Knightsbridge Wealth

Welcome to this latest edition of our Update. As the year draws to a close, at the time of writing, the world continues to offer investors significant challenges and opportunities.

COP 28 is underway but as countries collectively attempt to deal with the climate crisis their individual fortunes change.

China, having rejoined the world economy in 1978, became the most spectacular growth story in history. Farm reform, industrialisation and rising incomes lifted nearly 800m people out of extreme poverty. Having produced just a tenth as much as America in 1980, China's economy is now about three-quarters the size. Yet instead of roaring back after the government abandoned its zero-covid policy at the end of 2022, it is lurching from one economic challenge to the next.

By contrast India's trajectory is literally and metaphorically to the stars. Its space launch is only the latest manifestation of the country's growing global stature. Prime minister Modi is being wooed and celebrated by Western leaders in equal measure. Already the world's fifth largest economy, India looks poised to overtake Germany and Japan by the end of the decade to take third place behind China and the US. The $3.5trn stock market has outgrown London and Paris to become the world's fourth largest and will eclipse Japan's by 2030.

But over and above the long-term view of geo-political performance we should not forget how the here and now can change lives. The human tragedy unfolding in the Middle East is as undeniable as it is sad. From an investors point of view, it is far less obvious how this will play out. The long-term effects of the Israel-Palestine conflict will depend mainly on how long the conflict lasts and whether it spreads beyond its current boundaries.

Meanwhile, the world is still recovering and dealing with the fallout of the pandemic, whether that be the ongoing battle with inflation or the changes to workplace working.

As ever, this edition of Update is our attempt to offer insight into the key issues affecting your investment decisions. It has arguably never been as important as it is now to get an expert view on your investments. As we bid farewell to 2023 can I wish everyone a successful 2024 from all our team here and we look forward to working with you next year.

Our strategic partnership with UBS (Union Bank of Switzerland) gives the best of both worlds – personal service and the ability to react in a way that only a small firm can, partnered by one of the world's most prestigious brands.

Autumn Statement leaves the markets unmoved

The Autumn Statement left markets largely unmoved but that in itself might have been the achievement. The chancellor presented his autumn statement alongside the latest forecasts from the independent Office for Budget Responsibility (OBR).

Growth this year is expected to be a slightly positive 0.6%, rather than slightly negative -0.2%. The OBR attributes this to the economy proving “more resilient than we expected in the face of higher energy prices, inflation and interest rates”. Inflation has persisted for longer than thought and is now expected to return to the 2% target only in 2025, a year later than expected in March.

In truth, Britain’s economy, like many others, is struggling to grow fast enough to pay for heavy demands on public spending, from healthcare and education to defence. On top of that, Britain’s Chancellor has to pay higher interest on a 2.6 trillion-pound debt pile. The challenge is clear. The country has by historic standards now very high levels of tax and yet creaking public services, partly as a result of spending so much on that debt interest.

So the room for manoeuvre in this Autumn Statement was limited. Inflationary measures were off the table as the Bank of England continues its battle to tame inflation – meaning the Chancellor had only a few cards to play for now. He will be hoping for considerably more in five months’ time. His pre-election budget will be the last opportunity to produce some vote winning rabbits out of hats for a likely spring General Election.

For now, the headlines were few and far between. Jeremy Hunt did cut the social security rate by more than expected and business investment incentives were made permanent but these were accompanied by announcements that the UK growth outlook was downgraded by the OBR (the budget watchdog) and the observation by others that the tax burden still set to be heaviest since World War Two.

The market’s verdict was clear. Much of the Statement had had been floated in advance, which in part explains the FTSE’s muted reaction to the day’s course of events. The FTSE 100 remained largely unmoved throughout Chancellor Jeremy Hunt’s Autumn Statement, only slipping slightly as lower oil prices weighed on the index. Meanwhile gilt yields rose slightly during the day but then fell back to where they started. The yield on a 10-year UK government bond at the time of writing was 4.16 per cent compared to 4.17 per cent a week ago.

The FTSE 250 – which is more exposed to the UK economy – enjoyed more of a boost, closing that day of the Statement at 18,467, up 0.72 per cent and sterling also held largely firm.

By way of conclusion, the Chancellor’s package of new tax cuts for business investment (making permanent the previously temporary full expensing policy), cuts to National Insurance contributions and reforms to out of work benefits are aimed at incentivising and enabling more people to find work. The OBR estimates that these measures will boost employment by 144,000 and raise economic output by 0.3% in the medium term – a slightly larger impact than the measures he announced in his March budget.

But this was not an Autumn Statement for public sector growth. No extra money for government departments, despite higher-than-expected prices and wages, and the tight spending plans beyond the next election were extended for a further year.

The risk for the government is that it may end up not having the money it needs to continue with these and other tax cuts already baked into the system, which would be detrimental to companies and individuals who are attempting to plan for the future. Higher inflation provided higher tax revenues and the Chancellor actively decided not to reimburse public services on their increased expenditures but to gamble on private sector growth. Consequently, he has intensified and prolonged the intended budget cuts to public services. Between now and the pre-election budget he will be hoping for more good news on growth and taxes.

If not, he will have to make very tough decisions about how to pay for the tax cuts that have already been announced in addition to any other possible pre-election give-aways.

Vietnam's bright future

Vietnam's economic moment has arrived. The economy was Asia's fastest-growing last year and is one of only a handful globally to have managed two consecutive years of growth since Covid. Vietnam has benefited from global giants diversifying their supply chains away from China: Dell, Google, and Apple are among those to have set up new production lines in the country recently. Still, an onward march to high-income status is not certain. In the 1990s, regional neighbours Malaysia and Thailand were developing fast, but they ultimately succumbed to the middle-income trap: where growth stalls before an economy converges with the rich world.

It hasn't all been plain sailing. The VN-index of local shares plunged by almost one-third in 2022, one of the worst market performances worldwide. The cause was the usual suspects for meltdowns in emerging markets: overleveraged real estate and political shifts. An anti-corruption crackdown led to the resignation of the country's president in January (Vietnam's president has less power than the Communist party leadership). Meanwhile, the once-thriving real-estate sector is under stress. Last October, authorities launched a clampdown that aimed to curb land speculation and slow the rampant construction of luxury condominiums. With sales falling, dozens of property firms have missed bond payments.

Still, despite the wobble, the basic Vietnam growth story is intact, but without some of the hyperbole. Vietnam is still classified by index provider MSCI as a frontier market, like Burkina Faso.

An upgrade to the main emerging-market index could prompt an estimated $5bn-$8bn in automatic inflows from tracker funds. Authorities had been aiming to achieve an upgrade by 2025, but that deadline might prove optimistic:. Strict laws capping foreign ownership (overseas investors can only hold a combined 30% of a bank's shares, for example) and other rules restricting trading remain hurdles to obtaining emerging-market status. The VN-index has outperformed regional rivals this year, gaining 19%. Sentiment brightened after the central bank began cutting interest rates in the spring.

With inflation now down to 2%, officials have room for manoeuvre. Investors have also been tempted back by attractive valuations. As of June, Vietnamese shares were trading on ten times projected earnings, compared with 15.5 in Thailand and 13.3 in Indonesia. The VN-index is still about 20% short of its early 2022 peak.

Oil and troubled waters

While the human tragedy unfolding in the Middle East is undeniable, it is far less obvious how this will affect investors. The long-term effects of the Israel-Palestine conflict will depend mainly on how long the conflict lasts and whether it spreads beyond its current boundaries.

The global energy market was still getting used to Opec's production cuts and the fallout from Russia's invasion of Ukraine, when in early October, rising geopolitical tensions in the Middle East surfaced. It's a well-established geopolitical maxim that sudden spikes in oil prices are what typically trigger recessions, and the price of crude is highly influenced by developments in the Middle East.

On October 7, the attack by the Palestinian political and military group Hamas re-ignited the long-running conflict between Israel and Palestine. For more than a month, Israel has been bombing the Palestinian Gaza region in retaliation to Hamas, and the rising death toll continues to unsettle the commodities market.

In its October oil report, the International Energy Agency (IEA) highlighted the possibility of "higher for longer" interest rates due to price fluctuations, slowing down economic and demand growth for crude oil. This was in response to oil prices rising to nearly $98 per barrel in mid-September after additional production cuts by Saudi Arabia and Russia. However, in order for oil to hit $150 per barrel, the flow of petroleum onto international markets would need to be stopped, most likely by closing the Strait of Hormuz, which is where about 20% of the world's daily supply passes. In order for this to occur, the conflict must intensify beyond the parties involved and turn into a true regional conflict. Oil-producing countries are not directly involved in the combat between Israeli soldiers and Hamas fighters, in contrast to the surge in oil prices that followed Russia's invasion of Ukraine last year.

The chief energy adviser to the White House stated he is optimistic that Arab oil producers will not weaponise oil. Nonetheless, some analysts think that a decision to further reduce oil supply may be influenced by the fact that oil prices fell to a four-month low of $77 a barrel in November and that members' frustration toward the military action in Gaza is growing.

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The world economy is not as reliant on oil as it was in the early 1970s, and Opec is no longer such a powerful force. According to the Columbia University in New York's Center for Global Energy Policy, five decades ago the globe needed little less than one barrel of oil to generate $1,000 in gross domestic product. In 2019, the amount had decreased by 56% to 0.43 barrels. According to the study center, "oil has become a lot less important and humanity has become more efficient in making use of it."

"Voluntary cuts are expected to keep the oil market in deficit as Opec could pump 1.3 million barrels per day (mb/d) below the call on its crude in 4Q23," the IEA stated in its research. September was the biggest Russian oil export earnings since July 2022, rising from $1.8 billion (Rbs174.41 billion) to $18.8 billion.

September saw a 270kb/d increase in global oil output to 101.6mbpd, with Nigeria and Kazakhstan leading the way in production. According to the analysis, non-Opec global output is expected to grow by 1.5 million barrels per day in 2023 and 1.7 million barrels per day in 2024, while overall Opec output is expected to fall in 2023. The World Bank projects a 4.1% overall fall in commodity prices next year.

Strengthening their defences against such oil shocks, countries today have a more diverse base of oil exporters and energy resources, including renewables. Several nations have constructed supply coordinating systems, futures markets, and strategic petroleum reserves to mitigate the impact of oil shortages on pricing, according to the Bank. These developments suggest that the effects of an escalating conflict might be less severe than in the past.

The catastrophic suffering of people on all sides of this conflict in the Middle East affects us all. But to what degree this tragedy will impact global economic prospects is less apparent.

Brics failing to set global agenda

In Sandton, the financial district of Johannesberg, the leaders of the so-called Brics nations, made up of Brazil, Russia, India, China and South Africa, recently gathered for their annual conference this week. China's president, Xi Jinping, perhaps relieved to take a break from fire-fighting a wobbly domestic economy, used the summit for a fresh drive to turn the grouping into an alternative to Western-dominated bodies such as the UN or World Bank. He wants to add more members, launch common infrastructure programmes, and even a linked currency regime to dethrone the dollar. It is an ambitious plan. Can it work?

Brics was a term coined 20 years ago by former Goldman Sachs economist Jim O'Neil to describe the five nations he thought would dominate the 21st-century economy. With their huge populations, abundant natural resources and rapid growth, the Brics looked set to overtake a stagnant West. By 2023, you would have expected a Brics summit to be setting the global agenda. Yet that hasn't happened.

Russia is a basket case exiled from the global economy. Its president, Vladimir Putin, did not even appear in person at the conference, nervous that the South African authorities would have no choice but to place him under arrest. Russia is bogged down in a war in Ukraine that has turned into a stalemate, it has lost its oil and gas market in Europe, most major global companies have pulled out of the country, and many of the few that remain have been nationalised without compensation. We can be certain that Russia will not be rejoining the global economy any time soon. It will remain a corrupt gangster state reliant on selling natural resources to China.

South Africa is sinking under a wave of crime and corruption. Power cuts in many areas last for up to 16 hours a day, the rand is falling and growth has stalled. It is hard to portray a country as the future of the global economy when the electrical grid barely functions. And Brazil remains as chaotic as ever, riding the commodity cycle, but with very little progress towards creating a stable and prosperous domestic economy. If anything, those countries have gone backwards over the last 20 years.

The two largest Brics nations have, in fairness, made a lot of progress. India will this year overtake China as the world's largest country measured by population, and it has been growing by more than 5% year after year. It is steadily turning itself into a major economic power: it has already overtaken the UK in total GDP (admittedly not a huge achievement any more), and it is set to overtake Germany by 2027 and Japan by 2029, making it the third-largest economy in the world by 2029. And yet, under Prime Minister Narendra Modi, it is also increasingly protectionist, and the state is interfering more and more with major businesses. It is far from clear that it can keep on growing at its present rate. The same is even more true of Xi's China. It is struggling to reboot its economy after the Covid lockdown, and there are worrying signs its property sector is about to crash.

China and India may well emerge as the second and third largest economies in the world respectively by the end of this decade, but there is increasingly little in common between them, and the long border they share is likely to become a flashpoint as both countries assert their interests. Indeed, the real geopolitical conflict of the 21st century may not be between China and the West, but between India and China.

Xi will keep trying to promote the Brics as an alternative to the Western bloc. But the idea that they are a group of nations with a coherent set of interests and a common agenda has become ever more ridiculous. Two of its members are going backwards at an accelerating pace, one of them is struggling, and the two largest are increasingly pitted against each other. The group is less susceptible to Chinese leadership than ever. China may well continue its path to global dominance. But the Brics won't help it get there.

China's failing model

China's economy is suffering because an increasingly autocratic government is making bad decisions.

After China rejoined the world economy in 1978, it became the most spectacular growth story in history. Farm reform, industrialisation and rising incomes lifted nearly 800m people out of extreme poverty. Having produced just a tenth as much as America in 1980, China's economy is now about three-quarters the size. Yet instead of roaring back after the government abandoned its zero-covid policy at the end of 2022, it is lurching from one ditch to the next.

The economy grew at an annualised rate of just 3.2% in the second quarter, a disappointment that looks even worse given that, by one prominent estimate, the USA may be growing at almost 6%. House prices have fallen and property developers, who tend to sell houses before they are built, have hit the wall, scaring off buyers. Consumer spending, business investment and exports have all fallen short. And whereas much of the world battles inflation that is too high, China is suffering from the opposite problem: consumer prices fell in the year to July. Some analysts warn that China may enter a deflationary trap like Japan's in the 1990s .

Yet in some ways this is too mild a diagnosis of China's ills. A chronic shortfall in growth would be worse in China because its people are poorer. Japan's living standards were about 60% of America's by 1990; China's today are less than 20%. And, unlike Japan, China is also suffering from something more profound than weak demand and heavy debt. Many of its challenges stem from broader failures of its economic policymaking, which are getting worse as President Xi Jinping centralises power.

A decade or so ago China's technocrats were hailed. First, they presided over an economic marvel. Then China was the only big economy to respond to the global financial crisis of 2007-09 with sufficient force. Some commentators went as far as to say that China had saved the world economy. In the 2010s, every time the economy wobbled, officials defied predictions of calamity by cheapening credit, building infrastructure, or stimulating the property market.

During each episode, however, public and private debts mounted. So did doubts about the sustainability of the housing boom and whether new infrastructure was really needed. Today policymakers are in trouble since President Xi seeks an official deficit of only 3% of GDP. As a result, the response to the slowdown has been lacklustre. Policymakers are not even willing to cut interest rates much.

In August, they disappointed investors with an underwhelming cut of 0.1% in the one-year lending rate. This feeble response to tumbling growth and inflation is the latest in a series of policy errors. It has failed to deal adequately with incentives to speculate on housing and a system in which developers have such huge obligations that they are systemically important. Starting in 2020 regulators tanked markets by cracking down on successful consumer-technology firms that were deemed too unruly and monopolistic. During the pandemic, officials bought time with lockdowns but failed to use it to vaccinate enough people for a controlled exit, and then were overwhelmed by the highly contagious Omicron variant.

Why does the government keep making mistakes? One reason is that short-term growth is no longer the priority of the Chinese Communist Party (CCP). The signs are that Mr Xi believes China must prepare for sustained economic and, potentially, military conflict with America. Today, therefore, he emphasises China's pursuit of national greatness, security, and resilience. He is willing to make material sacrifices to achieve those goals, and to the extent he wants growth, it must be "high quality".

Yet even by Mr Xi's criteria, the CCP's decisions are flawed. The collapse of the zero-covid policy undermined Mr Xi's prestige. The attack on tech firms has scared off entrepreneurs. Should China fall into persistent deflation because the authorities refuse to boost consumption, debts will rise in real value and weigh more heavily on the economy. Above all, unless the CCP continues to raise living standards, it will weaken its grip on power and limit its ability to match America.

The fact that China's problems start at the top means they will persist. They may even worsen, as clumsy policymakers confront the economy's mounting challenges. The population is ageing rapidly. America is increasingly hostile, and is trying to choke the parts of China's economy, like chipmaking, that it sees as strategically significant. The more China catches up with America, the harder the gap will be to close further, because centralised economies are better at emulation than at innovation.

In the 2000s Western leaders mistakenly believed that trade, markets and growth would boost democracy and individual liberty in China. After four decades of fast growth China is entering a period of disappointment.

The new economic superpower

GDP could exceed Germany's by 2030, while recent progress in infrastructure and manufacturing, makes India a compelling growth story.

In the summer, India's Chandrayaan-3 lunar explorer blasted off from Sriharikota, in Andhra Pradesh, making India only the fourth country to achieve a soft landing on the Moon. The launch was greeted at the space centre by cries of "Bharat Mata ki jai" – Victory for Mother India.

The space launch is only the latest manifestation of India's growing global stature. Prime minister Narendra Modi is being fêted by Western leaders. Already the world's fifth-largest economy, India looks poised to surpass Germany and Japan by the end of the decade to take third place behind China and the US. The $3.5trn stock market has outgrown London and Paris to become the world's fourth largest and will eclipse Japan's by 2030.

The International Monetary Fund (IMF) forecasts annual GDP growth of just over 6% between 2023 and 2028, the average pace of the past 30 years. On its current trajectory, GDP looks set to match America's by 2050. Even if growth disappoints, the sheer size of the population, already the world's largest at 1.43 billion and growing, makes it "quite reasonable to assume that India will become a great power."

It wouldn't be the first time that India has stood at the forefront of global affairs. The Indian subcontinent had been the planet's largest economy for most of the last two millennia, says James Crabtree in his 2018 book, 'The Billionaire Raj'. He says that "in the late 17th century... India's Mughal Empire presided over close to a quarter of global gross domestic product" (a share similar to America's today). He believes British colonial rule pushed India to the periphery. By the time of independence in 1947, India's share of world GDP had fallen to 4%. Then Jawaharlal Nehru, the country's first prime minister, looked to the Soviet Union as a model of industrialisation. The result was a dense thicket of tariffs and regulations. The "British Raj" was replaced by the "Licence Raj".

Heavy-handed bureaucracy choked off growth; success in business was defined not by innovation, but by one's connections to the state, which handed out all-important permits. In 1991 this crony socialism ran out of steam amid a financial crisis that saw Indian GDP plunge to just 1% as a share of global output. While the crisis was wrenching, it also opened the way to liberalisation. During the 1990s, the dusty stockade of licences and tariffs was scrapped, and the economy was opened up to global trade. New fortunes were made in pharmaceuticals and car manufacturing. There was a huge IT outsourcing boom led by innovators such as Narayana Murthy, the founder of Infosys (and the father-in-law of UK Prime Minister Rishi Sunak).

In the early 2000s new magnates emerged in industry, infrastructure, and telecoms. These sectors had closer ties to the state; the need for construction and labour permits has not gone away. Some fear that these billionaires have come to wield too much economic and political power, ushering in a 'billionaire Raj' that looks suspiciously like the pre-1991 system. A lot of the massive new projects of India, the new highways, the new airports are completely authoritarian in the way that they are done.

> The MSCI India index has hugely outperformed MSCI China over the last 30 years in dollar terms. Over the past decade, the Chinese market has returned an annualised 5.69%, compared with 8.87% for India.

Others argue that India needs the new tycoons if it is to fulfil its growth potential. Take Gautam Adani, the billionaire behind a sprawling conglomerate that runs everything from ports to energy. The Adani Group of companies appears key to tackling India's infrastructure challenges, pouring billions into new energy projects as well as running India's largest airport operator and its biggest private port. If Adani stalls, many argue, then so could India's progress.

That theory was tested in January this year when Hindenburg Research in New York published a blistering report accusing the Adani conglomerate of "brazen stock manipulation and accounting fraud". The furore wiped $150bn off the value of Adani's shares, taking their collective value from 6% of the Indian market down to 3%. The affair shook confidence in wider Indian corporate governance too, wiping 6% off the Nifty Fifty stock index between late January and mid-March.

But then the scandal ebbed. In May, an interim official report said regulators had yet to find any evidence of share-price manipulation. Adani has sought to allay criticism by delaying new investments, paying down debts and bringing

new investors on board. Investors have shrugged off the issue: the Nifty and the BSE Sensex, another Mumbai-based stock benchmark, have both since rallied. Corporate governance problems are not unique to India, after all.

While Indian growth has been overshadowed by China's in the last few decades, the two countries' stock markets tell a different story. The MSCI India index has hugely outperformed MSCI China over the last 30 years in dollar terms. Over the past decade, the Chinese market has returned an annualised 5.69%, compared with 8.87% for India.

One explanation for India's stock market success is 'survival of the fittest'. While Beijing has provided ample support to help local industries thrive, in India success comes despite the government, not because of it. The cost of capital in India is far higher than in China. While that hurts growth, it also weeds out weaker firms. In the rough and tumble of the Indian marketplace, only companies delivering top-shelf returns on capital survive.

India boasts some of the highest-quality companies in Asia, and Indian corporations boast strong market positions, superior return metrics, solid balance sheets, consistent growth through cycles and some of the most capable management teams in the region. The result is that Indian shares trade at a long-standing premium to other emerging markets. The MSCI India index is on a forward price/earnings (p/e) ratio of 21, far above the average of 12 across emerging markets.

The country also trades on a premium to most developed markets. For example, the India-listed subsidiary of consumer-goods giant Nestlé trades on a forward p/e of 68, more than three times the rating of its Swiss-listed parent. Indian shares even command a 10% valuation premium to America's infamously pricey stock market. Yet, Indian shares are expensive for a reason. In a dangerous world where growth is becoming scarce, India still represents a "massive opportunity".

“Bharat Mata ki jai”
(Victory for Mother India)

There are reasons why Indian growth has disappointed before. The Indian state has often stood in the way of growth. While the upper echelons of Indian bureaucracy are quite impressive, the further down you go the more overwhelmed state services become. In the police, tax collection, education, health, power, water supply and elsewhere, there is rampant absenteeism, indifference, incompetence, and corruption.

In the late 2000s Pritchett dubbed India a “flailing” state, one that tries “to do too much and ends up doing things badly”, say Ajay Chhibber and Salman Anees Soz in their 2021 book Unshackling India. Delhi’s bureaucrats have a “penchant for grand schemes and plans”, but lack the means to execute them properly.

Some joke that India’s economy only “grows at night when the government sleeps”. The problem is not that the state is too big, but rather that it is over-mighty in some areas and under-resourced in others. India has too few teachers, doctors, judges, police personnel, while appearing to have too many clerical and support staff. In most government offices you will find many employees hanging about, not doing very much at all. The statistics ministry is dysfunctional. Inflation, for example, is calculated with reference to a basket of goods that hasn’t been updated in more than a decade, with the absurd result that the statistics ministry still collects sales data for near-obsolete items such as audio cassettes.

> Even if growth disappoints, the sheer size of the population, already the world’s largest at 1.43 billion and growing, makes it quite reasonable to assume that India will become a great power.

Economic data is often revised and there has been debate over how reliable GDP statistics really are. As former chief statistician Pronab Sen puts it: "We have [programmes] for people below the poverty line, but we don't know the number of poor people". For investors trying to gauge the scale of the opportunity for Indian growth, the task is thus complicated by the fact that the country has a serious data problem.

Key areas of the economy remain over-regulated. Restrictive labour laws prevent India from harnessing its most plentiful resource: its vast population. Other haphazard laws and regulations waste scarce land and capital. An inefficient banking system means that the spread between lending and deposit rates is among the highest in the world, making loans painfully expensive for budding entrepreneurs.

Other Asian countries have developed by first building a manufacturing base to export to global markets. Low-end manufacturing generates plentiful jobs that can offer a route out of poverty for subsistence farmers. Yet India risks 'premature' de-industrialisation: manufacturing's share of GDP fell from 17% in 2010 to 13% in 2022 (compared with China's 28%).

Instead, India's growth has been concentrated in areas such as IT outsourcing or e-commerce, where building permits and labour laws cause fewer headaches. While that generates opportunities for educated English speakers with software know-how, it does little for those who have had fewer academic opportunities: 42% of the workforce still toils away on the farm, a fact that weighs heavily on national productivity.

Yet India's manufacturing sector is now catching a favourable geopolitical wind. Stung by the disruption of the pandemic, multinationals want to diversify their supply chains, an approach dubbed 'China+1'. If India can attract enough new factories, then it might finally be able to fit the missing piece into its development jigsaw.

Manufacturing costs in India are still higher than in China, yet that hasn't stopped a couple of Apple's suppliers from setting up factories in southern India. JPMorgan predicts that India will make one in four iPhones within two years. India used to be at the back of the queue as foreign direct investment flowed to East Asia. Now, suddenly, executives worry about overheating.

The Indian stock market might also be overheating. Managers of several local small-cap funds are turning investors away amid unmanageably large inflows. Indian retail investors have been betting heavily on penny stocks. The BSE Small Cap index has gained 30% in the Spring, compared with 16% for its large-cap counterpart as a flood of liquidity chases gains in ever more obscure corners of the market. While the current trading frenzy warrants caution, the Sensex's swift rebound from the Adani sell-off earlier this year is a reminder that it hasn't paid to bet against India of late.

India is fixing some of its most long-standing problems. Infrastructure, for example, has been a major barrier to manufacturing investment, but it has noticeably improved recently. The road network has lengthened by a quarter since Narendra Modi took office in 2014, and the number of airports has doubled. New Delhi has also proved ahead of the curve on digitalisation, backing state-sponsored digital services, from e-banking to welfare payments, that reach hundreds of millions of people.

While growth rates can be difficult to predict, demography is a much surer bet. The median age in India is 28.2, compared with 39 in China. The workforce looks set to keep growing until the late 2040s, a long-lasting demographic dividend that should keep GDP ticking along.

Finally, the headroom for growth is immense. India's GDP per capita was still just $2,388 last year, according to World Bank data. That is only 19% of China's GDP per capita and 5% of the UK's. 'Catch-up' growth is easier to achieve than growing a rich economy that is already at the frontier of innovation. India's bureaucracy may be clunky, but that also means there is lots of low-hanging fruit still to pick.

India is about 18 to 20 years behind China in terms of manufacturing and urbanisation. Should it emulate its northern neighbour, the Indian growth story has barely begun.

Spirit of Adventure returns

Asked to guess what the best-performing sector in global equity markets has been so far this year, many people might say technology, especially given the pervasive coverage of artificial intelligence (AI) in the media. While this is a logical answer, it's wrong. The real success story has been the travel sector. Shares in booking sites, entertainment, airlines, cruises and hotels, in both the US and Europe, have easily eclipsed the technology-led Nasdaq index in 2023. Two years after the global economy gradually began to reopen, the travel industry is in good wealth and the long-term outlook remains compelling.

Of course, just because travel shares have done well doesn't mean they will keep soaring. However, the sector still has ample scope for growth. The industry is certainly doing much better than it was during the Covid pandemic, when most travel ground to a halt. But it still hasn't quite recovered from Covid, especially in Asia, where the volume of passengers is still 40% below its 2019 level owing to the region's relatively late reopening. As a result, there is still a decent amount of pent-up demand set to work its way through the industry, providing a further boost.

Increasing demand isn't the only reason to be positive about the travel sector. During the pandemic the industry survived by slashing capacity to the bone and selling assets. Even when economies started to reopen, most companies remained cautious. As a result, capacity hasn't come back in the same way that demand has. This imbalance created shortages in areas ranging from accommodation to flights, resulting in soaring. That's bad news for travellers, but good news for companies, especially those who took a gamble on increasing capacity.

> The industry is certainly doing much better than it was during the Covid pandemic, when most travel ground to a halt. But it still hasn't quite recovered from Covid, especially in Asia, where the volume of passengers is still 40% below its 2019 level owing to the region's relatively late reopening.

Higher prices and an increase in demand are one side of the equation. The other is reduced costs. The pressures of dealing with the pandemic may have threatened the future of many companies, but also provided them with an opportunity to assess business models and gauge where they had been failing. The industry has never been very good at keeping a lid on expenses, so Covid gave it a chance to slash costs through various methods, such as by renegotiating leases and contracts. As with prices, the process may have created losers, such as suppliers and staff, but combined with higher revenue, it has also boosted margins.

People in Asia may have been slower to return to the skies, but in the longer run the industry will benefit from the expansion in the numbers of affluent people in China, India, the Middle East, and emerging markets. In many ways, they are likely to want to experience the best that travel and tourism has to offer, in their own countries and abroad.

Perhaps the most obvious sign that the travel industry is doing well comes from the performance of the airlines. Three years ago, people were wondering if there would actually be an airline industry after Covid. Governments around the world were forced to pump in billions to keep it afloat. In the US, the industry eventually received $54bn in direct payments, another $25bn in cheap loans, and additional tax breaks. The German government also had to dig deep to save Lufthansa, its troubled national flagship airline.

Perhaps the most ominous moment was in May 2020 when Warren Buffett publicly revealed that his fund Berkshire Hathaway "had dumped its stakes in the four largest US airlines." But instead of sounding the death knell for the industry, Buffett's decision to exit from it represented a key moment of capitulation, with pessimism reaching such extreme levels that the only way for airlines' shares to go was up. Even before the vaccines arrived, the sector started to rally: the market began to realise that the world wasn't going to come to an end.

Of course, once travel bans were relaxed and then scrapped completely, the industry enjoyed robust demand for flights. What's more, there are signs that even the large increase in the number of people now working mainly or exclusively from home could have a silver lining. This is because remote working is starting to create a class of hypermobile workers who do their job from the hotel pool or the beach resort. Just as the last few decades saw the rise of the 'snowbirds', American retirees who move southwards in the winter and back north in the summer, the same may be starting to happen for today's working-

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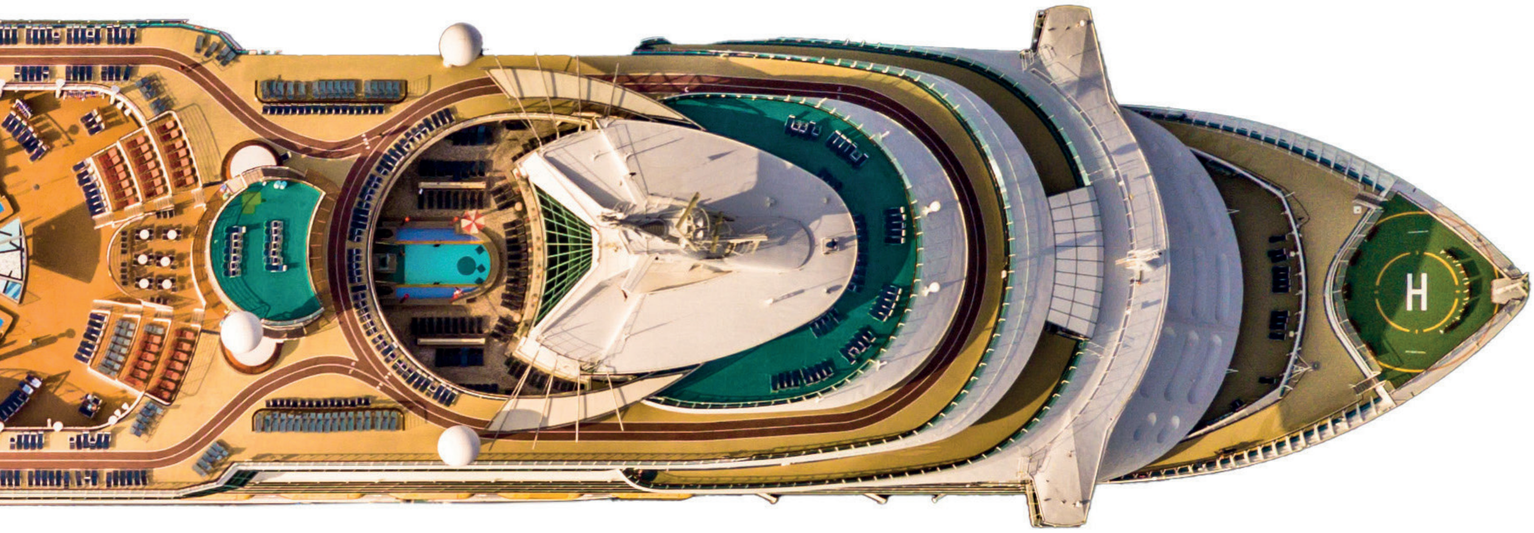

age 'digital nomads'. This won't just be an American phenomenon. Workers in northern European countries such as Germany, or even the UK, could well decide to spend a large chunk of the year in Portugal or Spain.

It is less likely that this will become an established habit, especially since rules around human resources, tax and immigration make it harder than you think to work in two countries. Tourism may not necessarily be a substitute for business travel for airlines since business travellers tend to pay premium prices. Indeed, the slow recovery of first and business class travel has been a major problem for the legacy carriers. Still, although business travel seems to have reset at a lower level for now, it will eventually recover as people drift back to work.

In any case, the pandemic seems to have accelerated the consolidation of the US airline industry, enabling the newly merged airlines to benefit from economies of scale in areas such as administration and marketing. It also gives them increased pricing power, a marked contrast to the destabilising price wars of recent years. Signs of a similar trend are starting to take place in Europe, with International Airlines Group, the owner of British Airways, in the process of buying Air Europa, and possibly even TAP Air Portugal.

The airline sector may provide the most visible sign of the travel industry's recovery, but it isn't the only area doing well. Hotels are bullish about the pace of the recovery and future growth. This is particularly the case at the luxury end of the market. Dino Michael, senior vice president and global head of Hilton's luxury brands, thinks that demand for hotels remains "unstoppable", with people around the world "continuing to seek travel experiences they put on hold" during the pandemic. The pandemic has in fact stimulated demand at the top end. There has seen a rise in customers wanting to be really taken care of, with expectations higher than ever before. In addition to the usual affluent customers, there are many who are treating themselves, celebrating, taking multi-generation trips with family or visiting for special occasions.

As a result, far from cutting back, Hilton is expanding its luxury offerings and is on track to open up to 20 luxury properties within the next five years in Europe, the Middle East and Africa. Other people involved in the hotel industry agree. Specialised areas are doing well, with the high-end golf segment back with a vengeance, while the overall luxury market has recovered very well from Covid. While a slowing economy and rising interest rates may limit hotels' ability to push for higher prices, the top end has remained the most resilient segment through the recent economic difficulties and will continue to grow for years to come.

In the longer run, one of the big trends of the last three decades, which is set to continue, is the increasing desire for 'specialisation and localisation'. In the past, travel was still considered a novelty, with tourists happy simply to be in a new destination, even if they ended up disappearing into generic spaces. However, today's travellers are much more demanding and keener to delve deeper into the history and culture of their destination. The trend is towards bespoke, niche travel experiences designed to impart a sense of authenticity and local colour. People are therefore willing to pay premium rates for superior

Despite the fact that the cruise-ship industry has recovered the least compared with airlines and hotels, demand still remains very strong. The Cruise Lines International Association recently revealed that the number of cruises taken by UK and Irish passengers in 2022 was more than 3.5 times the number taken in 2021.

design, decor, food and beverage, amenities, and service in their hotels.

Even demand for hotel rooms and spaces from business travellers and corporate customers seems to be returning. Nicolas Hauvespre of Shangri-La Hotels and Resorts, which operates over 100 hotels in 78 destinations, admits that demand from business is "bouncing back at different speeds in different markets". But he is encouraged by the fact that it has returned swiftly in key cities such as London, Paris, Dubai, New Delhi and Toronto. He expects an eventual recovery across the board owing to a "strong preference among our guests for in-person meetings and interactions" and humans' "innate desire to connect".

What's more, just as the rise of remote working has led to some people living in multiple locations around the year, hotels that cater to what Hauvespre calls "blended travel" – in which guests "balance business effectively with relaxation and exploration" – may do particularly well. This new breed of business travellers are seeking hotels that allow them to transition seamlessly, from work to leisure, either through wellness facilities that allow guests to unwind, or by engaging in immersive local experiences.

Flexible working is leading to the merging of business and leisure travel – people choosing to add leisure days to the beginning or the end of a business trip. A recent survey commissioned by World Travel Protection, which helps companies manage risks associated with travel, found that nearly a fifth of business travellers plan to combine personal travel with a work trip.

A key moment marking the advent of Covid was when the cruise ship Diamond Princess was quarantined. During the pandemic the cruise-ship industry was more completely shut down by Covid than any other part of the travel industry. What's more, given that, unlike airlines, cruise ships are not seen as an essential part of the global economy, they did not receive the generous support that the major national carriers managed to secure. As a result, cruise-ship companies remained afloat by selling assets and taking on large amounts of debt.

Despite the fact that the cruise-ship industry has recovered the least compared with airlines and hotels, demand still remains very strong. The Cruise Lines International Association recently revealed that the number of cruises taken by UK and Irish passengers in 2022 was more than 3.5 times the number taken in 2021. Combined with the reduced capacity, this allowed cruise lines to increase prices aggressively. The industry's incomplete rebound presents an opportunity for investors. They will have to bear in mind that many of these cruise lines are now much more highly leveraged than they were before the virus struck, but that does mean that the continued surge in revenue will have a big impact on the bottom line.

In the longer run, the cruise industry, like large parts of the overall travel industry, will become increasingly split between the mass-market budget end and the luxury element, with the mid-market consumers getting either squeezed. Of the two, the higher end of the cruise market has the most potential. Some cruise companies are already moving away from huge ships in favour of running smaller, bespoke cruises. While these may have fewer guests, they more than make up for it by commanding premium prices.

Two years after the global economy reopens, the travel industry is in good shape. And the long-term outlook remains compelling.

The return to the office

Businesses and workers are slowly emerging from their post-pandemic lockdown to head back into the office. Is this the end of working from home?

Not everyone, however, is back in the office. A crop of recent headlines certainly suggest that the pandemic-induced era of home working has peaked, even for cutting-edge tech firms. Amazon has warned white- collar staff they must now be in the office three days a week. Meta is doing the same from next month. And most strikingly even Zoom, the video-conferencing company that became a byword for home working during the pandemic (it saw its revenues leap fourfold in a year), has just told all employees they must be in the office at least two days a week. In the UK, bosses are just as keen to get staff back in more often.

Businesses are not dictatorships, so employees are not being ordered back. In a labour market that's still tight, they compete for staff on pay, but also conditions – and many people want to work from home (WFH) part of the time. According to the CIPD, an association of human-resources professionals, more than 80% of UK employers have some form of hybrid-working policy, and 71% of workers view flexible working as important when considering a new job. Behind the headlines about an ebbing tide of home working, a permanent shift is embedding itself. Transport for London's data show that, at Bank station, in the heart of the City, the number of people arriving on a typical Friday this year is just 35,000 – half the level just before the pandemic hit. Demand for office space in London is down 20%, and research by estate agents Knight Frank says half of multinationals plan to cut office space further within the next three years.

Full-time employees in the UK, US, Australia, Canada and other English speaking countries currently work an average of 1.4 days a week at home, according to recent research ("The Evolution of Working From Home", July 2023, Barrero, Bloom and Davis) based on a global survey carried out in the Spring. That 1.4 days is almost double that of mainland Europe (0.8 days) or the Asian countries surveyed (0.7). In the US, the research found that WFH increased persistently after the pandemic, rising fivefold from about 5% of working days in 2019 to 25% in 2023. There, about 60% of mostly lower-paid workers never work from home, largely due to the nature of their jobs.

The next biggest group, nearly 30% of workers, are hybrid workers who typically work from home two or three days a week- mostly these are better-off workers doing managerial and professional roles. The final group, comprising just above 10% of the labour force, work entirely remotely. They are typically in support roles and earn less than the typical professional hybrid worker. In other words, the bulk of workers in the US (where the overall picture is like the UK) never work from home. But almost a third relatively well-of professionals, still do so at least two days a week. This is in line with a report in May which found that on average, office workers in central London come in to work 2.3 days a week, or about 60% of pre-pandemic levels.

The open secret about WFH is that we all work a bit less hard. One US study published last month ("Working from Home, Worker Sorting and Development") by the National Bureau of Economic Research (NBER) found that workers, in this case data-entry workers in India, randomly assigned to work from home full-time were 18% less productive than those in the office. "Two-thirds of the effect manifests itself from the first day of work with the remainder due to quicker learning by office workers over time." That's a bigger productivity gap than the 10% cited by Barrero's study, but they came to the same conclusion. Fully remote working is less productive, with key factors being challenges with communicating remotely, barriers to mentoring and building culture, and self-motivation. That's not to say it can't still make commercial sense if the firm makes sufficient cost savings to offset the productivity loss.

Hybrid working appears to have small positive impacts on productivity. The cuts in commuting time and the positive impact on workers' levels of contentment are important factors, in addition to productivity. It's worth noting, though, that the 'new normal' hasn't yet been tested in a labour market where unemployment is high and workers are competing for employers, rather than the other way around. Meanwhile, for recent graduates and new recruits especially, the benefits of office life will remain crucial. In May it was reported that Global Accountants PwC and Deloitte, among others, have been obliged to offer more training to new recruits who went through school or university during the pandemic, after noticing that they were struggling with face-to-face communication and teamworking.

But WFH appears to be here to stay. The fact is that workers like it and expect it. But another fact is that 21st-century businesses rely on knowledge and creativity – things that happen more easily when people are together in the same physical space. There's nothing new about this. In his Principles of Economics (1890), the economist Alfred Marshall explored how workers benefited from proximity to others with similar skill sets, due to the information-rich nature of face-to-face contact. When people gather in clusters, he argued, "the mysteries of the trade become no mystery, but are, as it were, in the air". Marshall didn't have Zoom. But his thesis was true in the 19th century, and it's true today. At least, from Tuesday to Thursday.

Market report

Bonds
Trimming the trend

With a £20 billion tax cut at the centre of the Autumn Statement, the UK Treasury trimmed its aim for bond sales this year, but less than anticipated, which put an end to the gilt market's recent rise.

The Debt Management Office declared that it would reduce gilt issuance by £500 million to £237.3 billion in the current fiscal year, which is substantially less than the £15 billion that 13 institutions surveyed by Reuters had predicted.

In recent months, investors have sold off as a result of worries that interest rates will stay higher for longer as central banks struggle with ongoing inflation. According to some observers, the bond markets' "slow motion train wreck" will lead to an extended period of economic hardship.

Over the last six months, the cost of borrowing the US benchmark 10-year bond has increased by about 50%, and UK 30-year gilt yields have reached their highest levels since 1998. Germany and Italy have seen yield increases to levels not seen in over ten years, and not even Japan has been immune to the upward trend.

Foreign Exchange
Dollar losing ground

As they strengthen their wagers that the US Federal Reserve has completed its aggressive campaign of interest rate increases and will deliver numerous cuts next year, investors are selling dollars at the quickest rate in a year.

Currency investors have been selling dollars preferring to purchase a variety of Latin American currencies, the Canadian dollar, and the Japanese yen. The news that the dollar is losing ground will please Japan's finance minister. The yen nearly reached a 33-year low vs the US dollar earlier in November, increasing inflationary pressures by driving up the price of imported products, and putting Japan on course for a potential currency intervention. Although the yen has lost almost 12% of its value compared to the dollar so far this year, November has seen some improvement, with the value rising by roughly 1.5%.

Commodities
Supply issues

The commodity markets were stagnant for a large portion of 2023. In addition to supply-chain bottlenecks caused by COVID-19, Russia's invasion of Ukraine drove up raw material costs in 2022. However, a gloomy economic forecast made an active market dull.

Supply issues and rising demand in 2024 are more than possible in two markets. Certain metal markets appear susceptible. These appear to be well supplied for cobalt and lithium, two green metals that will be in high demand in 2022. Instead, keep an eye on copper, whose price dropped in 2023 as a result of slow Chinese growth. The ultra-niche uranium market may take off. Just as coups and conflicts have hindered uranium production, the crisis in Ukraine and the hunt for reliable sources of low-carbon power have increased governments' appetite for atomic energy. Since there are still market deficits, the metal's prices, which are currently at an all-time high, may rise even higher.

The grain market is also one to keep an eye on. The invasion of Ukraine by Russia did not shock the market for very long; in March 2022, wheat prices were $12 per bushel; by autumn 2023, they had dropped to $5. However, the fifth-largest grain exporter in the world, Ukraine, is currently exporting 35% less grain. The deficit has been made up by bumper crops from Russia, but unfavourable weather and rising tensions could put that at risk. Large exporters' stocks have been declining for years.

Oil
Middle East impact

As we report, the unfolding tragedy in the Middle East is likely to impact oil prices but particularly if the conflict spreads to producing nations. Nevertheless, with Brent prices down more than 15% from a peak in September, the Organization of the Petroleum Exporting Countries and its allies (OPEC+) are expected to continue or perhaps expand their oil production cutbacks throughout the upcoming year, as anticipated by the majority of the eighteen analysts surveyed. Notwithstanding a fourth-quarter supply deficit brought on by OPEC+ cuts and the possibility of additional disruptions to supply due to growing Middle East tensions, investors are concerned about growing non-OPEC production and declining demand in large countries, which has resulted in a dramatic decline in oil prices.

Equities
Underwhelming figures

Despite Beijing's attempts to rekindle trust in the world's second-largest economy, over three-quarters of the foreign capital that poured into China's stock market in the first seven months of the year has vanished, with foreign investors selling more than $25 billion worth of shares.

In January 2023, foreign investors started purchasing Chinese equities at an unprecedented rate, hoping for an economic revival following the nation's removal of its unpopular "zero-Covid" policy. In recent months, however, foreign funds have aggressively reduced their holdings due to growing worries about a liquidity problem in the real estate market and underwhelming growth figures.

Instead, according to estimates from Goldman Sachs, financial institutions have favoured the markets in South Korea and India this year, with net inflows of $6.4 billion and $12.3 billion, respectively. Seoul is on course to see net foreign inflows for the first time since 2019 thanks to worldwide purchases of Korean stocks.

Although Wall Street's largest investment banks' equities strategists predict China's stock market will perform better in 2024, there are wide differences in their estimates of how much will rise.

Gold
Standby mode

There is a feeling among many that Gold has entered standby mode as investors await fresh clues on the Fed's policy outlook. Having traded within a range over the past few weeks, all eyes on the $2,000 level. Gold is currently trying to settle above the $2000 level as precious metals move higher as falling Treasury yields are providing additional support to gold prices.

We've over 200 years experience in the world's largest Banks

Alexander Wade

Alexander is one of the most experienced London advisers in the international market, specialising in this field for over 17 years whilst at HSBC, where he was consistently recognised as one of its most accomplished advisers. He has over 25 years' experience in international wealth management.

Stuart Poonawala

Stuart has worked in financial services since 1998. In 2003, he helped to found HSBC's specialist London arm advising international clients which quickly became one of the bank's most successful UK divisions. In 2009, he launched Kubera Wealth, our sister company, focussing on providing quality advice to the UK market.

Graeme Cowie

Graeme is responsible for building our professional connections with international lawyers and accountants, as well as co-ordinating our relationship with key fund managers at a number of international Private Banks and Discretionary Fund Managers. He has spent over 20 years in financial services and investment management, most recently spending more than six years at UBS where he led the Strategic Partnership team.

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