

PROFESSIONALS' VIEW – OCTOBER 2010

Mr Bean speaks Out:

Mr Charles Bean, the Deputy Governor of the Bank of England, has reportedly told savers to “stop complaining about poor returns and start spending to help the economy....Older households could afford to suffer because they had benefited from previous property price rises” [*The Daily Telegraph* 28.10.10]. One can only assume – nay, hope – that these comments have been taken out of context for if they are accurate it simply helps to illustrate just how (and we use this phrase twice in consecutive months) jaw-droppingly detached from the “normal” person our senior civil servants have become.

Following the logic of Mr Bean’s argument, those at the top of the public sector pay tree should be more than ready to accept cuts in their salaries as they have “benefited” from generous superannuation contributions in the past which have allowed them the luxury to retire on index-linked pensions mirroring their final salary. These will ultimately cocoon them from the current uncertainty over whether we face imminent Japanese-style deflation or rampant inflation on the back of the QE experiment that the world has recently witnessed. With an index-linked pension it doesn’t really matter a jot, which way the pendulum swings. Your real income will remain steady. For the rest of us it can be life changing, making it even more essential that we hang on to as much of our hard earned as we can as some kind of protection against whatever the future has in store for us.

MoneyWeek published figures suggesting that the average public sector worker is paid £615 a week (once the pensions and sickness benefit contributions are included) compared to the average private sector pay packet of £479 a week. In the three months to February, private sector pay rose 1.8% on the year while public sector wages rose 3.7%. Yet in recent years apparently “private sector productivity has risen 20% while public sector productivity has fallen 3%” [*MoneyWeek* 24.10.10]. If the Government simply cut the public sector pay to that of the average private sector employee, they estimate that it would lead to savings of around £42 billion, starting by capping salaries over £150K to £150K. We somehow think that this would be as

unrealistic, or welcome, as telling those who have saved for retirement to stop complaining about their lot. It’s a shame that there is no practical way to do an obligatory job-swap between public and private sector workers to gain an appreciation of each other’s worth.

Back In The Real World:

None of this posturing helps those whose reality is ingrained in the fact that interest rates today are punitively low for anyone relying upon them for their income. The irony is that those who have taken the “risk-free” route to investment in the form of deposit account saving are those who now face the biggest risk of eating into their capital to survive. If ever there was a lesson in sensible, risk-adjusted, long-term investment strategies, this is it. Anyone who has time on their side with regard to their own retirement planning would be well advised to give it their utmost attention right now, while those who are suffering from not having considered alternative forms of income-producing investments in the past should be encouraged to do so now.

We make a prediction though. Fast forward the clock by about five years and we forecast that there will be thousands of incidents of people who have not taken a risk to date having broken free of their risk-free shackles at precisely the time that they should not have done so.

No one actually knows what lies in store for us all. We read about bond bubbles inflating. We read about Government deficits and sovereign debt defaults. We read about deflation in the same sentence as stagflation (just like this one!). No one actually knows.

Interestingly, one word that has slipped out of common use is “contrarian.” It was not that long ago that everyone claimed to be a contrarian investor, as no money was to be made by following the herd. The very fact that everyone claimed to be a contrarian ensured that contrarianism became the new consensus. But now there is no consensus, as no one can agree which camp they sit in. We have bulls v bears, deflationist’s v inflationist’s, coalitionist’s v New Millilabour. Clear divisions are forming in opinion, which is probably not such a bad thing, as time will prove some of us more right than

others, and of course vice versa. As Stewart Cowley, head of fixed interest at OMAM, says, “there will be reputations won and lost in the next three years” [*Investment Week* 27.10.10].

For his part he makes the bold prediction that gilt yields will plunge to 2% by the second quarter of next year but that they will more than double over the next 12 months. This basically supports the view that a bond bubble is indeed inflating, but not as quickly as some people are suggesting. If he is right (and it is a big if) then those who have exited the gilt market in favour of more “risky” assets already may have gone too early. But, *if* he is still right about the doubling in yield then the bubble theorists are very much correct, if slightly premature, and one does not want to be anywhere near the “low risk” asset class of Government bonds when it bursts.

And herein lies today’s problem. Timing has never been more important. To buy and hold *any* investment appears to be an extremely risky strategy right now as those with a low risk tag can become toxic while the higher risk assets may provide some comfort. Will the bulls who expect a double dip to be avoided and low, sustainable growth to continue be proved correct, or will the bears with their deflationary hats on, muttering about something dark and dreaded lurking out there somewhere, have their day. We suspect it will be a bit of both, and nimbleness and flexibility in investment decision-making will be key to a good night’s sleep in the coming months.

How Quick Can You Get Your Burger?:

A strange question but bear with us. We can often over-complicate things by poring over the tiniest piece of data and analysing it to the “n”th degree, while the answer may be staring us in the face. If you are confused about double dips, bulls, bears, bubbles and the like, it does not hurt to draw upon anecdotal evidence sometimes for a clue. For example, when the taxi driver discussed his latest dotcom venture, it was time to exit technology. When the cleaner (how bourgeois) wanted advice on their buy to let portfolio it was probably a good time to sell them yours. When the TV schedules are awash with programmes about how easy it is to make money out of something, it is time to tread very carefully indeed if you own any of what they are spouting off about.

We heard recently about the manager of a rock band who, when discussing investment opportunities, perked up considerably at the mention of Latin America. “We used to sell out gigs easily in the US,” he said, “but of late that’s been harder. But if we do a gig in Rio, Buenos Aires, Quito or Lima they don’t think twice about paying \$40 a ticket down there.” Maybe this isn’t the most compelling reason to invest in the region, but perhaps it is telling us something about the relative strengths of the different economies. Similarly, when trying to weigh up the probability of a double dip, look around your own environment. Are the restaurants empty, or is it still quite difficult to walk in and get your table? How busy are the local pubs? Are there as many “Sale” posters on every High Street window? How easy is it to get a builder to turn up at your house to do – and finish – a job? Have you tried to book a room in a London hotel at short notice recently?

All of these may shed anecdotal light on the robust, or otherwise, nature of the economic recovery without the need to pore over every GDP, output, national debt or any one of the myriad of numbers that we see daily. Or, you can simply trot off to McDonalds and order a Big Mac. According to Eli Lehrer, national director at the Centre of Finance, Insurance and Real Estate at the Heartland Institute, [*Fund Strategy* 27.10.10] McDonalds offers a snapshot of a local economy, offering poor service in a thriving economy and vice versa. Why should this be? “In a bad economy, skilled workers may be forced to work there, but as times improve, they quickly leave. In a good economy, McDonalds will have a hard time filling jobs” with the result that some of the poorer job candidates will be taken on, with disappointing consequences for one’s French fries.

Just don’t go too large.

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