Economics and Markets' Update Winter 2013
28 February 2013

In the Spring Bulletin, the first attaching document, I question the usefulness of central banks and, by inference, The Bank of England.

Now, you're going too far Davis! The Old Lady of Threadneedle Street is our guardian, our protector, indeed our saviour.

Well, if that's what you believe, go ahead.

Now the facts:

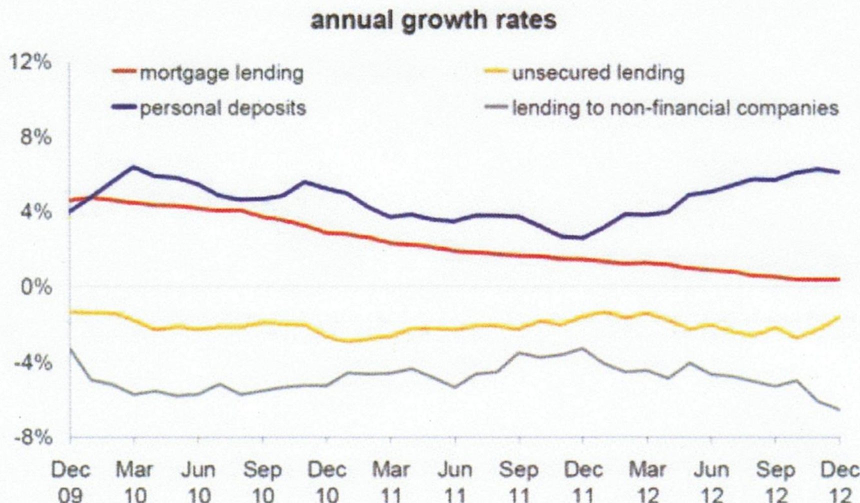
Due to The Bank of England's too low interest rates' policy for the decade before the 2008 collapse, borrowing and lending spun entirely out of control. Thus, eventually the banks collapsed and households and businesses are now left with gigantic debts, that they will never be able to repay.

The Bank then bailed out the bankers, with our children's money (borrowing from their future.)

The Bank – 'the all knowing and wise Bank' – didn't spot the coming biggest economic and financial collapse in history.

The Bank has kept interest rates at all time lows for the last 3 and a half years to help the economy. Have you seen any economic growth during the last 3 and a half years?

They say, by keeping rates low, more will borrow and invest etc.



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The above chart tells us they have failed. Loans to businesses have fallen for each of the last three years. As have personal loans.

Mortgages are about to turn negative i.e. less will be loaned on mortgages this year than last year.

Certainly, according to British Bankers Association, gross mortgage lending in each of 2012, 2011, 2010 and 2009 was lower than in 2001. Yet, what house price inflation have we had since 2001?

So what are they suggesting they do now? Are they saying they'll reverse their policies and do what people like me have been saying they should do i.e.

- Let the market decide on rates. (Rates would be around 5% probably if allowed to settle per market need)
- Stop printing money and handing it to a free spending government. (If you think there is government austerity I suggest you have a look at the numbers which show that this government continues to spend MORE than the previous lot.)

Would 5% rates help?

Yes. A lot.

- The prudent saver would no longer be bailing out the imprudent borrower.
- Those with savings, who experience practically no interest and higher and higher costs of living, would spend in the economy rather than on eating and heating their homes!
- We would stop handing bankers 10s of Billions EVERY YEAR. (We note, today, RBS announced c£5,000 Mns of losses. Bonuses to its bankers: £600Mns. Does anyone **still** seriously believe the bankers have been due their earnings of the last decade? We're paying for them)

Of course, they are not suggesting reversing their policies. They are suggesting to 'double-down' on them. They want to cut rates again. From 0.5%. They want to go negative!!! They want to charge savers for saving.

Again, if low rates helped why haven't they? Because they do not.

I refer you to the USA 1920/21.

Post First World War American industry took out (far) too much credit. They had a nasty credit bubble and prices, including stock prices, went up. A lot.

However, between the beginning of 1920 and the middle of 1921 there was a truly ugly deflationary collapse as the overheated credit markets blew up and manufacturers produced far more than consumers could buy. Stockmarket prices dropped by about a half ***and the collapse in producers' prices came at the fastest rate in American history -- surpassing even that of The Depression, subsequently!***

So did the President Wilson and US Government increase spending to stimulate the economy and did The Federal Reserve of the US slash rates?
No.
They did exactly the opposite.

The Federal Reserve ***increased*** rates and The Government **balanced the budget** instead of having a deficit of more spending than tax receipts – which we have had for what feels like forever.

The over-borrowed went bankrupt.

The markets then cleared ***and 18 months later the economy was back to full employment.***

They call the next period The Roaring Twenties.

You never hear of this deflationary recession talked about in the media or by bankers, politicians or central bankers. The only reason it was not called "A Depression" ***is that it didn't last long enough to qualify***.

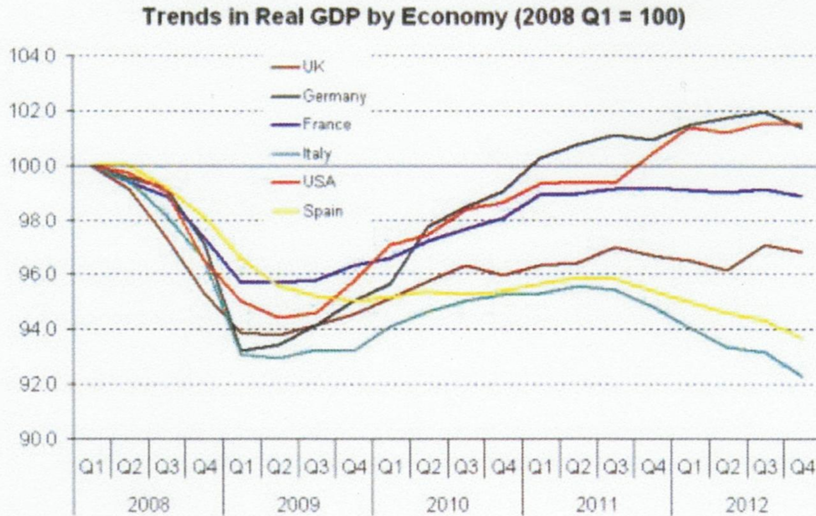
There are many lessons in history. Lowering interest rates and having high deficits, in fact, do not work.

At best they can manage to substitute false government-fed demand for a while and create an even bigger Depression than existed before. However, frequently they fail entirely and you get what happened in the 1930s which lasted to the 1950s* or the last two decades in Japan.

* If the Second World War was so devastating, economically, to Europe why was it also devastating to America which was 5,000 miles away? America continued in Depression in the 1940s due to 1930s borrowing and spending.

On the other hand, if central banks and governments were to stop the deficit spending and hike rates (and thus stop the debasement of people's capital) and refuse to feed an over-borrowed economy with ever-cheaper credit, ***history says the market clears and then the economy recovers.***

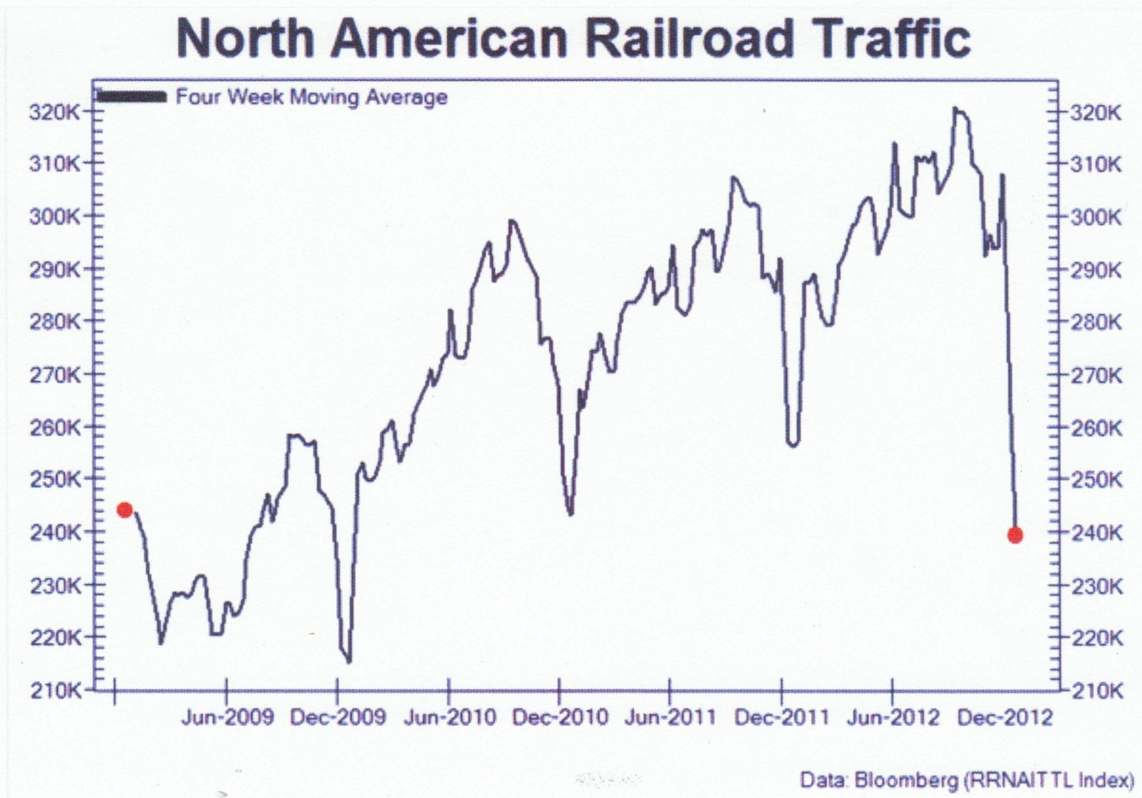
Current policies have NOT ONE example of success.



The above chart of economic malaise across the western world shows how all the money printing of 2009 to 2012 has failed to achieve its stated objectives. As we have said it would. The EU is now in Recession. Again.

Germany will be in Recession in 2013. Again.

The US will again fall into official Recession this year. (It's already in Recession but they do not admit it.)



If the US economy was doing so well, why is the amount of goods transported in the US at Depression levels? The US is, in reality, in Recession.

Finally, as a result of successive UK governments' and Bank of England's policies, the UK was, to put it in shorthand, downgraded last week. There will be another downgrade then another and so on for years. In this way, the market will eventually be able to determine our rates rather than the 'blind and deaf' academics in the ivory towers of Threadneedle Street.

Once interest rates start rising (as determined by the market) – I am not saying it will be soon – they will rise and rise for many years and probably for A GENERATION.

What will that do to the economy, house prices, the investment world, your retirement funds etc and your retirement and your children's and grandchildren's futures?

What should YOU do to secure your or your clients' wealth?
We urge you to speak to us.
Most people remain entirely oblivious to what is likely to happen from here. We can help.

Stay absolutely up-to-the-minute with economic and markets' analysis by 'Following' me on Twitter. Or you can just Save, as a favourite on your web browser, my Twitter page: www.twitter.com/jonathandaviswm. You do NOT need to sign up to Twitter.

Don't put it off till it's self-evidently too late.

Can you benefit potentially from our advice? We work with wealthy to very wealthy families (£300k to £25m of financial assets and/or high earners) and trusts. We have clients all over the UK and indeed on three continents.

Our most important and most often repeated philosophy is (as seen widely on our website): "We advise you based on what we would do, were we in your shoes, given what we know".

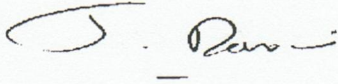
What should you do to secure your finances or help secure those of your friends, family, colleagues or, if you are a lawyer, your private and trustee clients?

Call me personally to see how we can help.

If ever you have any queries please do not hesitate to contact us.

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

With kind regards



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JONATHAN DAVIS WM
Leaders in Wealth Management

Spring 2013
Bulletin

Why do we have Central Bankers?

Do you believe it is because they are the font of stability and growth? As far as we are concerned, nothing could be further from the reality.

Maybe you believe they are the fonts of all knowledge and wisdom.

The following is an extract of US Federal Reserve Board meeting minutes on August 7, 2007 (as Sub prime bank mortgage lending was within weeks of bursting the US and, to some degree, the global economy):

Those quoted are Federal Reserve Bank Regional Presidents and the Chairman and they vote on interest rates and money printing.

Mr. Dudley: "We've done quite a bit of work trying to identify some of the funding questions surrounding Bear Stearns, Countrywide, and some of the commercial-paper programs. There is some strain, but *so far it looks as though nothing is really imminent in those areas*. Now, could that change quickly? Absolutely."

Mr. Fisher: "*No amount of rewriting of history will exonerate us* if we are not prepared for the more-dire scenarios that were presented by the staff. I would ask that we do some scenario preparation in terms of, should we encounter increased financial-market turbulence, what actions we might take to deal with it."

Mr. Bernanke: "I think the *odds are that the market will stabilize*. Most credits are pretty strong except for parts of the mortgage market."

The word useless is too kind.

These are the people who consistently tell the people that Zero Interest Rates and Money Printing is needed for economic growth. They have been wrong for decades about their policies and they remain wrong.

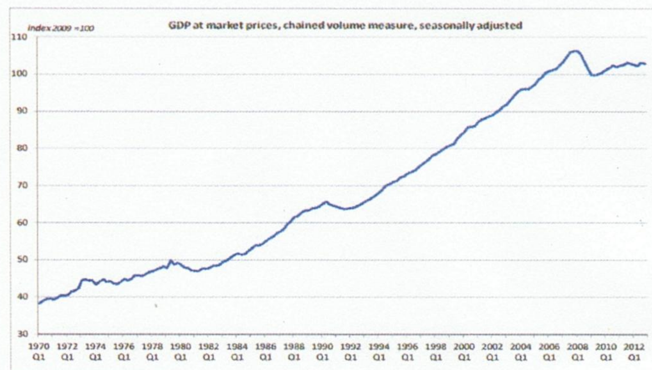
How about closer to home?:
Letter to the Financial Times from Mr Tony Clarke of Plymtree, Devon, 11 October 2012:

"Sir, I see Sir Mervyn King has signalled that he no longer believes that price stability should be the Bank of England's primary objective [Ed's note: not that he has aimed to achieve it for years in a Louis XIV way]. Perhaps if he had his gold-plated, index-linked pension replaced by a private sector annuity pension he would be more focused on reducing inflation."

Quite.

Let's give a word to the late Gore Vidal:

"The genius of our ruling class is that it has kept a majority of the people from ever questioning the inequity of a system where most people drudge along, paying heavy taxes for which they get nothing in return."



The above shows the UK economy and its growth, without taking into account inflation, over the last 4 decades. To which you say, well that looks OK. Indeed, now how would it have been without the falling interest rates and massive rise in debt?

Extrapolate the last several years of no growth with falling loans and rising interest rates. You think the line will be rising for 40 years? Think again.

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

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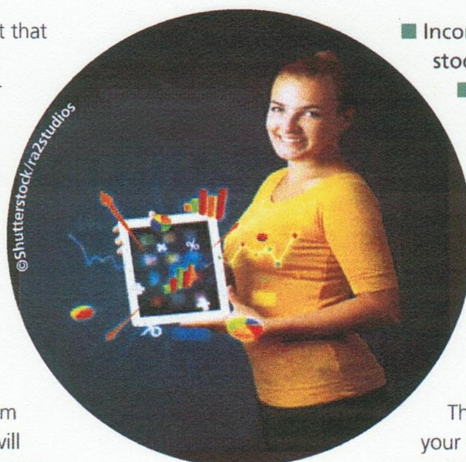
Tax saving in the run-up to the tax year-end

As the Government's austerity programme drags on, with an end date now pushed out to 2018, year-end tax planning for individuals and businesses has become more important than ever.

Tax changes in the last couple of years have meant that there are many tax saving opportunities on which you might want to consider action well in time for the end of the tax year on Friday, 5 April 2013. You might consider acting before the Spring Budget on 20 March, just in case there are some surprise announcements.



Pensions The Autumn Statement included some important pension announcements that take effect from April 2014, but they cannot be ignored in 2012/13.

For example, the lifetime allowance – the maximum tax-efficient worth of all your pension benefits – will fall from £1.5 million to £1.25 million. At the same time, a new transitional protection will be introduced, which will allow you to retain the £1.5 million, provided you make no further contributions or accrue no further pension benefits. There is therefore an opportunity to maximise your pension fund now – perhaps with 50% tax relief before that disappears in 2013/14.

Individual savings accounts (ISAs) The 2012/13 ISA contribution limit is £11,280, rising to £11,540 from 6 April 2013. There are four good reasons for making the most of your ISA allowances.

- **Income from fixed interest securities held in a stocks and shares ISA is free of personal UK tax.**
- **Interest earned on deposits in a cash ISA is also UK tax-free.**
- **Gains made within ISAs are free of capital gains tax (CGT).**
- **There is nothing to report about your ISA on your tax return.**

Inheritance tax (IHT) The IHT nil rate band of £325,000 was frozen on 6 April 2009 and will not change next year.

That freeze makes it all the more vital you use your annual IHT exemptions. The main £3,000 annual exemption can be carried forward, but only to next tax year (2013/14), and then can only be claimed once the 2013/14 exemption has itself been used up. If you and your partner have not made any gifts since 6 April 2011, you could now jointly give away £12,000 free of IHT.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice. The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

State pension reform changes unveiled

The much-delayed White Paper on the future of state pensions has been published.

The United Kingdom has one of the most complex state pension systems in the world. To quote the White Paper, 'many people do not have a clear starting point from which to plan and save for their retirement'. The solution proposed is:

- **Introduce a single tier pension of £144 a week in today's terms, marginally above the level at which any Pension Credit is payable.**
- **End accrual to the additional pension (the state second pension) and contracting out.**
- **Base entitlement on the individual, ending the right to inherit or take credit for the pension of a spouse/civil partner.**
- **Scrap the Savings Credit for new pensioners.**
- **Review (and probably increase) the state pension age (SPA) every five years.**

To gain the full £144 a week pension you would need a 35-year record of national insurance contributions and/or credits, compared with the 30 years currently required for the basic state pension. A minimum period to receive any pension will be set – probably at ten years.

The proposed starting date for the new pension regime is April 2017, 'at the earliest', and if you reach your SPA before then, you will be unaffected. It is not surprising that there are complex transitional rules to deal with state pension benefits accrued before the start date.

The White Paper admits that 'single-tier reforms have been designed to cost no more overall compared to the existing pension system' and the Department for Work and Pensions' own projections suggest that in the long-term the cost will be less.

While there will be many people, particularly those who are low paid, who will gain from a single-tier pension, the lower overall expenditure means there may be more losers than winners.

So while the proposals are a simplification, they are no substitute for private provision.

In early November 2012, National Savings and Investments (NS&I) announced an immediate cut in the interest rate on their Direct ISA from 2.5% to 2.25%. The move was in line with other short-term ISA rates, which have been falling since the summer. There is no sign that interest rates will be rising soon – the money markets imply virtually no change before 2015. If you started a cash ISA in March or April 2012, you should check what interest rate you will be earning after the first year's anniversary. You may find that last year's 3% becomes 0.5%. The FSA does not regulate National Savings products.

Inflation – making difficult times harder

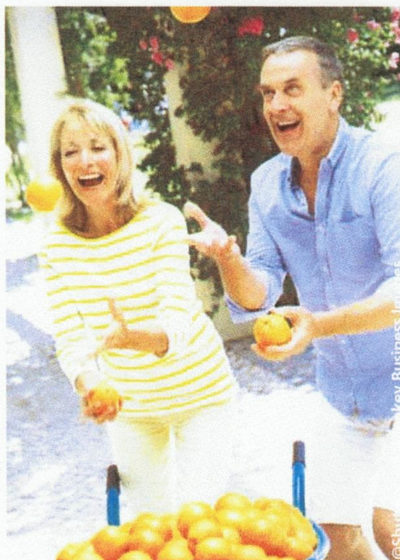
2013 is going to be another tough year as inflation is likely to remain stubbornly above target, according to the Bank of England's chief economist Spencer Dale.

Mr Dale was stating the obvious when he said many households and families were 'much worse off'.

Rising food prices, the fact all the 'big six' energy firms have hiked bills, rail fare rises and higher tuition fees are all having an impact.

Many accounts pay interest below the rate of inflation. A glimmer of better news is that the amount that can be invested into an ISA is to rise by £240 from £11,280 to £11,520 from April 2013. Further, the amount of annual gains you can bank before paying tax is rising by 1% in 2014 and 2015 to £11,100.

However, if you are saving for a pension there was some bad news in the Chancellor's Autumn Statement, with the annual allowance for tax-incentivised pension saving cut from £50,000 to £40,000 and the lifetime allowance reduced from £1.5 million to £1.25 million, both in 2014/15.



The basic state pension will rise by 2.5%, but when inflation is taken into account, pensioners are likely to be worse off. However, those funding retirement through pension drawdown will be able to take 20% more of their fund each year under rules that will take effect from 26 March 2013.

The Government has also announced that rises to tax credits and child benefit will be pegged back to 1%, rather than inflation. The change to tax credits comes into effect in April 2013 and will last three years; the change to child benefit comes into force in 2014 and will last two years.

However, the amount that can put into a child's junior ISA or child trust fund will increase from £3,600 to £3,720 from April 2013.

The news is not all bleak – unemployment is lower than anticipated and the Bank of England has predicted modest growth for 2013. But, given that inflation will be sticking around, taking expert guidance remains crucial.

Time to go east?

China is the world's most populous nation and its second largest economy, so after a rocky 2012, is it now a good time to look at investing there or in other Far East countries?

While it offers unique opportunities in terms of its scale and manufacturing capabilities, China's fortunes have been intertwined with the global economy – if wages rise, it becomes less competitive and if export demand falls, then so do its earnings.

China's performance has disappointed of late, with weaker exports and imports and signs of a property bubble. And, in March 2012, the Chinese Government revised its annual growth target for 2012 down to 7.5%, creating some anxiety.

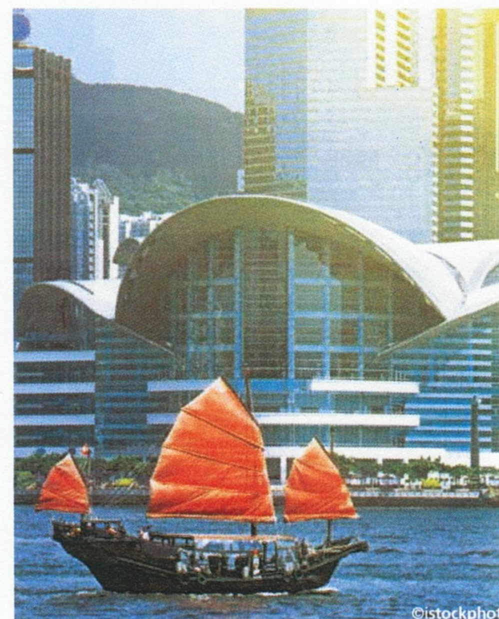
Despite the slowdown, the HSBC purchasing managers' index for December rose to 51.5 from 50.5 a month earlier, resulting from increased government spending on infrastructure. Meanwhile, predictions vary about what growth China will see in 2013. The official view is 7.5%.

China may suit you if you have predominantly UK and European holdings and favour diversification. What's more, valuations are roughly a third of the peak level reached in 2007. However, China is far from being the only Eastern player, and although Japan has been a disappointment for investors over the last couple of decades, it is suddenly looking a little more promising.

New Japanese prime minister Shinzo Abe has implemented a programme of fiscal stimulus, and although there have been false dawns before, some commentators believe that Japanese equities are looking good value. There are many funds on offer, so seeking guidance on those likely to outperform could make sense.

There is also a wide range of funds focused on the Asia Pacific sector. Some may be heavily influenced by China, but others may be investing in less promoted countries such as Malaysia, Thailand and Indonesia.

The region has also been bolstered by improved relationships with the United States – US President Obama described the region as a 'top priority' in terms of its importance as a leading trading partner and in having a pivotal role in the United States recovery. With many western countries being in the doldrums, it is no wonder eastern markets are receiving increasing attention.



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State pensions – still not enough

State pensions are still not an adequate retirement income, despite April's increases.

To date, the current Government has protected the benefits of pensioners more than those of other members of society. Universal pensioner benefits, such as the winter fuel payments, have been untouched and state pensions have at least kept pace with inflation, even though it is measured on the consumer prices index (CPI), which tends to rise more slowly than the retail prices index (RPI).

State pensions have been growing faster than average earnings which, according to National Statistics, increased by only 5.5% over the last three years to October 2012, less than half the rate of CPI inflation.

However, state pensions are still not enough to provide an adequate retirement income, despite their recent outpacing of earnings. Recent research published by National Statistics showed that in 2010/11 state pensions and related benefits accounted for less than a third of the income of pensioner couples, where the head of the household was under age 75.

There is another salutary warning from this set of statistics: for the same couples, earnings accounted for a greater proportion of their total income than did state benefits. If you do not want to be caught in that trap, make sure you review your private pension provision now.

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Bonus time?

It is here again – the time of year when with profits insurers declare bonuses.

About two years ago, the Financial Services Authority (FSA) issued a consultation paper, 'Protecting with profits policyholders'. The title reflected the FSA's concerns about the operation of with profits business.

Thirteen months later, in March 2012, the FSA published new rules and guidance. The current bonus season is therefore the first where the FSA's revised regime takes effect.

While investment conditions in 2012 were generally better than in 2011, this year's bonus rates are unlikely to be much better than last year's. All with profits insurers are facing the issue of historically low yields on the government bonds and other fixed interest securities, which form a large part (or sometimes all) of their with profits funds.

Low income returns generally mean low regular bonuses, but you should not automatically assume that it is not worth holding onto any with profits policies you have. There is no substitute for a policy by policy assessment, given the huge variations between both contracts and providers.

We can undertake such a review and supply an analysis of your options. Only then can you decide whether the low bonus rates are not as bad news as they appear.

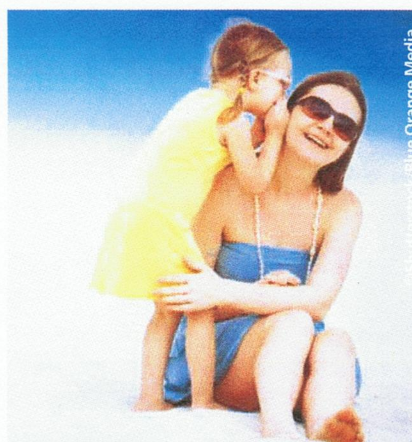
Let's get personal

Higher personal allowances could be an opportunity.

Next tax year's personal allowance will jump by £1,335 to £9,440. Will you make the most of this increase? If you are employed or you receive State and other pensions the answer is probably yes, because your earnings and pension count as the first slice of income for tax purposes.

However, if you or your partner largely rely on investment income or have total income below £9,440, then part or all of the personal allowance could be going to waste.

Sometimes the solution is to rearrange who holds which investment, so that you each have enough income to cover your own personal allowance. Often there will also be a need to change investments, because what is suitable for a taxpayer may be inappropriate for a non-taxpayer.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We can advise you on your options and warn you of the inevitable tax traps. The sooner you start making the changes, the sooner you will be in a position to benefit from April's increase.

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