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

Since the beginning of the new millennium, the world has seen many natural disasters. We have witnessed cyclones, hurricanes, bushfires, volcanic eruptions, droughts and flooding. Two years ago we had the swine flu pandemic, and who could forget the many earthquakes all over the world that killed so many people. The death toll of the Boxing Day Tsunami of 2004 alone was reckoned to be in the region of 230,000, and three other devastating earthquakes in Iran, Pakistan and China between them claimed nearly 200,000 people. Furthermore, we are still counting the costs – fortunately mostly financial – of the recent Japanese earthquake and resultant tsunami.

Natural disasters have happened throughout the ages, and one could possibly question whether mankind's meddling with nature has exacerbated certain aspects of them. Equally, it could be argued that man's ingenuity in preparing for disasters has been successful in limiting the damage in terms of collateral or human costs.

However, it is the *man-made* outrages and debacles that make us question as to whether the name "homo sapiens" (Latin for "knowing man" or "wise man") is an apt description for present-day human beings.

Over the same period since the beginning of the new millennium, we have witnessed a whole series of previously largely unthinkable events. The events on September 11 in 2001 remain imprinted on everyone's mind, leading to wars in Afghanistan and Iraq, not to mention the so-called War on Terrorism. More terrorist atrocities followed – bombings in Bali, Istanbul, on the Madrid trains, the London public transport system and the Mumbai attacks.

Far less calamitous but still indicative of this apparent moral and ethical decline are the events we have seen in the financial and commercial world. Remember the corporate governance scandals (Enron, WorldCom et al) that cheated employees, creditors and shareholders alike? Who could have imagined that we would have reasons to question the integrity of Wall Street institutions and leading accountancy firms? Who would have thought American financial institutions would offer mortgages to people who did not have a cat in hell's chance of repaying them, only to package these subprime mortgages alongside other debts in the form of CDOs (Collaterized Debt Obligations) and sell them globally to other financial institutions, investment trust or pension fund managers that were unsuspecting or naive enough to buy them? And where were the credit rating agencies when the volume in CDO issuance went up tenfold in just over three years? At the time, they clearly underestimated the CDOs' inherent risks and certainly did not take into account a possible severe downturn in the US property market. Rather more worrying, since we are talking about ethics, were the allegations that a hedge fund was instrumental in selecting the quality of the debts that made up a CDO, only to then short it, i.e. bet against it…

The resultant subprime mortgage crisis saw the demise of three of the largest American investment banks: Lehman Brothers was allowed to go bust whilst Bear Stearns and Merrill Lynch were sold at fire sale prices.

The financial crisis and the attendant credit crunch led to a global recession. In the UK, the taxpayer had to bail out most of our banks, and the very people responsible for the failure of the banks often were rewarded with huge remuneration packages or other emoluments in the form of pension entitlements or bonuses. The politicians on whose watch all this took place blamed it on the international financial crisis, and neither politicians nor bankers were seen to be considering their position.

If you took a slightly dim view about bankers gambling with other people's money or politicians' adherence to a moral or ethical code, nothing could have prepared you for the *Daily Telegraph's* revelations two years ago about MPs' expenses – now that really was scandalous! To make matters worse, it wasn't just Members of Parliament that cheated and enriched themselves at the taxpayer's expense. Even Members of the House of Lords were being "creative" in claiming their expenses!

In the event, several ministers resigned or were dropped in a cabinet reshuffle, some MPs had the whip withdrawn and a few, including a life peer, have since faced criminal proceedings resulting in custodial sentences. Most of the wrongdoers announced that they would not stand for re-election at the next general election, and of those who wanted to be re-elected, quite a few found the electorate had other ideas.

Thank God for the Freedom of Information Act 2000, a part of Labour's manifesto in 1997, you may say. But hang on a minute: the information we *would* have seen under the Act was so heavily redacted ('blacked out' to you and me) as to be almost useless. Had it not been for the fact that full and uncensored copies of all expenses records were *leaked* to the *Daily Telegraph*, we still would have been largely left in the dark. Thank God for the gentlemen of the press, then!

Alas, following the recent sensational disclosures about phone hacking and other nefarious means of obtaining information – euphemistically called "engaging in the dark arts" by press insiders – we now know that some members of the so-called Fourth Estate are anything but gentlemen, and some of them will have their shoulders tapped by the long arm of the law. At least we can rely on the integrity of the police. Or can we? The resignations of MET Commissioner Sir Paul Stephenson and Assistant Commissioner Yates, whilst laudable, leave a question mark about the extent of this particular scandal. Are we talking about a few rotten apples or are we looking at more systematic police corruption? Only time will tell.

Man-made outrages and debacles: misguided or fanatical terrorists, crooked corporate executives, untrustworthy accountancy firms, greedy bankers, shameful MPs and peers, repugnant pressmen and corrupt police – homo "*sapiens*"?!

The current media feeding frenzy concerning the Murdoch empire, its executives and employees, its cronies and toadies as well as its critics will continue for some considerable time. It is a shame that in taking up so many column inches and so much air time it completely overshadows other potential disasters in the making, namely the sovereign debt crises in the Eurozone as well as in America where we have a political deadlock between President Obama's administration and the Republican-led Congress about raising the US debt ceiling.

Let us look at the American situation first. The “debt ceiling” is rather similar to the credit limit on a credit card, and US Treasury Secretary Timothy Geithner has told Congress that the debt ceiling would have to be raised by 2nd August to avoid a potential default situation. President Obama wants to see what he calls a “balanced approach” to solve the problem, suggesting raising taxes alongside public spending cuts. To some Republicans, the mere mention of tax increases is like a red rag to a bull, and the stand-off among politicians is replicated in public opinion polls.

According to Federal Reserve Chairman Ben Bernanke, a US default would be a “financial calamity”, and he hinted that he would consider a third round of quantitative easing. Credit rating agency Moody’s saw fit to downgrade the outlook on its triple-A rating for US sovereign debt to “negative”, and Standard & Poor’s followed by suggesting that there was a 50-50 chance of a reduction in the triple-A rating over the next three months.

If a default were to happen – and we are talking about the world’s largest reserve currency! – it would undoubtedly lead to a broad sell-off of Treasury bonds, and American interest rates would have to go up to attract future buyers, something neither America nor the rest of the world would want to happen, given the rather fragile state of the global economy at present.

Political impasses in US politics are nothing new, and both Senate and the House of Representatives usually manage to do the right thing at the eleventh hour. Nevertheless, to guarantee the retention of its triple-A status, America desperately needs a credible plan to reduce its indebtedness.

Let us now turn to the European problem by posing this question: Does one spell “pigs” with one “i” or two? No, we are not talking about the porcine providers of chops and sausages. We are talking about the acronym PIGS representing the Eurozone’s troubled member states Portugal, Ireland, Greece and Spain. If you add an “i” and change that to PIIGS, it includes Italy, and it is Italy that increasingly is troubling Europe’s central bankers and finance ministers.

As this is being written, the leaders of the Eurozone are meeting in Brussels to hammer out a plan to help Greece overcome its huge financial problems. Equally important is the need to stop the contagion creeping across the Eurozone with Italy as a potential candidate for an additional sovereign debt crisis. It is worth noting that whilst Greece has €340 billion of debt, Italy’s amounts to €1,600 billion! Italian sovereign debt so far managed to avoid the attentions of bond speculators. Unlike Greece, it has always been honest about how much debt it has. It has kept its deficits under control (unlike Portugal), has not seen a construction boom and bust (unlike Spain) and Italian banks did not participate in foolhardy lending (unlike Ireland).

However, faced with having to pay back €900 billion of debt over the next five years, Italy’s Finance Minister Signor Tremonti’s handling of the proposed austerity package upset Prime Minister Silvio Berlusconi (and the chances of staying in power after the next general election...), resulting in a public spat between the two and the perception among investors that Italy could become vulnerable because of political risk. Bond yields climbed steadily and dangerously, and all of a sudden Italy’s problems became Eurozone’s problems, something the Eurozone currently could do without.

One of Italy’s problems is the fact that it has a large black economy. Even big companies are rumoured to engage in questionable and “off the books” transactions, and many other forms of labour are performed on a “strictly cash” basis. This has gone on for centuries and is therefore deeply rooted in Italian culture. Clearly, this has a negative effect on Italy’s GDP, and inclusion of the black economy in the GDP figures would make the ratio between GDP and sovereign debt much more palatable. It is also worth mentioning that tax evasion is seen as something of a national pastime…

Greece, of course, is an altogether different problem, and we will see whether it will be delaying tactics, a secondary Eurobond market operated by the EFSF (European Financial Stability Facility) or an immediate, additional bailout that wins the day in Brussels. German Chancellor Angela Merkel and French President Sarkozy met last night in an effort to reach agreement concerning their very different approaches to this conundrum before today’s meeting.

Broadly speaking, Frau Merkel wants private investors and banks to accept a “haircut” on their bond holdings whereas Monsieur Sarkozy and the European Central Bank are desperate to avoid anything that could be interpreted as a default.

There were smiles as they emerged from the meeting, but one should not read too much into that. Even if a temporary agreement between them could be achieved to deal with this current “make or break” situation, long term readers of this newsletter will know that the serious flaws concerning the Economic and Monetary Union which we have highlighted on many occasions will not be rectified by today’s decision.

As you can see from the enclosed portfolio valuations, markets have been largely flat during the first six months of this year, but short of politicians on both sides of the Atlantic being completely bereft of common sense thus triggering another financial crisis, we are quite hopeful for the second part of 2011. Nevertheless, we continue sticking to our rather defensive stance for the time being.

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