

ECONOMIC UPDATE

Winter 2010

'There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency'. John Maynard Keynes, father of, er, Keynesian economics – to which we are all subjected, more's the pity.

As wealth managers, who seek sound money and also honesty in politics and banking, like him or loathe him, we are inclined to agree with much of what Nigel Farage of UKIP says on economics. If you haven't seen him talk, you may wish to spend a few minutes watching this: [Nigel Farage on Ireland, Portugal etc and Euro 24 Nov 2010](#)

We do not agree with him that the Euro (by and of itself) caused the nation bankruptcies of Ireland and Greece, to name just two that have already happened and there are more due to happen. However, it didn't help. I remind you it took a civil war and 100 years for the US to accept a common currency. And they had one language!

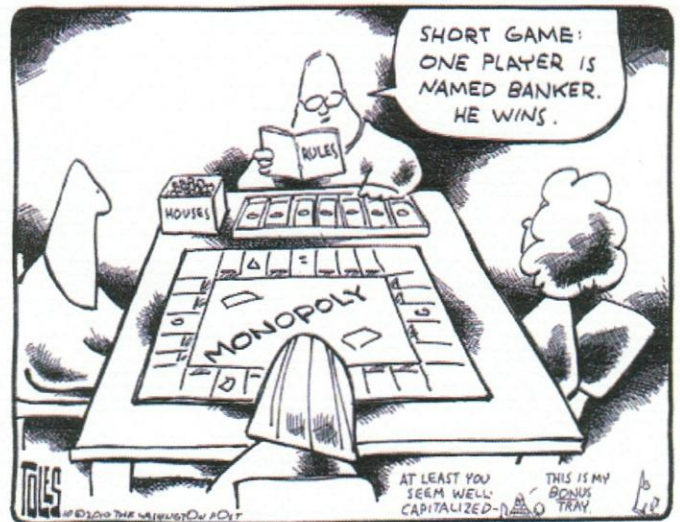
So, Ireland is now bankrupt. T'was inevitable due to the colossally bad lending over a decade. We, the UK taxpayers, are in hock for hundreds of billions of the debts. As we are for Spain and Portugal etc etc. Who'll bail us out...? The problem is the huge pretence that there is no major problem. The fact is we are in the fallout of the biggest debt bubble in history. The last one was Japan, as we wrote about in the Autumn Bulletin. The previous one, everyone knows a little about in the West, was in the 1920s, leading to the Great Depression of the 30s.

"Capitalism without failure is like religion without sin" Charles Kindleburger

All the apparent costs of all the issues in our society pale into insignificance to the amount we handed over to bankers.

Welfare cheats - £1.5Bns. Tax Evaders - £7Bns. Housing Benefit - £12Bns Etc.

Yet, we gave the bankers £850 Bns in 2009. This towers over EVERYTHING ELSE. All of our economic and societal ills would be averted if only our government had the gumption to tell the bankers 'never again will we bail you out'. We do not have capitalism in banking. We have socialism. When they make money they make money. When they lose money (never small amounts!) they are bailed out by the far less wealthy taxpayers.



Jonathan Davis Wealth Management
www.jonathandaviswm.com | Tel: 0845 862 2919
Correspondence: 6 Riverside Avenue, Broxbourne, Herts EN10 6QZ
City: Token House, 12 Tokenhouse Yard, London EC2R 7AS

The day after any government made that announcement our currency would go through the roof. Import costs would plummet. We would have the most attractive nation on Earth into which to invest. Everything would be cheaper and we could start to borrow, spend, invest and employ. Until then, we shall more likely remain in Depression.

I fail to understand why elected politicians (anywhere apart from, apparently, little Iceland!) will not allow banks to take losses after they lent to consumers with no possibility of being repaid and to governments, like Greece and Ireland, at the same rate of interest as they were lending to the far more successful and prudent Germany. If any reader has a clue, let me in on it, please.

Until we sort out the banking system and industry we will not grow our economies.

George Osborne says he's sorting out our banking by levying a tax on profits of £2.5Bns. Yes, 2.5 v 850 we gave them. The bankers are again laughing their heads off while we pay extra taxes (direct and indirect eg tuition fees), have lower public services and higher unemployment etc. And they pretend they're doing something...

Just so readers realise how atheistic we are about politicians (i.e. they're all a shower), last time, we railed against New Labour. Well, as I am showing, The Tories are no better. Whenever they talk about 'the cuts' to help our finances, remember all they're *proposing* is a reduction in *the rate of increase* in spending. Thus, they'll take us back to 2006/07 levels – hardly major. There was an interesting programme on Channel 4 in November called Britain's Trillion Pound Horror Story. I wonder if you caught it. It was wholly opinionated, however it informed us of some interesting insights. For instance, there are c 6-7m employed by the state, one way or another. If you add up all the front line staff, namely, nurses, doctors, teachers, policemen, firefighters, soldiers etc, they come to 2m. What on earth do the others do? More to the point why will no government ever do anything about it, until its way way too late as in Greece and Ireland? Come on George, do what's best for the country and reduce how much we owe, not just how much we're borrowing.

GDP may not go significantly negative in the near future. Thus, they will say we haven't gone back to recession. However, without at least 2%+ growth each and every year it will feel like recession until we do get that kind of number consistently. We know unemployment will rise by hundreds of thousands and we know the long term unemployed numbers have risen dramatically. The numbers moving from full-time to part-time (involuntarily) have risen dramatically. The number of bankruptcies have risen dramatically. As will home and commercial property repossessions (just look on any High St for the To Let signs). GDP growth, without the majority experiencing it, is illusory and just statistics.

NB. If you are sitting in a traffic jam with your engine idling, that contributes to GDP. If you get divorced, that contributes to GDP. So, when they announce the monthly GDP statistic, take it with a pinch of salt. Perhaps a new definition of GDP is what is needed...

Who to trust with your money?

I see huge wealth managers, in this case UBS, are in the dock for funnelling \$2Bns of client investment funds to arch fraudster Bernie Madoff. Apparently, investors should trust multi billion \$ companies purely because of their size. No, I don't get that either.

Our most important and most often repeated mantra is seen widely on our website:

"We advise you based on what we would do, were we in your shoes, given what we know".

Who do you know who could benefit potentially from our advice? We await your contact or referral.

Please remember, investments can fall as well as rise. And they will!

With kind regards,



Jonathan Davis BA MBA FCII AIFP FPFS

Chartered Financial Planner, Managing Director

 jdavis@JonathanDavisWM.com  www.JonathanDavisWM.com

Sign up to follow us for up-to-the-minute comments @ [Twitter/JonathanDavisWM](https://twitter.com/JonathanDavisWM)



Jonathan Davis BA MBA FCII AIFP FPFs
Chartered Financial Planner
Managing Director

JONATHAN DAVIS

Leaders in Wealth Management

“During the preceding boom, credit expansion had caused an unsustainably high rise in living standards and the propaganda about a “new era” created the idea that this standard was some sort of divine right”

This quote came not from an analysis of the 2005-2007 housing and debt bubble nor from an analysis of the 1998-2000 Dot Con (!) bubble but ...from an analysis of the 1920s and the Great Depression.

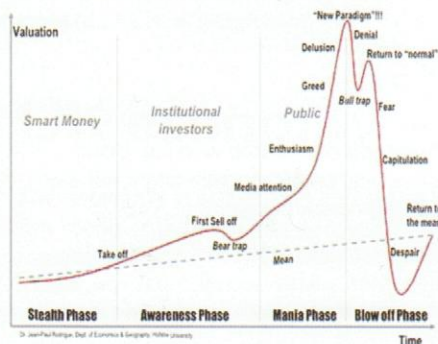
Plus ça change (plus c'est la même chose).

The more things change, the more they stay the same.

Think about a bubble of which you may have some knowledge. How about house prices? Starting from a low base in the early 90s, they grew gradually until around the end of the decade then boomed to the mid 2000s then whoosh there was an absolute mania in 2005-2007.

This progression has been seen over and over again in bubbles throughout hundreds of years of recorded economic history. Most recently it was experienced also in shares in the 90s and again – only a decade or so later – during the mid part of the decade to 2007. It will happen again. And again. And again.

Main stages in a Bubble



The difference is that as it happens to houses it affects, directly, far more families than anything to do with shares. However, as our house prices continue to fall – as we forecast they will by perhaps 30% from this point – then people hope their investments and pensions will look after them in later life or to keep them secure, if already retired.

Historically, the rate of interest our government pays for debt has a very high correlation to the stock market. Also, the debts market traditionally leads the equities market. In this chart (the 4 years of 2007-2010) we see that the rate on 10 year debts (Gilts) moved almost in tandem to that of the FTSE until earlier this year, with equities (shares) slightly moving away from last year and moving in the opposite direction this year.



The debt market sees deflation on the horizon. Equities see inflation. Which will be right? Who knows?

However, why even try to choose? Why not wait to understand more what the global economy will be like once we settle down with US Federal Reserve asset purchases (the second round of Quantitative Easing) and see if they have helped or hindered recovery. (NB. We believe hindered but what we believe is irrelevant.)

Mostly, investment portfolios in the UK are equity heavy and that has helped them for the last year. The problem is they were equity heavy in 2007 too. It definitely did not help over the 2 subsequent years. As well as 1999. And 1929.

Making money in the long term from investing is not about quick gains. With these come quick losses. It is about compounding returns and making as few losses as you can. The loss of 2008 to most portfolios in the UK will affect long term returns far more than most appreciate – or that most professional investors or advisers will admit.

What should you do to secure your finances or help secure those of your friends or family or your private and trustee clients? Call me personally to discuss how we can help.

In this issue:

- Navigating the corporate year-end • Could your family take the knocks? • No Pre-Budget Report, but....
- UK economy – still in recovery • How low can you go? • All wrapped up • The Pay As You Earn mess

Jonathan Davis Wealth Management

City Office:
Token House
12 Tokenhouse Yard
London EC2R 7AS

Tel: 0845 862 2919
www.JonathanDavisWM.com

Head Office and Correspondence:
6 Riverside Avenue
Broxbourne
Herts EN10 6QZ

Jonathan Davis Wealth Management Ltd is authorised and regulated by the Financial Services Authority. Registered in England No. 05942730.
Reg Office: The Granary, 39 Bell Street, Sawbridgeworth, Herts CM21 9AR

This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The FSA does not regulate tax advice, so it is outside the investment protection rules of the Financial Services and Markets Act and the Financial Services Compensation Scheme. The newsletter represents our understanding of law and HM Revenue & Customs practice as at November 2010.

Navigating the corporate year end

If your company's year end is 31 December, now is the time to focus on tax planning.

Each year the question of what to do with company profits is complicated by changes to corporate and personal taxation. 2010 is no different:

- **Tax relief on pension contributions** New rules are due from next April, although some of the precise details remain unclear.
- **National insurance contributions** The main rates for employers and employees will all rise by 1% from 6 April 2011.
- **Corporation tax** The small profits (formerly small companies') corporation tax rate is due to fall to 20% from April 2011.
- **Capital allowances** The annual investment allowance (a 100% allowance for plant and machinery expenditure) was doubled to £100,000 in April 2010, but will fall to £25,000 from April 2012. The main writing down allowance for plant and machinery will be cut from 20% to 18% in 2012.

The interaction of these changes is complex and will depend upon your and your company's specific circumstances.

At its simplest, the mathematics of the bonus/salary/pension director's decision for this year is shown on the 'Bonus v Dividend v Pension' table, based on a marginal £50,000 of profits.

There is no substitute for a face-to-face meeting to go through the figures relevant to you and your company and explain the options. However, the number-crunching for such a meeting can take time, so the sooner you can fix an appointment, the better.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.

	Bonus £	Dividend £	Pension £
Marginal gross profit	50,000	50,000	50,000
Pension contribution	N/A	N/A	50,000
Corporation tax	N/A	(10,500)	N/A
Dividend	N/A	39,500	N/A
Employer's NICs	(5,674)	N/A	N/A
£44,326 @ 12.8%			
Gross bonus	44,326	N/A	N/A
Director's NICs	(443)	N/A	N/A
£44,326 @ 1%			
Income tax	(17,730)	(9,875)	N/A
Benefit to director / amount in pension	26,153	29,625	50,000

Assumptions:

1. Company's marginal corporation tax rate is 21% for calendar year 2010.
2. Director's marginal income tax rate for 2010/11 is 40% (32.5% for dividends less 10% tax credit).
3. The special annual allowance charge does not apply to the director.

Could your family take the knocks?

With the rising cost of living affecting virtually every family's budget, this is a sensible time to review your personal protection insurance.



The chances are that over 2010, inflation will lift prices by around 3%, based on the consumer prices index. Inflation in 2011 will then be boosted by the 2.5% January increase in VAT to 20%.

The rise in prices is one reason why it makes sense to review your life and health protection cover now. If you have not done this in the past few years, you could find that inflation has reduced the real value of your family's financial protection. For example, based on the retail prices index, the £1,000 you had in January 2006 is now worth less than £860.

It is particularly important to review the cover you have to protect your family in the event of ill-health:

- If illness or accident meant you had to stop working and/or caring for the home, your income protection plan might not pay out enough to take care of day-to-day expenses.
- If you had a serious illness, such as cancer, your critical illness cover might not provide you with a large enough lump sum to give you time off work to recuperate or to reduce outstanding loans. It is important that you review which medical conditions are actually covered by your policy.

If you are hoping to rely on state benefits to cover such situations, you are likely to be disappointed. In October 2008, the last Government replaced Incapacity Benefit with the Employment Support Allowance (ESA). As the name suggests, ESA is more focused on what work a claimant is capable of doing rather than on what they cannot do – as used to be the case.

In ESA's first 13 months of existence, just under four out of ten would-be claimants were classed as 'fit for work', according to figures from the Department for Work and Pensions (DWP). And over a third left ESA before completing the 13-week first-stage Work Capability Assessment. The new Government is considering a further restructuring of working age benefits, with the objective of cutting DWP expenditure.

Unless you want to find out how weak the social security safety net is becoming, you owe it to yourself and your family to make sure you have adequate private provision against the consequences of ill-health. We can help you to ensure that your cover meets the needs of you and your family and we would be happy to go over your options with you.