JUSTIN'S COMMENTARY

Justin Urquhart Stewart is one of the most recognisable and trusted market commentators on television, radio and in the press. Originally trained as a lawyer he has observed the retail market industry for 30 years whilst in corporate banking and stockbroking, and has developed a unique understanding of the market's roles and benefits for the private investor.

ARE WE OVERHEATING YET? HOW CAN WE TELL?

Domestically we are all used to signs of overheating - with everything from the kettles squealing, boiling saucepan lids clattering and even mopping our own brows when we realise that the sun has come out at last. We know these signs and we usually know what to do. However when it comes to economics and economies we seem happier to look in the rear view mirror and to try and see if the last problem is about to repeat itself - again.

If there is one thing we can say, it's that the next financial crisis will be different from the last one. Of course that doesn't stop the politicians and regulators from banging on about tightening controls to make sure "there is no repeat of any such disaster". So they will take action to try and stop yesterday's problem and promptly walk straight into the next one.

So what should we be looking out for?

Riskier Mortgages

All areas of overheating should be identified and already you can see the start of such areas developing. Last week we saw the significant return (by which I mean a sizeable rise in approvals) of higher risk mortgages of 90% Loan To Value (LTV). You may recall that 125% LTV mortgages appeared before the financial crash when Nationwide and Northern Rock came out with a small number of these. So with their return we can see that the attitude to risk from the providers is changing.

Private Equity deals

Now look at the growing number of corporate deals being done. These can be the floats by many of the private equity firms trying to clear out their stale portfolios that they couldn't cycle before, through to the number of deals they are trying to close. However it's not the deals that worry me, but rather the surplus amount of cash that there is around, chasing a limited supply investment opportunities. For many of the private equity firms, if they can't find anything to invest in then they will often have to return their investment money back to their investors and in doing so effectively do themselves out of a job. Therefore rather than do that, they will chase any deal, and in doing so run the risk of greater risk at greater cost and thus build up an investment credit risk which will explode when the cost of money does finally start to rise.

Cheap Money

The QE money has flooded the markets and to an extent has done its job of maintaining and sustaining the system, however with rates at rock bottom cheap money will be thrown at just about anything. Last week we even saw the Swiss selling their national 10 year debt at negative rates of minus 0.055%. Now Germany, Austria, Finland and even Spain have sold shorter term debt at sub-zero yields, but for medium term ten year paper, the Swiss offering was a record. Oh yes and it was all sold - and in fact comfortably oversubscribed.

The effect of cheap energy; more corporate deals

The price of crude oil has changed much of the financial structure of most countries, some negatively (from Russia to Venezuela and even Scotland) and others who consume the stuff, like China, India and Japan, very positively. However think of the industry itself. Suddenly the cost and need for exploration has just disintegrated - unless it just pops out of the ground by itself. I am sure some maybe excited by the potential of "Texas tea" in Surrey but the financial benefit is going to be far more marginal at only $50 to the barrel.

This then leads onto the forthcoming raft of corporate deals that will be being considered in this new world. Following on from the BG and Shell deal, others will be being considered now, just as when in 1998 with a weaker price we saw a raft of deals done like BP and Amoco. Now though we will be seeing a greater number of deals rippling not just through the majors but I suspect through the entire food chain of the energy industry.

Now this of course will be good for the corporate advisers and other investment leeches who will no doubt be proposing opportunities to their clients to try and manufacture corporate deals. As we have seen before "opportunities" will be offered to one side and, if rejected, then offered to the opposition. If you are being cynical about it, then it does look like a form of very polite corporate blackmail. So deals can be good for advisers, but not always good for companies, although in the short term provide a fillip for investors as markets overheat with merger mania froth and punters try and guess the next one.

So please be aware, we have had a great quarter when nearly all assets (except most commodities and Brazil) did well, and bonds and equities mostly went up. This has been a long bull market fed on cheap money, low demand and low growth. For us as investors we can enjoy the ride for the moment but we must all be prepared for the bull to buck. It could be a hotter summer than many expect.

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And finally...trouble with the neighbours? Building a dodgy extension, digging an underground flat (grrr - my current angst), or even an appalling roof extension; these can all be terrible developments from a neighbour. However as yet I have never gone quite as far as moving the local river.

Now it seems a Washington state man has been convicted of environmental violations after he used an excavator and a bulldozer to try to fill a section of the Tahuya River and change the waterway's course.

A jury in Mason County found William Cayo Sr. guilty of violating water pollution and shoreline management laws as well as conducting prohibited hydraulic activities when he changed a Tahuya River channel. His unauthorised work filled one channel of the river, removed a bend, and deepened and straightened another channel.

"In dodging the proper environmental review and planning, Mr. Cayo did serious damage to the Tahuya River and put fish, wildlife, and his downstream neighbours at risk," an official said. Mr Cayo faces up to 364 days in jail, a possible restitution order and up to $16,000 in fines.

On balance I think I will stick to the roof extension as straightening the Thames would just be too complicated, and make the Boat Race even less exciting.

Have a good week.

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