

Investment Newsletter

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equilibrium
asset management

Health, Wealth & Happiness

We recently held our latest investment dinner, together with fund managers from Invesco Perpetual's Global Equity team.

One topic that came up during discussion was that, in looking at the economic impact of issues, we can sometimes forget the social impact.

For example, we debated the merits of the government's spending cuts. A number of economists have recently put their names to a letter criticising the cuts, saying that this is having a negative impact on economic growth.

We need economic growth to be strong, as this increases the government's tax take which therefore helps the UK balance sheet. There is a school of thought that we should carry on spending and not make such deep cuts just yet, thereby stimulating growth so that finances will improve through the stronger tax revenue.

However, we clearly can't go on spending more than we bring in and borrowing at an exponential rate. At some point markets will stop lending to us, or make us pay a higher rate. There needs to be a balance between cutting spending and stimulating economic growth, and that's a very difficult tightrope to walk.

From a purely economic point of view this is difficult, but factor in the social impact and I don't envy the politicians at all. Spending cuts are directly affecting people's lives. Perhaps they may lose their jobs, or can no longer access a service they rely on. Maybe they can no longer be able to afford to go to university.

We should never ignore the social implications. Our job is obviously to look after your finances and therefore we tend to comment on the economics, however social and financial issues are often interlinked.

For example, cutting funding for university may mean less people can afford to go and study. Graduates are the people who are meant to be earning big salaries through their career. They're the people who (in theory) ought to be bringing the most to the economy through their taxes in the future. So the social impact of today has an economic impact down the line.



Wealth Creation

Different types of investment also have social impacts in different ways. For example, it is easy to think that by investing in a less developed country we are in some way exploiting them, but this generally is not the case.

Take a country like India. Economic growth in India, aided by outsourced Western call centres and some world class Indian companies, is helping transform cities and create a burgeoning middle class.

According to the UK Department for International Development, during the period between 1973 and 2000, the incidence of poverty expressed as a percentage of people below the poverty line declined continuously from 54.9% to supposedly 26% (although definitions of poverty vary).

The growing economy is clearly making a difference, and this is expected to accelerate as the "trickle down" effect of money from the middle classes continues.

Whilst true investment creates wealth, this is very different to pure "speculation" which does completely the opposite.

For example, commodity prices have been extremely volatile, and many commodities are trading at near record highs. This doesn't really matter when it is something like gold but when speculation is affecting oil or food prices, this starts to affect people's quality of life. In the USA, a government oversight committee reported that "excessive oil speculation could be inflating prices by up to 30%."

This has been fuelled by the derivatives market which allows speculators to bet on the price of oil without ever having to own the actual commodity. According to Dr Massood Samii, a former OPEC Chief Economist, one million contracts of future oil are traded in New York and the size of each contract is one thousand barrels. This is more than 50 times U.S. oil consumption of just under 20 million barrels per day and 12 times daily world oil consumption.

The United Nations has recently proposed a tax on commodity transactions, to curb speculation which the organisation believes is artificially lifting prices, and volatility, of raw materials.

We are often asked why we don't invest in commodities and one of the reasons is that prices can be very volatile, and often don't reflect the actual fundamentals of supply and demand. If we can't assess true value, and if the risk is so great, it just doesn't fit with our aims of steady, predictable returns.



Better Life Index

We tend to measure the health of a country by purely looking at their Gross Domestic Product (GDP), essentially the country's turnover. However, the OECD (Organisation of Economic Co-operation and Development) has recently launched their "Better Life Index" to provide an alternative measurement.

The survey found that people in the UK work around 1,646 hours each a year, 93 hours less than the average for all 34 countries analysed by the OECD. Britain came fifth in terms of wealth and has an above average life expectancy of 79.7 years, despite having above average levels of obesity!

Purely looking at "life satisfaction", the UK fell pretty much in the middle. The proportion of Britons saying that they are satisfied with their lives is 68% which is 9% above the average, although we still only came 15th out of the 35 countries surveyed. The most satisfied nation in the survey was Canada.

Of course, happiness is completely subjective, and so you can personalise the index on the OECD website. Different people place different importance on different factors, such as income levels, community, work/life balance, education or health. You can design your own personal happiness index here: <http://www.oecdbetterlifeindex.org/>

Happiness does not necessarily go hand in hand with wealth. However, whilst money might not make you happy, having below a certain amount means you are certainly more likely to be unhappy! The poorest countries in the survey such as Mexico and Turkey consistently rank in the bottom few countries, no matter what measure you look at. The survey is generally confined to economically developed countries and it would be interesting to assess the results in some of the world's poorer nations in the same way.



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General Economic Overview

GDP growth is expected to remain muted but has returned to positive territory after a negative result in the previous quarter. Inflation may remain well above the Bank of England target for some time. We believe interest rates will rise this year or early next, but will remain low for some time. If our scores below turned out to be correct, our balanced asset allocation could return around 8.05% over the next 18 months compared to our long term assumption of 7.6% pa.

Asset class key

+ positive	+5 strongly positive
- negative	-5 strongly negative
= neutral (normal behaviour)	

	Outlook
Equity Markets Equities still look reasonable value based on current earnings. Despite low economic growth, earnings have scope to grow meaning prices could rise. We believe that high quality, well capitalised companies should outperform.	+2
Fixed Interest We are concerned about the risks of investing in pure fixed interest, given our views on inflation and interest rates. However, we believe there is value in inflation linked, variable interest rate, and some high yield bonds.	-4
Commercial Property The rental yield on commercial property remains attractive but this is diluted by high levels of cash in property funds. We expect little capital growth until well into 2012.	-3
Residential Property We believe prices are likely to remain flat over 18 months.	-5
Cash With interest rates remaining at record lows, returns on cash could remain below average for some time.	-5