Ben Marlow
COMMENT

Failure to rein in pay only hands a gift to Corbyn

It is tempting to view last week's climbdown on pay at London housebuilder Berkeley Group as the biggest victory yet in the fight against boardroom excess. After all, chairman Tony Pidgley has consistently ranked among the best-paid bosses in the UK over the last decade so any clip to his earnings must surely send a message to other errant bosses.

Indeed, at one stage the housebuilder's turbocharged incentive scheme was so generous that Pidgley, and four other directors, were in line to collect the best part of half a billion pounds when the 10-year plan matured in 2021. It would have been the largest-ever payout at a UK-listed company.

The scheme was eventually capped after furious shareholder protests; Berkeley halved the maximum amounts that could be paid, but only after dishing out £92m in bonuses in 2016.

It has now been scaled back again after the climbdown failed to calm investor disquiet. Bosses will be forced to hang on to shares earned through the company's long-term incentive scheme for an extra two years. Pidgley and his fellow directors will also have to re-earn any shares that have not vested through the scheme by 2021 over the following four years.

The changes will be seen by some as a turning point in the battle to curb runaway corporate pay. Other egregious schemes have been reined in: Persimmon was forced to chop an eye-watering bonus for former boss Jeff Fairburn by £50m after howls of protest; WPP's Mark Read stands to earn nothing like the sums that ensured predecessor Sir Martin Sorrell regularly topped the pay league, and even turnaround outfit Melrose said future bonuses may be limited, after anger at a £167m jackpot for four directors.

Still, it's a bit too soon to be cracking open the champagne. Berkeley is hardly about to become a byword for corporate restraint. The housebuilder still handed bosses £32m last year, despite profits sliding by a fifth, and Pidgley being ranked among the best-paid bosses in the FTSE 100. He scooped £8.3m for the second year in a row, including a £200,000 salary, £8m in bonuses and around £57,000 of benefits including a company car and medical insurance. You are not about to see him checking into a flophouse.

> 'This is about a shift in the public mood. Excessive [bosses'] pay undermines trust'

It is true that there is more scrutiny than ever on pay. Theresa May's public register of firms where pay policies had suffered a shareholder revolt of more than 20pc is a welcome development, helping to name and shame the biggest culprits, but I'm not convinced it has had much of an impact.

Some progress has undoubtedly been made. Average pay packets for the bosses of Britain's biggest firms fell from £5.7million in 2017 to £4.6million last year. And the number of major revolts has fallen across the FTSE all-share index of around 600 companies from 47 to 40.

But there is plenty of evidence to suggest that things are going backwards at the highest levels.

Pay may have come down but the truth is that the boss of a large company will still take home in one year way more than most people could ever dream of earning in a lifetime. Last year, two-thirds of top bosses took home 100 times more than the average worker. Meanwhile, shareholder revolts have doubled at the blue-chips, with companies from AstraZeneca to BT and Shell suffering serious protest votes. This tells us two things: investors are becoming less tolerant but, more importantly, not enough companies are taking decisive action.

Boards complain about the subjectivity of corporate remuneration and the pressure to pay chief executives the going rate, while many bosses claim the complexities of running a large multi-national mean they earn their big pay packets. Then there's Standard Chartered boss Bill Winters who thinks investors are "immature" for protesting.

This is about a shift in the public mood. Excessive pay undermines the image of big corporates and trust in business, and inaction bolsters Jeremy Corbyn's crusade against capitalism. Business leaders need to wake up and see the bigger picture before it is too late.

Recession? What recession?

Red warning lights are flashing on the dashboard of the global economy once again, sending markets into blind panic. A steep fall in German industrial production, escalating trade wars and a succession of interest rate cuts in India, New Zealand, and Thailand have stoked fears of a worldwide recession. Investors have piled into the safety of government bonds.

Time to don the tin hats? When it comes to the world's largest economy, it depends on where you're looking. Economists at Standard Life Aberdeen suggest a 50pc chance of a US recession when assessing market data such as yield curve, credit spreads and equity prices.

But a quite different picture emerges with key economic indicators such as jobless claims, household debt, corporate credit and America's unemployment rate. Under that scenario, the fund manager's models spit out a much more modest 20pc chance. Don't panic just yet.

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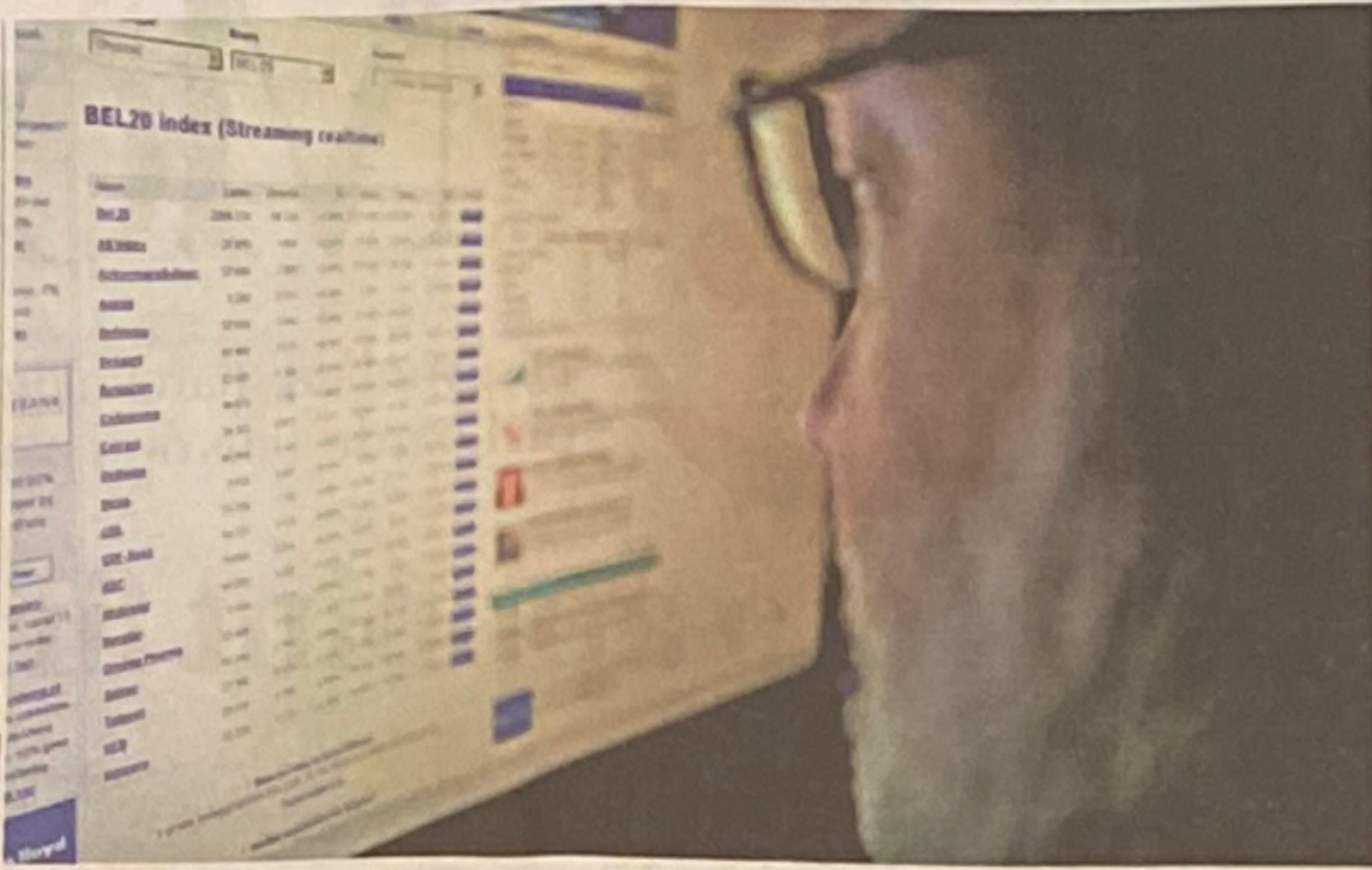
There is nothing wrong with short selling, but this one has a bad smell

JEREMY WARNER
VIEWPOINT



It never rains but it pours. The bad news just keeps on coming at the beleaguered Woodford Equity Income Fund. Just as you think things cannot possibly get any worse, they do, the latest bombshell being last week's 50pc plunge in the value of the fund's largest investment – the litigation specialist Burford Capital. Hapless investors in Woodford meanwhile remain locked in, unable to take evasive action as the vultures pick the last scraps from the corpse.

Amid all the dogs, Burford had been a rare ray of sunshine in Woodford's otherwise challenged assembly of investments, more than quadrupling in value over a two-year period. But then along comes the US short-selling specialist, the aptly named Muddy Waters, to pour a bucket of the proverbial over the AIM listed superstar. Burford's rebuttal of Muddy Waters' list of allegations, including the virtually actionable claim that the company was "arguably insolvent", was impressively comprehensive and convincing. There were some clear factual errors in the analysis.

But mud sticks, and even if every allegation made is entirely untrue, the damage has been done. It will take years to dispel the cloud of suspicion that now hangs over the company. For its part, Muddy Waters stands by its report, and insists that the substantive points were not refuted at all.

Short selling – the practice of selling shares you don't own in the expectation that the price will drop, allowing you to close the position at a profit – generally gets a bad press. Vilified by regulators, the media, targeted companies and many investors, this form of speculation does indeed sometimes seem a somewhat distasteful activity.

The short seller walks away with his instant profits, while the long-term investor, dutifully sticking to the principle that equity investment is about providing the economy with the capital to grow, gets hammered. No doubt a Labour Government would ban it, given the chance. And during the financial crisis, regulators did indeed outlaw the practice for systemically important banks and insurers.

Most of the time, however, short selling is a perfectly legitimate part of the price discovery process, and though we might disapprove of those who profit from other people's losses, that in a sense is what stock markets are there for. In a market economy, it is essential that capital is allocated as efficiently and justifiably as possible.

Short sellers frequently perform a service in shining a light on companies that really don't deserve the investment rating they command. On its website, Muddy Waters boasts of peeling "back the layers, often built up by seemingly respected but sycophantic law firms, auditors, and venal managements". It adds: "We pride ourselves on assessing a company's true worth, and being able to see through the opacity and hype that some managements create." And certainly, it has had some notable hits, including Sino-Forest, a Chinese timber merchant that claimed to manage millions of acres of commercial forest in Asia. Muddy Waters' gloriously named frontman, Carson Block, labelled the company a "multibillion-dollar Ponzi scheme". Nine months later he was vindicated when the company went bust.

There is nonetheless a bad smell about this latest exercise in "short, report, trash, pocket the money and run". If as a financial journalist I had done something similar – taken out a big short position in the shares and then published an article damning the company in question – I would rightly be out on my ear, and quite likely later prosecuted. Now obviously there is a difference between a newspaper and a hedge fund. With a newspaper, there is the reputational damage to consider.

It is important for readers to know that journalists are not personally profiting on the side from their analysis and commentaries. But with a hedge fund there is no reputation to lose. Their raison d'être is to profit from their investment view.

Even so, in an age of social media and mass communications, there is a sense in which we are all journalists now. In this case, Muddy Waters built up a 0.71pc short position, notionally worth nearly £200m, and then tweeted: "Muddy Waters is now in a blackout period until tomorrow 8am London time when we will announce a new short position on an accounting fiasco that's potentially insolvent and possibly facing a liquidity crunch. Investors are bulled up about this company. We're not." Mr Block claims the tweet was entirely innocent, in that it didn't name the company. Indeed, it was part aimed only at picking up London followers for his Twitter account, he bizarrely insists.

But investors soon guessed who he was on about and started dumping the stock. There were also big falls in Rolls-Royce and NMC Health, on speculation that Muddy Waters was about to give them the treatment. Mr Block's report on Burford was then duly published and the shares plummeted further. The position was partially unwound, leaving Muddy Waters tens of millions of pounds richer. If it walks, swims and quacks like a duck, then it is probably a duck. No doubt Muddy Waters is satisfied about the legality of its actions, but regardless of whether its hatchet job on Burford is correct, in most people's understanding of the term, this looks suspiciously like market manipulation, something Mr Block denies.

But don't take it from me. Muddy Waters may have chosen the wrong target in taking on Burford, its chief executive, Christopher Bogart, tells me, not because the company's business model and accounts are beyond criticism, but because it is staffed by extraordinarily experienced and aggressive US litigation lawyers. "We are uniquely qualified in this department, we have launched our own market manipulation investigation, and we aim to go after them," he says. The fund management group Invesco, accused separately in the report of "unethical behaviour", is also consulting its lawyers. Mr Block naturally refutes the charge, which he insists wearily, is said about virtually all his reports. Legitimate criticism is always met with ad hominem counter attack, he claims, but in the end he has a history of being correct.

Burford had been a rare ray of sunshine in Neil Woodford's investments, more than quadrupling in value over a two-year period, that was until last week's accusations from Muddy Waters

> 'The Brexit supporting Crispin Odey has accumulated a number of big short positions in prominent UK companies'

As I say, there is nothing wrong with short selling as such. A lot of this activity nonetheless sticks in the craw. As it happens, current short selling activity in the UK market is not particularly high by historic standards. But there are some notable exceptions. The Brexit supporting Crispin Odey has accumulated a number of big short positions in prominent UK companies. And there you were thinking Brexit was meant to be a patriotic pursuit.

There is also nothing wrong with research that highlights legitimate concerns about a company's business model and its accounting practices. On the contrary, it is vital that this service is provided. But when publication is conjoined with a large short position, it all gets a little suspect. We are privileged in this country to have such free, open and transparent equity markets, so it is doubly important that these freedoms are not taken for granted. Already you can hear the thundering hooves of the regulators in hot pursuit.

Perspective needed about world economy

GERARD LYONS

The world economy is slowing. Since the beginning of this year, expectations for global growth and trade have eased. Inflation forecasts have also been trimmed. In turn, monetary and fiscal policies at a global level have been relaxed and will continue to be.

While one should take downside risks seriously, this policy easing should allow the global economy to stabilise later this year.

Friday's news of a fall in the UK's second quarter GDP figures cannot be seen in isolation from this global downturn. Stockpiling in the first quarter, plus uncertainty over Brexit which has dampened investment, clearly did not help. But the weakness of global manufacturing is also part of the backdrop. Last week also saw a collapse in German production.

Thus one needs to retain perspective about the UK economy, where the solid labour market and stronger wage growth with easing inflation should underpin consumer spending in coming months. There is also scope for policy easing. Of course, how Brexit is resolved will be key.

The world economy grew strongly from the middle of 2016 and into last year. Then it weakened, triggered by monetary policy tightening globally, tighter policies in China and trade tensions. Since then, the first two of these have reversed but the trade dispute between the US and China has escalated.

It is the latter that is the worry. As the International Monetary Fund (IMF) said: "Consumers in the US and China are unequivocally the losers from trade tensions." Any escalation would reduce growth in the US and China and there would be wider contagion, as it slows global demand, dampens trade, adds to uncertainty and disrupts global supply chains. Two recent events have spooked financial markets. One was President Trump's announcement of further tariffs on all imports from China, effective from Sept 1. This signalled an escalation of the trade war.

The other was a weakening of China's currency last week. This triggered fears of a currency war, where other countries would allow their currencies to depreciate. These fears are premature but indicative of the current cautious mood. China may not shift currency policy, but if it did it would exacerbate global competitive pressures, hitting economies elsewhere.

This has triggered a flight to quality across financial markets, including government bonds and triggered volatility in equity markets, given the juxtaposition of high valuations and downside economic risks. Last year the world economy grew at a solid 3.6pc. This year the IMF expects 3.2pc. (Anything around 3pc is regarded as weak).

In recent years central banks have been raising rates. For some the aim was to normalise policy, for others it was a response to stronger growth. Now we are seeing an about turn.

There is now a long list of central banks that have cut interest rates this year. Last week it was the turn of Thailand, India and New Zealand. The previous week included Brazil and the US.

Central banks should not be criticised for their previous tightening but instead congratulated for their responsiveness in easing this year. We are witnessing again how monetary policy can respond quickest. But in the future there is the expectation that fiscal policy will have to do more.

Global bond markets have seen yields plummet. Over $15trillion (£12.4trillion) of global government debt now has negative yields and a further $30 trillion yields less than inflation. This means investors are worried and governments are effectively being paid for borrowing. Trouble is, high global debt is already a concern. That's the dilemma. Notwithstanding that, current negative or low yields, as in the UK, where 10-year yields are 0.5pc, should incentivise borrowing to fund much needed infrastructure. This fiscal action should further help UK growth.

A man walks past a money exchange shop decorated with banknotes at Central, a business district in Hong Kong

> 'Central banks should not be criticised for their previous tightening'

Global bond markets are signalling that there will be recession in Western economies, or that interest rates will be cut aggressively to prevent this, or at least ensure it is a minor one.

Another gauge of weaker global growth and subdued inflation is the oil market. In the second half of last year oil supply surged just as demand slowed. By the first quarter of this year oil demand was exceptionally weak. According to the International Energy Agency, oversupply is expected to continue until next spring, suppressing prices.

Given the damaging economic implications, one might expect the most likely outcome to be a resolution to the US-China trade dispute. However, geopolitics may prevent this.

North East Asia warrants close attention. This weekend, Japan and China hold their first strategic dialogue since 2012, focused on bilateral ties. Prime Minister Abe of Japan, meanwhile, is expected to meet President Trump on the sidelines of the late August G7 meeting in Biarritz as Japan and the US finalise their planned trade deal.

Also, there are signs the trade spat between Japan and South Korea is on the way to being resolved. In early July, Japan tightened regulations on exports of three high tech materials to Korea, vital for their supply chain. Last week Japan took the first steps to resolve this. Thus not all news is pessimistic.

Likewise, in China, trade data and domestic policy suggests China's 2019 growth will achieve the official 6pc to 6.5pc target. China looks set to achieve the target it set itself in 2010 of doubling its economy, in real terms, within the decade. In recent years the fastest growing region is South Asia, with its vast young population. Since 2014 it has grown at more than 7pc. If this is sustained for a decade, that region's economy will also double in size in a decade.

Thus, while we need to be vigilant about how the US-China trade dispute will unfold, before we become too pessimistic some perspective is needed. The world economy is growing. But more of that growth is explained by emerging economies.

This summer the US recovery became the longest ever. Yet, while long, it is weak by historical standards. Indeed this ageing expansion has fed market fears in recent years of an eventual downturn. Emerging economies led by China will prevent global recession but they will exacerbate the competitive problems in the West, keeping inflation, rates and yields low.

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