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A Capital Endeavour

Published on: 9 February, 2024 | Author: Investment Team

In the 19th century, at the peak of Empire, Great Britain was simultaneously the "workshop of the world" and banker to the world.

Immediately prior to the explosive demolition of Edwardian gentility in the trenches of the 1St World War, it is estimated that 50% of the capital invested throughout the world had been raised in London's capital markets (assisted by those in Birmingham, Liverpool, and Glasgow and other, notably northern cities, all of which are now long departed).

In the absence of the deep capital markets that developed throughout the British imperial period, it would have been impossible to finance the growth and expansion of the long 19th century. The British invention of the "joint-stock" company permitted investors to combine their funds to participate in the, usually, large profits obtained by investing in wheat, palm oil, cotton, coffee and shipping, amongst all the other aspects of economic activity.

Interestingly, in a characteristic nod to the British upper-class, liability was unlimited lest "limited liability" lead to a loss of "probity" and a diminution of standards. The more commercially minded New Yorkers introduced limited liability as early as 1811; it took until 1855 for the UK to follow suit.

The words "unlimited liability" should send a shiver down every investor's spine. By contrast "limited liability" allows investors to invest only as much as they can afford to lose. It thus broadens and deepens the pool of savings available for investment.

The development of public capital markets allowed for the concentration and mobilisation of the "savings of the nation" making them available for current investment, and laying the ground for future prosperity.

Individuals, companies, and countries that fail to invest condemn themselves to a future that is poorer than it could or should be. Obviously, it helps if that investment is productive but any company that allows its depreciation charge to exceed its capital expenditure will eventually run itself into the ground. Investment is not a discretionary spend.

Given the importance of investment to economic well-being it is becoming clear that the events of 2007/8, the global financial crisis, has had a much more serious and long-lasting impact on the economy than had been anticipated. Virtually every major economy saw a dramatic fall-off in the level of aggregate investment during the crisis and few economies have fully recovered.

Prior to the crisis, total investment in the US was running at 23% of GDP, but at the trough it dropped by over 5 percentage points to 18%. The recent update to the IMF World Economic Outlook suggests that US investment, though on a rising trend, will be at 21% of GDP, still below that of 2007/8, as far out as 2028.

In the UK, though it is on a rising trend having troughed at 14% of GDP, investment barely recovers to 18% of GDP by 2028. Germany, France, and Italy all invest more. Spain is an interesting case, since pre-crisis, its total investment numbers were pushed sharply higher (30% of GDP) by excess investment in property but nonetheless, aggregate investment in Spain is running higher than that in the UK.

At the other end of the spectrum is China. It is well known that China has a high investment share in its economy and, by contrast with the West, a low consumption share. Immediately prior to the GFC, investment was 47% of the economy and even though the Party has moved to reduce investment, it is still some 42%.

As you may know, unlike the West, where we have been struggling to contain inflation, excess investment and excess production in China alongside weak export markets have conspired to create deflation (which in a highly indebted economy can be deeply damaging).

Looked at this from a top-down asset allocators perspective, the UK long ago ceded its status as the “workshop and banker to” the world to the USA. The deep and liquid pools of capital that once belonged to the UK now reside in the States; capital moves to where it is most productive.

The US remains the key high productivity/high investment economy on the globe and therefore it remains a magnet for international investment flows. Perhaps surprisingly, the key European economies are seeing a recovery in investment boding well for the future but, as the UK balance of payments would indicate, here in the UK, we have yet to find the appropriate balance between present consumption and future prosperity; we consume too much and invest too little.

Talk of the “China century” already seems quaint and as Mark Twain might have said, “reports of the death of US economic supremacy been greatly exaggerated.”