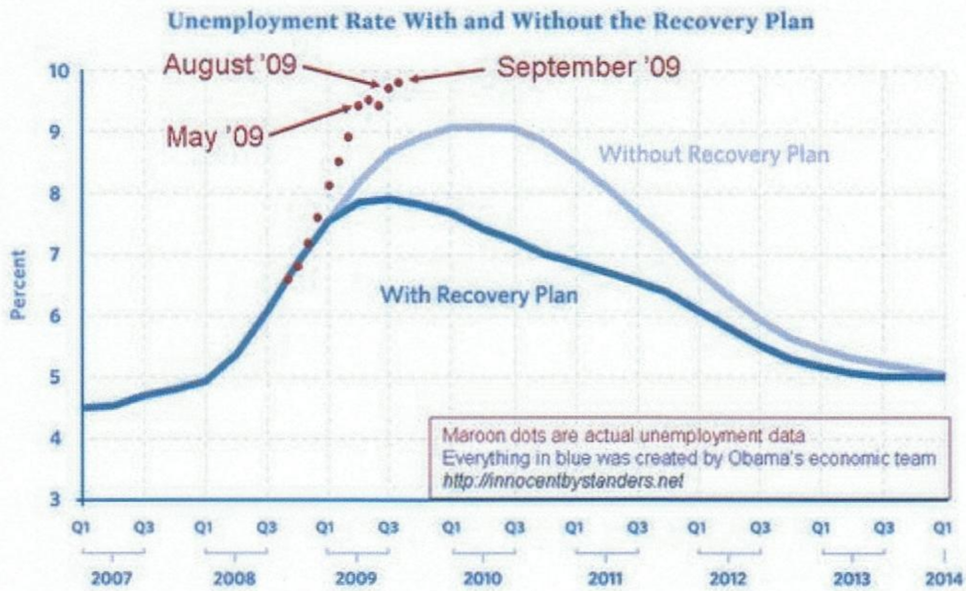
Armstrong Davis

Leading the Management of Wealth

December 2009

We have pleasure in sending you the Winter 2009 edition of our Financial Bulletin, enclosed.

US Unemployment (Chart produced October 2009)



The US jobs' numbers, which came out on 4 December 2009, were hailed as the start of the end of the recession, with the unemployment rate falling from 10.2% to **10.0%.** What they don't say includes:

- There are 9.28 million people working part time in the US who would rather work full time. Last year it was 7.3 million.
- There are 2.3 million (up from 1.92 m a year ago) who were not counted as unemployed (the 'Marginally Attached').
- There are 291,000 more NOT in the labour force.

The unemployment number fell by 325,000…

Real US unemployment, from the US Bureau of Labor Statistics, is actually **17.2%** and will likely continue rising to 2011. Recovery? Not even close.

UK Housing Market

Some national economics' journalists (ask me and I'll to you who) have been doing their best recently to get it wrong as usual. They're saying Buy-To-Let (BTL) is strong at this time (November 2009) because **gross lending** is up from the very low base of 2008 and showing the first rise in 2 years. Apparently, Cluttons (maybe they should be called Gluttons!) estate agents say that professionals such as accountants and doctors are buying property as investments. So when did accountants and doctors become investment experts? What they don't tell the hundreds of thousands (millions) of opinion formers who read the broadsheets' business sections is that the Council of Mortgage Lenders also reported the lowest BTL remortgaging in 2 years. Thus, all those hundreds

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of thousands of BTL mortgages, taken out between 2005 and 2008 at ridiculously high Loan To Value percentages and on big discounts, cannot be remortgaged away from ultra low variable rates.

What's going to happen when mortgage rates rise further, as they have this year? (Not the Bank of England base rate but – due to the ongoing banking crisis – higher and higher mortgage rates actually charged.)
BTLers will hand the keys back, or they'll be repossessed as they cannot charge the rent they 'need'. So, on top of **expected falls in capital values** they will also lose on monthly income v outgoings. Some economics' writers have been the biggest apologists for Brown and the Labour government in the mass media and they have consistently said there is no major long term problem. It's all sorted. Move along, nothing to see here.

Well, they got it wrong about the banking collapse (essentially saying the problem is now nothing to worry about) and the property crash which started in 2007 (essentially saying there would be no crash right up to that point - and beyond!) and they continue to forecast through rose tinted glasses. **They preach money printing as the solution. Actually it's the problem.**

Note where bankrupt Iceland is, on the chart above. Didn't Gordon Brown say the UK is 'best placed' to weather the economic storms? How do you know a politician is not being straight with us?

We have the largest peacetime government debt in history. In the 70s, when Denis Healey went 'cap in hand' to the IMF as we were practically bankrupt, we were borrowing around 7.5% of national income. Within a few short years from now, our government has put in place, in our name, that we will owe more than our national income? (The Tories would have done the same had they been in power.) This as the tax take is falling due to higher unemployment and lower corporate profits. This as inevitably the global lenders slow down their purchases of government gilts thus raising our long term interest rates and mortgage rates. So, not only will we have to pay the hugely rising interest

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each year but somehow also pay back the debt. So, our taxes will have to rise after the election – and stay high FOR YEARS AND YEARS. And public spending will be scaled back for years and years.

Conducive to long term recovery in the economy? The housing market? The commercial property market? Of course not. The same is evident right across the world (though our position is the worst in the developed economies).

Conducive to a sustainably rising stock market long run? Very doubtful.
Short run into 2010? Why not – the stimulus is simply huge and continues to affect markets positively. (Markets. Not economies). Bingo! Bankers win yet again. How do *you* feel about your taxes rising and rising and interest rates rising and rising etc to pay for a few thousand people to receive £ million or £ multi-million bonuses? This week's alleged proposal to tax the banks is paltry and will achieve extremely little, financially.
(When inflation takes hold markets may well rise though our economy will become even less competitive. So we would have rising pensions but we will also have rising prices in the shops and yet fewer jobs etc).*

1% Housing tax on £2m+ properties
Finally, we hear of a sensible proposal from politicians – from the Lib Dems. Of course, it'll never happen though it should. How can it possibly be sensible to heavily tax income and wealth generation (Income and Corporation Taxes) yet not tax the entirely unproductive use of capital i.e. housing?

As we do not tax housing, that is why we are a nation of property transactors, as opposed to an economy which makes world-leading industrial equipment and cars like Germany. I know I'd rather we had their economic strength than our disaster of an economy. Wouldn't you?

So, how does all this relate to our services as wealth managers?

- Well, our client **portfolios have grown around 15-30% over the last year** (to 5 December 2009) depending on the portfolio. Yet, we have not chased the stock market – too volatile for us. We have continued to hold a capital preservation mentality, in a continuing deflationary period. (When inflation arrives then we will be prepared for it and we will move our objective to preserving purchasing power.)
- We believe – as we have been told – that our clients do not need to fret about their savings and investments. However, we have participated in the almost unprecedented rally. Clients' portfolios – those who have been with us since before the crash - are *all* **above** where they were in October 2007 – the start of the crash – while, for example, the FTSE is still **down 20%**.
- We shaved some exposure from the stock market some weeks ago, in order to **lock in some extraordinary gains**. We prefer to sell at highs and buy at lows. (Wouldn't you?)
- ***Price is price and value is value.** They are not one and the same. Unfortunately that simple thought has been schooled out of the masses. Real value is enduring. I find value in Google. I find value in electric motor vehicles (so why are we putting billions into a 100 year old industry, via the Scrappage Scheme, which might be dying in only 10 years?). I find value in sharing time with my wife and our friends. I find value in remaining financially viable.
  I do not find value in an unpayable black hole.

  Yet politicians, estate agents, car salespeople, buy-to-letters, stockbrokers and bankers (above all!), traditional unit trust managers, 'financial advisers' et al will argue 'till they are blue in the face that there is nothing *much* to worry about. The economy is basically sound and we will in due course get back to where we were.

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Back to loose lending? Back to an economy based on buying and selling houses? Back to a decimating currency? Back to an entirely uncompetitive economy?

I certainly hope not! The fact that the stock market has risen dramatically this year, and residential and commercial property have also risen, is merely hot air. It is simply a set of prices. It does not represent long term value. When house and commercial property prices had risen 15 years, until 2007, and we said they will fall dramatically (and everyone else said they will not fall) and the same for the stock market, who did you believe?

That they are saying the same things now (plus ça change..!), who is more likely to help you preserve your wealth and your lifestyle or those of your clients?

Ask us what we can do for you and/or your clients. What can you lose?

With kind regards,

J. Davis

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Bulletin

Winter 2009

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For this Bulletin, we are indebted to Greg Pytel of the blog

"FINANCIAL CRISIS? IT'S A PYRAMID, STUPID." for allowing us to use his 25 October 2009 diatribe:

"Will the UK go bust after the elections?

Sir Howard Davies made some very refreshing comments at recent HSBC clients' gathering in London. It is clear that the public do not understand the scale of the crisis which was caused by a collapse of the giant pyramid scheme. The demands of those who are still at work, from postal workers to university professors, make it clear that the current crisis appears as something unreal. And, ironically, it is.

The government have no idea of the size of liquidity hole they are trying to plug. It may still be some hundreds of billions, if not trillions, of pounds. On top of that they keep on spending money to sustain artificially the lifestyle the UK cannot afford any longer (if it ever afforded at all). This puts the country in even more debt. As the government does not want to lose the next elections (or to lose them by the least possible margin), they keep the public in delusion of affluence like someone who got unemployed and is draining his credit cards to their limits.

The Conservatives, seeing the public mood and appetite for continued high lifestyle, are too afraid of telling the harsh truth: that the UK is already in a very deep debt hole and tightening of the belt has to start now. They do not want to be accused of scaremongering by the Labour, which may well result in scuppering their elections chances of near-certain (at the moment) victory.

It is this rather unholy alliance of interests of both sides of the political spectrum: the Labour's and the Conservatives' contributes not only to irresponsible but economically irrational behaviour. We try to live financially as nothing has happened. After the publication of the recent economic figures, the time till the next elections increasingly looks like the last dance on the Titanic. The reality check will come after the elections. Doesn't matter who wins: there is a pretty good risk that the UK will be bust by then."

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I believe Mr Pytel has nailed it. His blogs are incisive and very well researched and informed, a little dramatic however no-one said Shakespeare was the worse for being dramatic (well perhaps Ben Jonson 1572-1637).

We would not be surprised at all if the next two ONS announcements of GDP are positive – just in time for the election. Inevitably, given the macro reality, the ending of the recession can only be temporary. After the election, taxes will rise and government spending will be cut. (Either greater or smaller, depending on who wins. The result on the economy and assets will be the same).

So, the stock market has had the incredible run over the spring and summer – the biggest summer rally in 60 years. Our clients, on a bespoke advised basis, reduced – a little – exposure to stocks and commodities in the weeks ending 9 and 16 October 2009, thus locking in some more extraordinary gains created by Govt.con. We still steer clear of illiquid property. Incidentally, on 28 October I wore my tin hat again when I returned (having done so in 2008 also) to speak at *"Survive and Thrive 2009"* – the national conference of... Estate Agents. It's a funny old world...☺

There are some very interesting developments taking place in the world of the markets. Deflation or inflation? That is the question. Now what is the answer?

What do you need to do to secure your position and your future?

Contact me to discuss how we can help you or your clients.

Jonathan Davis

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