# Quarterly Newsletter / Autumn 2010

**Lacomp plc is an independent investment management company providing portfolio management services to private investors worldwide.**

After a respectable 2009 stock market performance, this year has provided us with something of a roller coaster.

The beginning of 2010 was marked by steady optimism, but we then saw a rapid fall to fresh year lows in July, and that was followed by a gradual retracement to the former levels. Just like a real life roller coaster – breakneck speed on the way down, and a rather slow climb back to the previous high. For the year to the end of September, the movement in total has been fairly unremarkable, with the MSCI World index up by a measly 1%. The Dow Jones registered a gain of 3.5%, the FTSE 100 2.5%, and the BRIC countries (Brazil, Russia, India and China) 3.7%. Japan, on the other hand, showed a negative 11.2%. Nice to see, therefore, that our more defensive approach has been the right approach as the CF Lacomp World Fund increased by 8.8% over that period.

One of the chief gainers this year has been the gold price which has risen from $1,097 per ounce to well over $1,300 ($1,370 at the time of writing).

However, the ride on this roller coaster has been far from comfortable. Investor sentiment swung wildly from gung ho to risk averse, influenced by wide ranging events over the course of the year to date, many of them from unexpected quarters.

Apart from the eruption of the Icelandic volcano, which caused the biggest disruption to air travel since the attacks of 9/11, there has been political unrest aplenty. At one point, it appeared that the violent protests in Thailand might escalate into a civil war. Ethnic unrest in Kyrgyzstan and heightened tension between the Koreas following the sinking of a South Korean naval vessel provided other flash points. Then there was the dispute between China and Japan over fishing rights, and nearer to home we witnessed serious rioting in Athens over the proposed austerity measures. All these events almost overshadowed the ongoing problems in the Middle East and the increasingly difficult Afghanistan war.

Plenty of reasons for a bearish view of the world, but the key to this rapidly changing sentiment lay in the divergence of views among economists, policy makers and commentators on issues such as inflation versus deflation, expenditure versus retrenchment and structural reform versus free market thinking.

Of course, everyone is still arguing whether the recovery is sustainable, whether it will be weak or strong or, indeed, whether we are heading for a double dip recession and, even worse, a period of depression. Take your pick, but for what it's worth, we at Lacomp think that the recovery, whilst sustainable, will be on the weak side.

Politics has provided a bigger than usual part in this. In America, President Obama is facing strident opposition to his reform programme from, above all, the phenomenon called the 'Tea Party'. Without central leadership, this political movement represents a loose affiliation of different local groups pursuing similar, yet often quite different aims. Broadly speaking, they are against "big" government and wasteful spending and in favour of lowering taxes and reducing the twin deficits. They are clearly well right of centre, largely supporting the Republican agenda.

America definitely is worried about a double dip recession, and only last week, Federal Reserve chairman Bernanke gave his strongest signal yet that he will start another round of quantitative easing. This will almost certainly weaken the dollar further, and that could be something of a double-edged sword with the upcoming mid-term elections looming large. The relative strength – or weakness! – of the dollar could provide the beleaguered Presidency with a high profile weapon. “China bashing” always goes down well in the Midwest, and the clamour for China to revalue its currency has reached ever greater volume.

Of course, America is not alone in criticising Chinese currency policy. Europe very much is an ally in that endeavour, though the Americans recently have adopted a tougher stance by threatening to impose sharply higher tariffs on imports from China. That is a dangerous ploy: a currency war is the last thing the global economy needs right now!

Over recent years, China instinctively resisted such pressures, and it was therefore surprising when, only three days ago, the Chinese unexpectedly announced that they would increase interest rates. Reaction was mixed: Western stock markets, in particular Wall Street, reacted negatively, whilst some commentators pointed out that the move was very sensible as it would stop the Chinese economy growing too quickly and run the risk of overheating.

The issue of the renminbi’s value remains a burning one, and the charge of currency manipulation is easy to make in the face of China’s record $2.6 trillion of foreign exchange reserves. However, the renminbi bit by bit has been revalued by 20% since 2005, and that has had very little impact on the US deficit. There is a lesson to be learnt from history as the revaluation of the Japanese yen in the 1990s was not able to save the US car industry from Japanese imports either.

From America’s point of view, and despite all its sabre-rattling, a weakening dollar provides a speedier and surer way of addressing the twin deficits than fiscal stimulus and financial reform. The steady weakening of the dollar since June will not have caused too many sleepless nights in Washington!

Another, equally serious worry that concerns the financial world revolves around the sovereign debt issue, the worry being that it might provide a fresh leg to the fallout from the banking crisis. Ratings agencies have downgraded sovereign debt in Portugal, Spain and Ireland, and the debt issue in Greece threatened to bring the entire eurozone experiment crashing down. In the event, Germany led, and heavily financed, a massive rescue package which brought some apparent stability, but there are continuing fears that Hungary or Ireland will need to call on the scheme for support as well, which could easily trigger a fresh period of tension in currency and bond markets.

In the UK, politics have provided us with plenty to think about. The coalition, the first since 1974, appears to work far better than most expected, and in view of the bitter medicine that the electorate has to swallow, it might be a blessing that two parties rather than just one are doing the dispensing.

The drawn-out Labour leadership election gave us a spectacle almost worthy of a Greek tragedy. Political fratricide is a new phenomenon, and back-stabbing is meant to be the preserve of the Conservative Party. During his election campaign, Ed Milliband positioned himself well to the left of his brother David, and having obtained the backing of the unions, he narrowly won the election. Immediately after the election, though, he quickly tried to distance himself from the “Red Ed” soubriquet, declaring himself “his own man” and not in thrall to the unions.

Yesterday, we had the comprehensive spending review, and if anyone was of the opinion that the cuts might, as the Labour manifesto suggested, be delayed for another year or two, the figures we are confronted with make sobering reading. We know that the present overall indebtedness means that the nation has to find £120 million *a day* just to service that loan, so that means paying over £43 billion a year in interest alone! The coalition reckons that this will rise to £63 billion a year by the end of this parliament, and they are costing in a substantial rise in interest rates over the period.

It is quite incredible how easily these figures nowadays roll off the tongue, and it is difficult to comprehend them. A million, a billion – what difference does it make? Well, to put it in context, for a million seconds to pass takes over eleven days, whereas a billion seconds last nearly 32 years!

It will take some time before all the small print of the spending review has been examined, dissected and minutely scrutinized, and there is no point in trying to second-guess the precise effects of the cuts at this stage. I am sure the media will be full of analytical comments over the coming days or weeks.

Suffice to say we are in for a tough time for quite a few years to come, and we have heard the "we are all in this together" too often to ignore the fact that the measures announced yesterday will hit everyone, and that even includes Her Majesty with the proposed abolition of the Civil List and new ways to fund the Royal family!

Bagshot, 21st October 2010

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