

UPDATE



Knightsbridge
Wealth

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The Knightsbridge Wealth magazine for international clients

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becoming hostile to investors**

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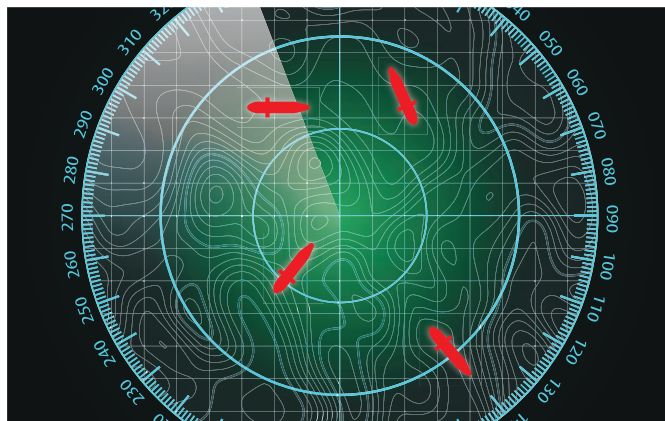
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A welcome note from Knightsbridge Wealth

Last month, it was back to school time in the northern hemisphere, and we have an eventful term ahead. In biology, we will learn whether vaccines can prevent further COVID-19 lockdowns. In politics, we will find out what happens when you try to pass an \$83.5 trillion fiscal package with thin majorities in the House and Senate. In economics, we'll see how slower central bank bond purchases affect bond and equity markets. In business studies, we will think about the implications for profit margins when both revenues and costs rise. In ecology, we will consider the impact of 'reinflation.'

Here in the UK, I am convinced as ever that with Brexit off the front pages and the UK's COVID-19 strategy proving to be more successful than one might have suspected last year, there is no good reason for our market to be trading at a 60% discount to the US market.

There is talk of us now being in a 'technological growth' cycle. Much of the time, the principles of investing rarely change. But every now and then (five times the last 550 years) we get a sudden speeding up in innovation – a technological revolution. Think of the industrial revolution, the age of steam, the widespread adoption of electricity, and the age of oil and mass manufacturing.

In all cases there are two stages. First the Installation Stage in which the new technology enhances a few sectors and makes a few great fortunes. These stages – which typically last 20 years – tend to be characterised by rises and inequality and social unrest. Next comes the good bit – the Development Phase – when the new technology enters all parts of the economy and benefits everyone. A renowned economist thinks we are at the beginning of this part of a stunning information technology revolution right now.

An example is education. COVID-19 has led to a rise in online courses using the internet to open access to high-status education to everyone with the ability to take it on. Health is another area where COVID-19 has sped up change. Diagnosis is well on its way via artificial intelligence. Think about the change underway, the change to come and the almost limitless opportunities there are for companies set up to grasp them.

This new focus on technology and green economics needs to be carefully balanced in a diversified approach as these sectors develop and then mature.

Travel and connectivity seem to be returning. After months of relentless lobbying from the UK and the EU, the White House has agreed to end a sweeping travel ban first imposed in March 2020. Now, almost all Europeans are banned from the US. Only American citizens, their families and permanent residents can enter, if they have been in the UK or the EU at any point in the previous two weeks. However, Joe Biden has announced that people who have had two doses of a coronavirus vaccine will be able to enter the US from the EU and UK from November.

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.



But, whilst UK citizens may soon be able to visit the US again, it seems that hopes of a post Brexit trade deal with the US have all but evaporated. Johnson once touted a bilateral Free Trade Agreement with the US as a key Brexit win, highlighting the prospects for British exporters unfettered from the EU. But the government now accepts that it sees little prospect of progress towards a one-to-one deal before the next general election in 2024, as the Biden administration focuses on other priorities.

It's true that Biden was hardly enthusiastic about a US/UK trade deal, but it was hardly the snub that some of the government critics imply. Compared to previous statements, his overall tone sounded more well disposed towards Brexit Britain than he has before. Still, the boring truth is that a bilateral trade deal has been a diplomatic dead duck for a while.

In these challenging times, the quality of advice, service and active management from a well-regulated firm has never been more important. The team at Knightsbridge Wealth are committed to help in every way possible and we look forward to working with you.

A handwritten signature in black ink, which appears to read "A Wade".

Alexander Wade

Special feature: China

The Middle Kingdom is becoming hostile to investors

There's a growing sense that foreign multinationals and investors have underestimated the risks of doing business in China and overestimated the benefits. From reining in tech billionaires such as Jack Ma, to making life harder for multinationals trying to access the Chinese market while staying on the right side of Beijing, all indications are that China under Xi Jinping is increasingly prioritising absolute control by the Communist Party of China (CPC) over further economic liberalisation. The first big red flag came last November when financial regulators suddenly suspended the IPO of Ma's Ant Financial, days before its listing in Hong Kong and Shanghai. Warning bells have been ringing ever since.

One that spooked investors was the tightening in late July of regulations governing China's \$100bn private tutoring industry, banning firms that teach the school curriculum from making a profit. Specifically, the worry concerns a new ban on Chinese tutoring companies using a corporate structure known as the Variable Interest Entity (VIE). That's essentially a holding company aimed at circumventing the strict rules banning foreigners from owning assets in key sectors, such as technology – and it's long been a primary channel for foreign investment. Both Beijing and big Western institutional investors, such as BlackRock and Fidelity, have until now been happy to gloss over the risks of the structure, says the Financial Times. That no longer looks so wise.

Earlier this year China passed a new data security law that forbids firms from handing over any data to foreign officials without government permission. It strengthens the authorities' already vast powers to intervene in individual businesses, by compelling them to share data collected from social media, e-commerce, lending, and other businesses, and classifying

Xi's China is not the China they know. He is putting in place an updated version of Mao Zedong's party.

such data as a national asset. The New York listing of Chinese ride-hailing firm Didi was a salutary reminder to investors of the political/regulatory risk involved. No sooner had investors put \$4.4bn into the biggest Chinese IPO in the US since Alibaba in 2014, then China's internet regulator accused it of "serious violations of laws and regulations" in collecting and using personal information.

The developments at Didi amount to a shock-therapy type of enforcement. More control by the state, with in-effect data nationalisation as the end result. The Didi fiasco was a particularly painful reality check for any Western investors complacent enough to think that 'long totalitarianism' was a smart trade.

It has been clear for years that the symbiotic relationship between China and the US is fracturing, and that the CPC's core goal is not global economic dominance but retaining domestic power. As China's demographics bite, and its growth slows, that task will get harder while the Cold War between China and the US gets more pronounced. All that means is increased risk for investors and businesses.

How will that manifest itself? Sometimes it will be in obvious ways. For example, with a new law aimed at punishing Western companies that comply with US sanctions – and which is expected to be extended to cover business based in Hong Kong. That could leave Western multinationals stuck between complying with US regulations and getting sued in China. On



other fronts, the risks are increasingly more subtle. Take China's cinema industry, which has bounced back strongly this year and is by far the world's biggest theatrical marketplace. But the slice taken by US releases has slumped, in part because the ban on foreign film releases during the peak summer period has been stricter and longer than usual in deference to the 100th anniversary of the founding of the CPC. Or consider the speech in the summer by Xi attacking wealth inequality: it sent the share prices of Europe's big luxury goods businesses reeling. In 2021, China's shoppers are expected to buy 45% of all the luxury goods sold globally, according to Jefferies, up from 37% in 2019. A drive by Beijing to rein in the rich would-be bad news for makers of posh handbags and investors are reassessing the risks.

Some multinationals are already suffering from collateral damage. Ericsson, for example, the global number two maker of cellular equipment, reported in mid-July that its sales in China had plunged, and warned that its market share there was set to shrink sharply in coming months. The reason, it believes, is Sweden's decision late last year to ban Huawei from the buildout of its 5G network. Multinationals in every industry doing business in China are acutely aware that as the geopolitical environment worsens, all the money and effort they have put into building their businesses there could be at risk. In the worst-case scenario, that means confiscation.

Investors should prepare for turbulence. Foreign investors who put money into China find it hard to recognise all these increased risks because China has confronted so many difficulties and come through. But Xi's China is not the China they know. He is putting in place an updated version of Mao Zedong's party. No investor has any experience of that China because there were no stock markets in Mao's time. Hence the rude awakening that awaits them.



Xi's crackdown spreads

Recent crackdowns have proven that few sectors are safe from Beijing's control and no industry looks as vulnerable as Macau's gambling market. Shares in the territory's casino operators fell sharply amid a regulatory review that may end up cutting the number of casino licences in the world's largest gambling hub. Should the new laws limit the number of licences below six, some operators could go out of business when all current permits expire in June 2022.

Even if that doesn't happen, Macau will be more demanding than in past years. Operators may face unprecedented micromanagement, including state representatives scrutinising daily operations, and stricter oversight for junkets, which organise visits and credits for high rollers. There's even a suggestion that firms may require government approvals to pay dividends.

The message for markets that extends beyond Macau is that China is serious about its 'common prosperity campaign'. Hence shares in Hong Kong's four biggest property developers also tumbled after reports that Beijing has asked the territory's real-estate billionaires to resolve the city's housing crisis. The high cost of property in Hong Kong is often blamed for fuelling the widespread political protests in 2019. Investors now fear developers could be forced to donate some of their large land banks to the government.

Deflating Hong Kong's real-estate bubble won't just mean squeezing the tycoons – it will also require a big shake up in tax policy. The territory earns twice as much from land sales as income tax, which is partly why tax rates have stayed so low until now. Hong Kong's housing market has produced immense wealth for some... leaner times could be ahead.

Banning Crypto-currencies

Chinese regulators have moved one step closer to banning cryptocurrencies. Last month, the People's Bank of China (PBOC), the central bank, announced that "virtual currency-related business activities are illegal financial activities". The bank blames cryptocurrency speculation for "breeding illegal and criminal activity".

Beijing's crackdown on cryptocurrencies has been going on since 2013. Earlier this year, it banned financial institutions from providing crypto-related services. That edict had sent Chinese bitcoin buyers onto overseas platforms instead. The new rules seek to close that loophole. The measures don't appear to amount to an outright ban on cryptocurrency possession. But related activities are now heavily restricted, and the PBOC has made clear that digital currencies are "not legal tender".

A ban on transactions may not tank prices because about 70% of all circulating bitcoin is now held by long-term holders, up from 59% in May. For now, crypto markets appear to think that they can do without China or its vast market. Yet whether that lasts remains to be seen as other Asian countries such as Singapore also tighten the screws.

Britain's supply lines falter

The UK's Prime Minister, Boris Johnson, is engaged in a war of words with farmers and businesses over shortages. The food and road-haulage industries, in particular, have blamed recent fuel shortages and supply-chain disruption on Britain's more restrictive immigration policy, which they claim has created a shortage of workers. In response, the government has argued that firms are at fault for not properly preparing for the end of the free movement of labour within the EU and continuing to use immigration as "an excuse for failure to invest in people, in skills and in the equipment or machinery they need to do their jobs".

Cheap immigrant labour has allowed big business to drive down pay for decades and it was always inevitable that there were going to be some bumps in the road once Brexit rules reduced the supply of it. The short-term problems may be painful and annoying for some companies but should make way for long-term wage gains. Firms have already been bailed out to the tune of hundreds of billions of pounds to keep them afloat and save jobs during the pandemic, and the government is looking at them now to be grateful.

Britain is not the only country having to deal with these issues. There are shortages of lorry drivers across Europe – hauliers and retailers are now paying the price for a failure to attract workers into an industry where the average age is now 53, with just one in 50 lorry drivers aged 25 or under. The stresses to supply and demand caused by government responses to COVID-19 have also hit global supply chains – the price of shipping a cargo container has risen four-fold; the average door-to-door shipping time has risen from 41 days to 70.

Some of the supply-chain problems are clearly the result of temporary forces beyond ministerial control. Still, it remains hard to deny that the problems are especially acute in Britain. In addition to global factors, supply chains ending in Britain have been stressed by Brexit-related form-filling; tax tweaks have also affected take-home pay for some lorry drivers, at the same time as the number of drivers from the EU has fallen by more than 12,000, or 10% of the total; and the government's lack of communication and transparency has contributed to the panic-buying of petrol.

If the government's more restrictive immigration policies were really upending Britain's low-pay, low-productivity model, then that would be a great thing. Sadly, the evidence so far is that it isn't. The number of jobs offered on zero-hour contracts is increasing, not declining. And data from the Office for National Statistics suggests that growth may already have stalled, with real wages down in July from where they were in April. If what Johnson is calling a "period of adjustment" turns out to be permanent, then he may come to regret claiming that it was a price worth paying.





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Submarine deal makes waves

The unveiling of Auks, a trilateral defence pact between Australia, the UK, and the US, is one of those rare occasions when you see the tectonic plates of geopolitics shifting in front of your eyes. The treaty envisages a wide range of diplomatic and technological collaboration from cyber-security to artificial intelligence. At the heart of the deal is a plan to provide Australia with eight nuclear-powered submarines, presumably based on the US's Virginia class or the UK's Astute class – an initiative that also involves cancelling a \$90bn (£48bn) agreement for Australia to buy conventional submarines from France.

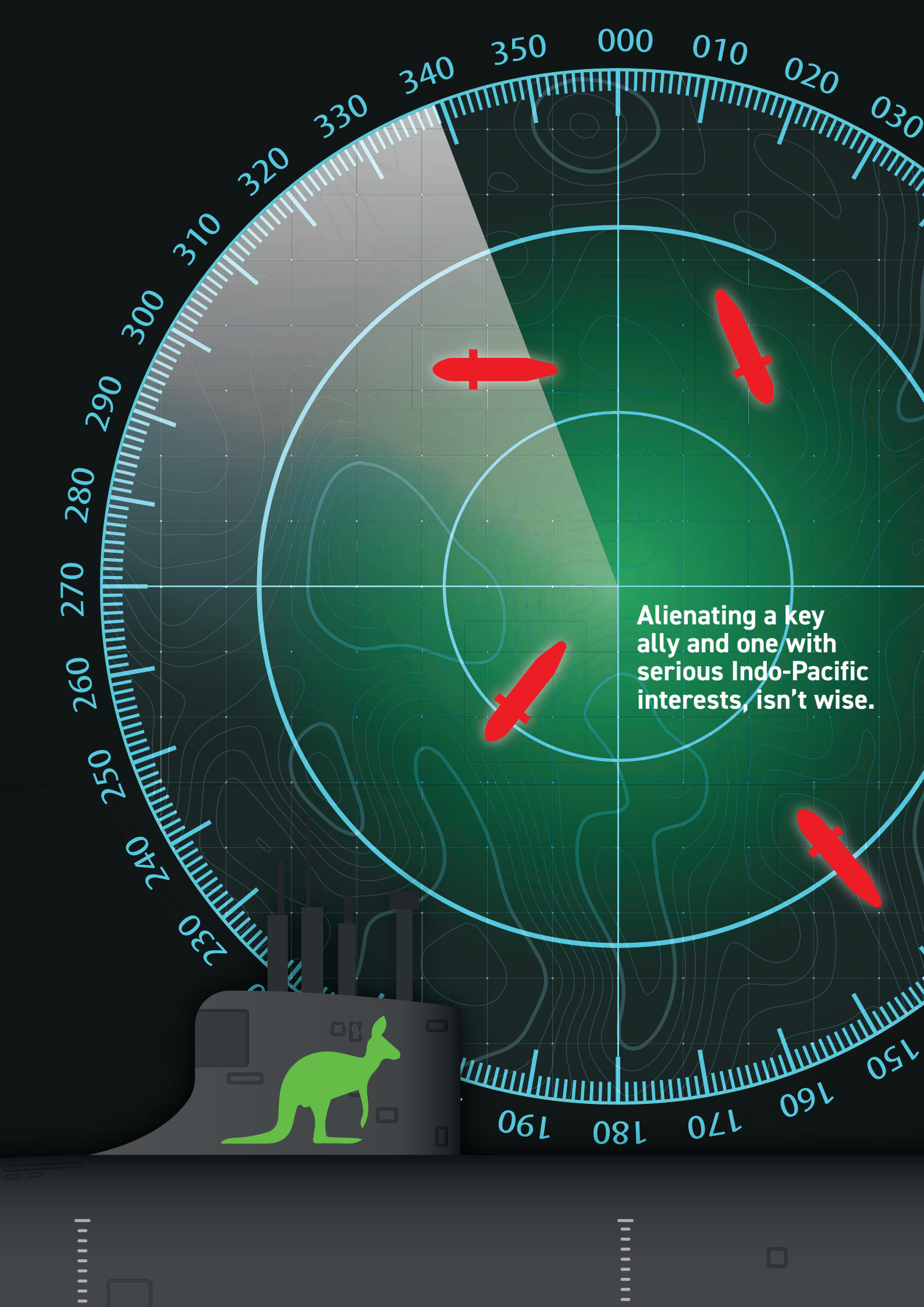
It's rare that a submarine deal – or any military partnership – creates quite as many waves as this has. It is certainly significant. The reason why Australia wants to become only the seventh country to have nuclear submarines is clear, as is America's willingness to share a capability it has previously only offered to the UK. The greater power and endurance provide a critical technological edge in any future tension or conflict with China which is already in the nuclear sub club and is now upgrading its fleet with Russia's help. So, the deal "should be celebrated by those favouring robust allied sea power as a bulwark against Chinese aggression – and at least understood by all who believe in national interests and sovereign decisions.

However, the decision to ditch an order for 12 French Shortfin Barracuda subs – which are France's own latest nuclear fleet adapted for diesel – was not well received in Paris. The immediate response of Emmanuel Macron was to withdraw his ambassadors from Canberra and Washington in an act of almost "comic sulkiness," according to Daniel Hannan in The Daily Telegraph. This is not the first time that the French president has ordered French envoys

home in a fit of pique and it underscores why Anglosphere democracies do not see him as a reliable partner. Given that France is one of the few countries capable of projecting global naval force and one with significant territories in the Pacific – the region is home to nearly two million of its citizens and 7,000 of its troops – it is worth considering why the Anglosphere acted as they did. It would be wrong to attribute all the blame to one president, but Macron's unnecessary, and often counterproductive, words towards the UK over the past four years has not inspired confidence.

Still, America's handling of the French was graceless. Alienating a key ally and one with serious Indo-Pacific interests, isn't wise. Creative efforts will now be needed to mitigate the damage. More broadly, it looks like an extension of Joe Biden's failure to engage with Europe over Afghanistan, which has created considerable bad feeling. The US president may be calculating that Europe will have no choice but to follow him on his China course, or simply that Europe is no longer an important player but those are two mighty risky assumptions.

Biden doesn't care. China is the theme that connects his exit from Afghanistan, his grudging tolerance of a gas pipeline from Russia to Europe, his refusal to pick a fight with Saudi Arabia over sundry misdeeds and his greater investment in the Quad, the informal strategic grouping of the US, Australia, India, and Japan. There is nothing ambiguous about this strategic monomania, even if it is hard for Europeans to grasp how all-consuming his fixation with China is.



Alienating a key ally and one with serious Indo-Pacific interests, isn't wise.



Market report

Bonds

Sustainable Bonds to excel

As economies reopen, inflation has spiked. However, central banks including the Fed, have stated that they are willing to tolerate an inflation overshoot relative to their targets and withdraw stimulus much later than they did in previous cycles. US rates will gradually climb in the coming quarters as rising vaccination rates and vaccine effectiveness against severe disease allows for a gradual reopening, the labour market recovers and the Fed inches closer to reducing its asset purchases. Within credit, spreads have compressed, and the upside appears limited from current levels. US investment grade remains expensive due to tight valuations and its vulnerability to rising yields. Asian High Yield Bonds look attractive. However, valuations are discounting significant default risks within the China property sector.

Sustainable bonds are likely to excel. Investors receive returns that are comparable with otherwise identical traditional bonds. However, as in traditional credit investing, picking the rights names and bonds can also deliver outperformance as demand is likely to grow, driving up prices.

Oil

Strong demand recovery

Despite OPEC+ having added nearly 2.7 million barrels per day of supply between April and August, oil inventories have continued to decline in recent months. This suggests the market is still in deficit. Better fundamentals are the result of non-OPEC+ supply growing only moderately, and oil demand continued to increase, although unevenly across regions and oil products.

The strong demand recovery is particularly visible in the largest oil consumer – the US. According to the Energy Information Administration, US oil demand in June was just 0.6% below that of June 2019. Oil demand will exceed 99 million barrels per day later this year, meaning that oil inventories will decline further, and Brent prices likely to reach \$75 per barrel this year.

Hedge Funds

Useful source of stability

Multi strategy funds continue to appeal for diversification, in addition to strategies that can take advantage of market dislocations. Strategies that can navigate macroeconomic uncertainty are particularly attractive as well as strategies exposed to tech, healthcare, and Asia. Direct lending, core real estate, and infrastructure are attractive ways to generate yield and income in a diversified portfolio.

Foreign Exchange

Japanese Yen looks vulnerable

Among the G10 currencies, both the Euro and US Dollar look good value. The economic recovery has made progress but is not yet strong enough for the Fed to rush ahead with tapering. The Euro to US Dollar exchange rates are trending sideways and is more in balance as the European currency remains supported by the global recovery.

Currencies backed by central banks that are about to unwind stimulus measures are favoured. Besides the US Dollar, these are likely to include the British Pound, the Canadian Dollar, the Norwegian Kroner and the New Zealand Dollar at the forefront. Relative to them, negative-yield currencies will suffer as the cycle progresses this year and next. With vaccinations making headway, coupled with stronger global GDP growth, safe-haven demand for the Japanese yen is likely to ebb. In Asia, the Singapore dollar should outperform its regional peers as the Monetary Authority is likely to adopt a policy of gradual currency appreciation in April next year stop.

Commodities

Setback for gold

Broadly diversified commodity indexes are up 24-27% this year – one of the strongest years to date returns on record. Given the magnitude of these returns, apart from precious metals, forecasted return expectations have less room to run. That said, there is likely to be mid digit upside growth over the coming months.

Most market dynamics continue to point to a tight market backdrop for base metals, particularly in the US. Broadly based metal inventories remain low, and further pressure on inventories are likely in the coming months, as seasonal demand picks up across Europe and the US. Policy support will drive a pickup in demand in China towards the end of the year.

There is now a weaker environment for gold over the rest of 2021 and next year. No doubt, in the short-term, market participants will focus on the risks to growth from the delta variant and any signs of setbacks in the labour market. Gold is likely to fall to \$1,700/oz by the end of the year, and then decline further in 2022. Investors should hedge their gold positions or reduce their long-term holdings.

Equities

UK and Japan favoured

Global equity portfolio performance has further to run, driven by a rise in forward earnings growth forecasts, an expected fall in COVID-19 cases, and still strong growth activity. Valuations are still elevated in absolute terms, but growing earnings outlooks should pave the way for further gains in global equities. The upcoming tapering by major central banks could bring some volatility to the market but should not derail the overall trend.

Japanese equities look particularly attractive. They showed a strong performance over the summer, outperforming global equities by nearly 5%. After showing a rebound in late August, Japanese equities gained further upward momentum after the Prime Minister announced that he would not run in the Liberal Democratic Party's leadership race. The out-performance is likely to continue, driven by a catch up in Japan's vaccination rates with other developed countries, and solid earnings in the coming quarters.

UK equities have underperformed significantly recently. Despite the strong rebound in earnings, the UK stock market trades at a significant discount to global equities and future price rises are likely.

The energy super-cycle

Energy prices continue to soar. Brent crude oil was trading above \$82 as we went to print, a three-year high, after the OPEC+ group of producers said it would not add additional production in response to the price spike. US WTI futures are at a seven-year high. Dutch wholesale gas prices have also gone above €100 per megawatt hour for the first time. Prices have more than doubled since the start of September.

There was much talk earlier this year of a coming super-cycle: a prolonged period of rising commodity prices owing to structurally higher demand. Yet while energy markets boom, other commodities have come back down to earth. US lumber futures gained 600% between April 2020 and May 2021 but are now down by 40% since the start of the year. Copper rocketed to an all-time high in May this year but has gone nowhere in recent months. Still, in aggregate, commodities are up: the S&P GSCI index of 24 major raw materials has risen by 40% in 2021.

Most elements of the super-cycle story remain unchanged. The recovery from the pandemic, combined with lavish fiscal and monetary stimulus, should continue to power prices higher. Yet the prospect of coming interest rate hikes and signs that China's appetite for raw materials is ebbing are sowing doubt. The jury is still out.

The Economist thinks that this year's price movements look less like a super-cycle, and more like simple chaos. Stop-start lockdowns and geopolitical tensions are interacting in unpredictable ways. For example, iron ore has cratered on weaker Chinese steel demand. Yet coking coal, which is also used in steel production, is still glowing hot because of a lockdown in Mongolia, a major producer.

The energy transition is a key element of the case for a new super-cycle. Plenty of copper and rare earth metals will be needed to build all the fuel cells and green power grids of the future. But more efficient use of raw materials can bring down demand over time. Higher prices also encourage users to switch to cheaper alternatives: witness the use of aluminium power cables as a substitute for copper when the price of copper is too high.

More efficient use of resources, combined with new exploration, means that commodities are a surprisingly poor long-term investment. Deutsche Bank's Long-Term Asset Return Study notes that commodities have seen negative real returns of -0.8% per year over the last 100 years. Commodities should provide protection if inflation spikes but think twice before making them a large part of a long-term investment strategy.



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Alexander Wade

Alexander is one of the most experienced London advisers in the international market, specialising in this field over the last 20 years at HSBC, consistently recognised as one of its most accomplished advisers. He has over 24 years' experience in financial services. He is particularly interested in the Middle East market and understands the specific issues which are relevant there.



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.

New Additions to the Team



Michelle Bye joins the team as Business Manager, having worked in Financial Services for over 21 years. Her first role was back in 2000 when she joined a local independent financial advisory practice. By joining the firm during its infancy, Michelle gained experience in all the different areas of the business during its expansion. She managed all client events and business development campaigns and projects.

Michelle has overseen the successful acquisition of a local advisory firm by a National one and assisted the lead company in setting up its Learning & Development function.



Claire Hobbs has been appointed as Senior Client Services Assistant. Previously, Claire worked for a Founder Member and Principal Partner Practice at St. James's Place Wealth Management, gaining specific expertise in providing high quality client servicing. Claire has a very international background, since her father served in the British Army, requiring frequent relocation. After returning to the UK, she graduated from the University of Winchester with a degree in Media Production.



Kellie Lewis
Client Relationship Manager



Caroline Lvy
Client Relationship Manager



Kelly Kular
Personal Assistant
to the Partners



Daniel Hawes
Relationship Officer



Heidi Witham
Paraplanner