Something's gotta give: Han K. Lee tips shares to fall

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"After unprecedented stimulus, inflation will overshoot before things normalise again," says Han K. Lee. **Photo: Jesse Marlow**

Sally Rose

Veteran fund manager Han K. Lee says inflation is about to bite, leaving global sharemarkets set for the biggest tumble since the global financial crisis.

Prime Value Asset Management, the firm Lee co-founded with chief executive Y. Yong Quek in 1998, is again encouraging shareholders to think about keeping more cash on the sidelines.

Meanwhile, the investment team is looking for new ways to skew their Australian equities mandate towards companies with earnings underpinned by real assets, such as infrastructure projects and gold.

Lee and Quek have the loyalty of many of their clients as a result of advising them against piling more money into equities ahead of the start of the global financial crisis in 2007.

"We were a bit early in making that call, but the exact timing of a market correction is impossible to predict, and when a crisis hits, it happens faster than you have time to respond to," Lee says.

Australian shares will increase but, for the most part, the bull run is over and the inflationary risks are inevitable, he says.

It is the long-term effects of the unprecedented experiment in global monetary stimulus, led by the United States Federal Reserve, over the past six years that has Lee worried.

'Irrational exuberance'

The fund manager nods to the work of US economist Robert J. Shiller when arguing global asset values are being buoyed by what former US Federal Reserve chairman Alan Greenspan referred to as "irrational exuberance".

"About a year ago, it was weird that bad economic news was being interpreted as good news by the market, because it was seen as a sign that stimulus would be ongoing," Lee says.

"Vice versa, good news was eliciting a negative reaction from the market due to the belief it could signal a decline in central bank support. Now the situation is even more perverse. It doesn't matter whether the latest data is good or bad,

brokers are finding a rationale to interpret everything as an excuse for why shares should continue to rise."

Eventually, bad news will again be rationally greeted as bad, and when that does happen, the market could fall sharply, Lee says.

Investors need to prepare for high rates of inflation over the coming years, he cautions.

"Inflation will be very bad.

"After unprecedented stimulus, inflation will overshoot before things normalise again."

Current global central bank policy is being based on Keynesian economic theory developed in the 1930s, when economies were more contained, he says.

"Today, in a globalised world, the knock-on effects across markets and asset classes are more complex."

America has over-borrowed and overspent, while China has over-borrowed and over-invested, Lee says.

"Neither strategy is viable in the long term, so something has got to give."

'Economists should know better'

Lee is sceptical about just how well the real US economy is going, citing political manipulation of the employment data.

"Many more Americans receive food stamps, a pre-requisite for which is being unemployed, than appear in the jobless numbers. It's obvious why politicians want to discount the existence of the long-term unemployed who have given up hope, but economists should know better.

"America is running on zero real rates with lenders subsidising borrowers. It's the mother of all carry trades."

Another danger is that China's currency will depreciate.

"The renminbi will fall," he says.

"China has almost reached export saturation point."

One of the main reasons inflation has not caught up yet is that China has been exporting disinflation, but inflation will eventually come and the risk is it will come in a crushing rush, he says.

When global inflation starts to turn, investors will want less exposure to the financial system and more exposure to real assets, Lee says.

Now aged 77, Lee still has a pivotal role in the business; as director of investments, he develops the firm's macro-economic view that directs the focus of the stock research led by joint chief investment officers Shih Thin (S. T.) Wong and Leanne Pan. The team is busily searching for listed companies with earnings underpinned by real assets. Infrastructure groups are the most obvious hunting ground.

Scarcity of choice in the listed infrastructure space poses a challenge to implementing Lee's strategy, so a raft of slated government asset privatisations in coming months are of keen interest.

"We always look seriously at floats of government assets, particularly utilities or other infrastructure assets. Possible IPOs of government-owned service businesses, such as Medibank Private and perhaps later Australia Post are also very interesting."

Look for companies with large market share

More broadly, Lee's tip for picking good stocks is to look for companies with large market share, giving them a high degree of control over their customers and suppliers.

Woolworths, Wesfarmers, Amcor and Brambles are all good examples of that, as is Telstra, despite increased exposure to regulatory risks, he says.

Lee also likes the biggest iron ore and coal miners, BHP BIlliton and Rio Tinto, and, to a lesser extent, Fortescue Metals Group.

The current appeal of investments backed by real assets supports Lee's enduring appetite for investing in gold as a risk

hedge.

"When you buy a sovereign bond, you are relying on politicians to pay you back, and I don't trust politicians."

Although it is a concern that central bankers and financiers are manipulating the price of gold, meaning it is definitely an imperfect market, he says.

"However, the more important factor though is that consumers in China and India are buying more physical gold and that will drive real demand growth."

Unfortunately, just as there is limited choice on the ASX in the listed infrastructure sector, there are even fewer opportunities to invest in profitable gold producers, with the embattled Newcrest Mining the only major player.

"Top-down I like gold; sadly, bottom-up, there is not much to choose from. The kindest thing I can say about Newcrest is that the company has management issues."

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