

And the Wolf shall dwell with the Lamb

– *Isaiah 11:6.*

Electoral a Conservative / Liberal Democrat coalition may be the making of both parties. Assuming they can make it work. If there is truth to the suggestion that Labour proposed the television debates to split the vote for change, then they have been hoist by their own petard.

A cross party consensus for dealing with the high level of indebtedness in the UK is essential. The entire country will suffer the consequences of the buy now, pay later obsessions of both government and households during recent years. It would be a travesty if the inevitable austerity allowed Labour to bounce quickly back into power.

Financially the coalition may offer a more coherent and politically acceptable way forward than either offered separately. Mathematically the Tories are right to start making small savings quickly, which is shown by the power of compounding. Ultimately this will lessen the need to reduce government spending on services, as less will be spent on debt servicing.

From the perspective of wealth creation, and ensuring that high marginal tax rates do not act as a disincentive to work, the Lib Dems are correct in believing that higher personal allowances will be positive, as they will encourage participation. Dropping the Tory pledge for inheritance tax change seems fair in a time of national belt tightening.

If David Cameron wishes to continue a reform of the Conservative Party, to make it more acceptable to greater proportion of the electorate, then a coalition with Nick Clegg

may be useful to him, as it may reduce his dependence upon the perceived “nasty” elements of his own party. For Nick Clegg there is the equally great prize of proving that the Lib/Dems can be trusted in office.

Cameron failed to make any political capital with the notion of the “Big Society”, because he omitted to explain what it was, and how it would be implemented. We can only guess what he meant. However if it was along the lines of improving public service delivery by using co-operative models, like the John Lewis Partnership, as espoused by a number of thinktanks, then ostensibly Clegg would be a natural ally. Such a change would encourage self-determinism of small collectives, and thus a sense of responsibility. It has many consistencies with social networking and social media, and is the way of the future. It has also been shown to work, both in service delivery and financially. This would be progressive politics.

For financial markets there are varying outcomes, aside from their having been buffeted recently by the bail out of Greece. Sterling has suffered from electoral uncertainty, and may therefore rally somewhat, however in the long run it should weaken further. As fiscal screws are tightened, so monetary policy can remain looser for longer, and interest rates lower for longer. Loose monetary policy typically implies a weak currency.

Gilts should benefit from the prospect of greater fiscal discipline, but not substantially at this stage, and corporate bonds and infrastructure seem more attractive.

CGT Alert

The new government has warned us that CGT will rise. please look at all the investments you have which we do not manage, and consider whether you should crystallise capital gains prior to the announcement on 22nd June.

SIPPs and Annuities

The coalition promises to scrap the requirement to buy an annuity within a SIPP by age 75. Many people will consider this a very positive change.

New Colleague

We are delighted to announce that Simon Hebb has joined Mark Arkwright in our Harrogate office. Simon has more than 10 years experience in the financial services sector, including both investment management and business development. Simon previously worked for IM Asset Management and at Rensburg Sheppards Investment Management, after spending a number of years as an IFA.

Please note our new Harrogate address at the bottom of page 2.

UK Equities are largely hedged against Government failure. The London stock market is an international market, not just a local bourse, and thus UK equities will remain highly correlated with other major stock markets. We have positioned our clients' portfolios in well financed companies, which are in some cases arguably more credit worthy than Western Governments. We believe defensive sectors should outperform more cyclical names, as strong finances will be more important again. Pharmaceuticals, tobacco, food retailers, and telecoms should do well. In addition, we emphasise exposure to emerging markets.

The next few months will be unsettling for investors. But some good buying opportunities will arise as this round of the credit crisis unravels.

“The mountains look on Marathon –
And Marathon looks on the sea;
And musing there an hour alone,
I dream’d that Greece might still be free.”

Lord Byron, The Isles of Greece

Greece remains fettered within the Eurozone. Finally the other members and the IMF came up with a package to ensure that the Greeks would stay. For now at least. One more example of the European project being driven by the political elite rather than by popular demand.

How did they reach such a sorry pass? Bureaucrats across Europe blame hedge funds. In part they are right. At the nadir of this fall from grace, hedge funds had sold Greek debt aggressively, precisely to force either intervention such as we have seen, or the Greek government’s defaulting on their debts. But the root cause was the fact that the Greeks have run unsustainable fiscal policies for too long. Not only this, but also the eurocrats connived to allow the massaging of Greek economic statistics to allow them entry into the euro, despite their not having been able to meet the stated criteria at the time. Had the drachma still existed, circumstances would have been much less dire.

The government in Athens has had to agree to an austerity package, which is causing civic unrest. Austerity will remain de rigueur for some time, if a recurrence of the crisis is to be avoided. But the scale of the intervention was needed for secondary reasons.

Spain, Portugal, Ireland and Italy were at risk, as the weaker fiscal partners in the Eurozone. The fear of default spread contagion to their debt, and thus the credibility of their fiscal policies. Moreover

many European banks were large holders of Greek and other Mediterranean debt, and fears about their capital and solvency rose. Action was needed to avert part two of the credit crisis.

To ensure adequate liquidity in the system, the European Central Bank has been given the power to buy European sovereign debt. This should deflect the current stress on the euro framework.

For those who believe that monetary union can only succeed with fiscal union, the scent of schadenfreude is pleasing. It may be that this intervention represents the founding movement of a Eurozone treasury, but such contemplation is irrelevant to current necessity. In the immediate future banks with significant exposure to the debt of weaker European nations must shore up their balance sheets against future risk of default. Spain and Portugal should take pre-emptive action by tightening their fiscal policies. If these events do not occur, the ramparts will be assaulted again.

In recent history, developed countries have been able to grow or depreciate their way out of fiscal imbalance. Now we all are so heavily indebted that growing our way out is improbable. We British should be thankful that we did not join the euro, and the Liberal Democrats should take note. Ironically it was Gordon Brown’s five economic tests which prevented us from being bound by the same constraints as Greece.

Dividend income, not interest income

With the election behind us, fiscal policy will tighten. This means that the net amount of stimulus to the economy will fall.

It is not only the Treasury, but also the average UK private individual, who is massively over-indebted. With such a huge volume of interest payments subject to movements in the price of money, bank rates will have to remain low for years to come.

The more the Treasury succeeds in cutting its debts, the longer interest rates will be able to remain low. Cutting government spending will sustain the spending power of the indebted UK citizen.

But individuals with net savings will continue to suffer if they remain reliant upon interest income. Dividends offer much more attractive levels of income, despite the fluctuations in share prices.

We have been focusing our equity investments upon companies with strong balance sheets and substantial excess cash flow. Typically they have plenty of exposure to the faster growing developing markets, and have products for which demand is not especially cyclical. They already pay reasonable, sustainable, dividends, and have the capacity to increase those payments to their shareholders.

This latter point is extremely important for people who are dependent upon the purchasing power of their investment income. It seems increasingly likely that, despite the prospect of weak growth in the developed markets over the next few years, inflation in the UK will return to a higher level than we have experienced over the last decade. This is due primarily to weak sterling and higher input prices. In these circumstances the value of fixed income payments will be eroded over just a few years. However dividend increases from the companies we are focusing upon have, we believe, a very good chance of substantially exceeding inflation.

For reasons well rehearsed previously we shall not witness strong growth in developed economies over the next few years. Thus fiscal austerity, and low interest rates are the necessary combination for the years ahead. No doubt the Greeks have a word for it.

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