►On Target

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Investing in Liquid Sunshine

Oil recently topped $100 a barrel. Does this make investments in it a buy… or a sell?

Oil has been in a strong uptrend since early 2009. The main driver has been global economic recovery. But an increasingly important factor has been exploding consumption in emerging economies.

Barclays Capital's commodities chief, Roger Jones, expects demand from countries outside the OECD, accounting for one third of world oil imports, to grow four times faster this year than those of the group of advanced economies.

The largest of the emerging economies, China, is already the world's second biggest consumer – using about half as much as the US. On current projections China's annual demand will exceed America's in about 15 years' time – and require an extra 10 million barrels a day, equivalent to the production of, say, five major new oilfields.

Oil provides the liquid fuels that drive the world's transport system – road vehicles, ships, aircraft. There are no major alternatives. As the global economy grows, so does demand for oil, at an average rate of about 1.4 per cent a year.

But oil is more than that. It is the key to life-quality enhancement. Once a family rises out of poverty, able to afford high-protein foodstuffs and the space and privacy of a decent home, a priority is acquisition of a car. No product of industrialization has done more to transform living standards.

Years ago I described the motor car as the Liberation Machine. "No other invention has done as much to bring personal freedom to the masses. It allows people to travel where they wish, when they wish, without any expense for additional passengers such as children. It adds immeasurably to city-dwellers' quality of life."

Nowhere is this happening more dramatically than in China, where every year tens of millions of people see their incomes rise to levels where they can afford the items that mark them as reaching the status of "middle class."

This year it's forecast that about 18 million new cars will be sold in China – compared to perhaps 12 million in the US. That means huge additional demand for petrol. Yet car ownership in China relative to population size is still a fraction of America's. The future potential for vehicle manufacturers – and for the liquid fuels that power them – is mind-blowing.

In this issue: Oil ▫ Inflation ▫ Uranium ▫ An investment for a ten-year lock-up ▫ The small-cap effect ▫ Germany's toxic debt ▫ US dangers

What are the alternatives to oil?

Most of them are uncompetitive, many of the most promoted requiring huge subsidies that have now become unaffordable for governments whose finances have come under acute stress because of overspending and soggy revenues.

In a new study on the energy outlook for the next 20 years, BP forecasts blistering growth in production of biofuels, forecasting they will account for 30 per cent of the global increase in energy supply.

I cannot believe that. It suggests BP is out-of-touch with political realities, as it showed itself in its Gulf of Mexico crisis last year.

Most biofuels depend on diversion of crops from consumption as foodstuffs to conversion into liquid fuels. That will become politically unacceptable in a world likely to face food shortages. For how much longer, for example, will it be possible for the US to divert 40 per cent of its corn crop into highly-subsidized and protected ethanol manufacture?

In time, it may become commercially viable to make ethanol from waste, or diesel from inedible crops grown on wasteland. But we are still a long way from doing that, or doing so on a large scale.

The only viable major alternative

The current fad is for electric cars, hugely subsidized by governments. How much longer can they afford such subsidies? Besides, the electricity that substitutes for liquid fuels has to be generated. On balance there is no energy benefit relative to oil, and little or no benefit in reducing production of greenhouse gases.

The vehicles will continue to face consumer resistance because of their high cost (even after subsidies) and performance limitations.

I think electric cars do have a future -- because of the immense government-driven policies to promote them, improving battery performance, and lower production costs that will come with greater volume. I just don't think they can be a major alternative to traditional vehicles fuelled by petrol and diesel for the foreseeable future.

The most viable alternative to oil is natural gas.

It is far more abundant in terms of reserves relative to current demand, especially since technological breakthroughs in the US have made it possible to harvest gas from shale and similar previously largely-ignored resources. Huge reserves are also conveniently located in politically-favourable environments, such as America and Australia.

However, production of "tight gas" and shale gas formerly not viable to exploit has transformed the supply situation, halving US prices for natural gas, which have plummeted relative to oil, with which it competes in some uses.

In the US, the Energy Information Administration says its most likely forecast is for the annual average price of gas at the wellhead to remain below $5 per unit for the next decade. This means gas is likely to remain an attractively-priced alternative to oil for years to come. Perhaps. But low gas prices are also discouraging exploration.

Vehicles driven directly by compressed gas have been around a long time. But they haven't made much of an impact.

Gas only becomes a serious competitor to oil when converted into liquid fuels. Sasol, the South African specialist, has been doing that successfully on a massive scale for half a century as the second stage of converting coal into oil, and is now exporting its expertise to the rest of the world. It is a partner in a Qatar gas-to-liquids project and has just paid $1 billion for a half-share in a Canadian gas-to-liquids venture.

However, the capital and current costs of converting gas to liquids will limit the potential to substitute natural gas for oil, especially as gas is in such strong demand for easier and more direct uses -- power generation, heating, petrochemical feedstock.

Oil itself can be recovered from unconventional resources such as the tar sands of Canada and Venezuela. The deposits are enormous, but they are difficult and expensive to recover and process. Canada's 170 billion barrels are the world's second largest oil reserves after Saudi-Arabia. Current production is now about 1½ million barrels a day and announced investment plans should nearly double that before the end of the decade.

But opposition from the environment lobby grows stronger by the year. Recovering oil from the sands is a particularly dirty process and processing usually requires a lot of natural gas, which critics say would be better used directly as a clean fuel.

At prices around $100 or more a barrel, many unconventional resources are economic to exploit.

World reserves of conventional oil have risen by 23 per cent over the past decade – partly because of new discoveries such as offshore Brazil and offshore West Africa, but mainly because steady improvements in industry technology has made it possible to harvest commercially a higher proportion of known resources.

That has – so far – discredited the Peak Oil Theory that production would soon top out and then go into decline because there were no more giant new discoveries to be made.

Where can extra supplies come from?

However, it is true that there are increasing geological, commercial and political problems with expanding supply of conventional oil.

The important new discoveries are deep under the oceans, so very expensive to find and exploit. It becomes increasingly difficult for oil majors to operate internationally because of resource nationalism – protection for state oil interests and more aggressive taxation. Nomura recently estimated that seven of the ten top source countries shut out Western oil companies.

The multinationals also face increasingly aggressive competition internationally for access to oil wealth from the China's three giants: PetroChina, Sinopec and CNOOC, which are still largely state-owned, and have virtually unlimited access to cheap state capital. They are strongly promoted by Beijing to meet the nation's huge future needs for oil imports and as a better use for trade surpluses than investment in US paper assets.

Longer-term, I expect oil supplies to struggle to keep up with growing demand. The International Energy Agency predicts production will only increase by an average of 0.3 per cent a year over the next quarter-century. But even that assumes discoveries at a much greater growth rate than has been experienced in recent years.

I don't expect additional energy supplies from unconventionals (tar sands, gas-based liquids) and alternatives (biofuels, battery power) to become large enough to make a significant impact. The long-term uptrend in oil prices is likely to continue. And there is always the risk of a price spike due to some major catastrophe impacting on supply, such as closure of the Hormuz Straits because of a Mideast war.

If you fancy investing in oil, the simplest way is to buy units in one of the exchange-traded funds whose values move in line with the internationally-traded prices of crude. However, technical factors muddy the picture, such as the disparity between the two crude benchmarks, the WTI (sensitive to US demand) and Brent (driven by Asian demand). The disparity is now huge because of a build-up of supply within the US relative to storage capacity.

The direction of the dollar is important, to which crude prices move inversely. When the dollar is strengthening, oil weakens, and vice versa.

If you prefer to invest directly in the shares of oil companies, I find it hard to find any to recommend for a core holding in a portfolio.

The problem with oil firms is that virtually none of them has an impressive earnings growth record. The profits of most of them are driven mainly by the switchback prices of oil itself, rather than the rewards of new discoveries or successful takeovers. They are more like commodity index trackers than corporate growth stocks.

Very few of the majors have delivered sustained earnings growth over the past few years. I reckon the best of the lot are:

• **Chevron** (ticker: CVX:NYQ) has a respectable 3 per cent dividend yield more than three times covered. It's the world's fourth largest oil group by market capitalization, with nearly three-quarters of its earnings originating outside the US. Its foreign interests include a major stake in Nigeria's offshore fields and in Australia's giant Gorgon liquefied natural gas venture.

• **CNOOC** (883:HKG), which of the three Chinese majors is the one most focused on developing offshore China and foreign resources. Its recent production growth has been very strong, and it's overwhelmingly an oil rather than a gas play. It has overseas interests in Argentina, Indonesia and West Africa, a stake in the world's first coal-gas-to-liquids project in Australia, and a promising business position in Iraq, with its enormous under-developed resources.

• **BG Group** (BG:LSE) is a very large global specialist in natural gas (although oil production still accounts for 70 per cent of its value). It's expensive with a tiny dividend yield and a high price/earnings ratio, but good earnings growth and prospects have made it a stock-market favourite. Its diverse interests encompass the Caribbean, North Africa, the North Sea, coal seam gas in Australia, shale gas in the US and, in particular, a pole position in the deep-water discoveries off Brazil.

Six other oil companies that caught my attention are:

• **Premier Oil** (PMO:LSE) is a reasonably-valued UK mid-cap with strong earnings growth. It plans to double production to 100,000 barrels a day from its traditional North Sea/onshore UK interests and its more recent focus on Asia, where it has wells or projects coming on stream in Indonesia, Pakistan, India and Vietnam.

• **PTT Exploration & Production** (PTTEP:SET) is Thailand's leading oil company, but is rapidly diversifying internationally with interests in Australia, Canada and Burma. It offers a decent 3 per cent dividend yield, 2½ times covered, and plans to triple its current production of 300,000 barrels a day over the next nine years.

• **Crescent Point Energy** (CPG:TOR) is a speculative play for individual investors. A respected Canadian analyst says this tiny company "does seem to have the best growth and production prospects" in Canada "over the next ten years," with the best-located reserves in south Saskatchewan. It's also been paying good, stable dividends.

• **China Oilfield Services** (2883:HKG) stands to benefit from China's huge expansion in energy resources irrespective of what happens to oil prices. Although it has a thin dividend, it's on a cheap PE ratio and has had the strongest earnings growth of all the companies I looked at.

However, I don't think this is a particularly good time to buy any oil stocks.

Although world oil demand rose by 2.8 million barrels a day last year, that was a rebound from a recession-hit 2008 and 2009, when demand fell by 1.5 million a day. The International Energy Agency is forecasting an increase of only 1.5 million b/d this year. Demand growth in China is expected to halve this year, to about 6 per cent.

Victor Shum, of Singapore-based consultants Purvin & Gertz, suggests that oil prices around $90 to $100 are "not due to supply tightness" as the market is "well-supplied," with "a lot of inventories, a lot of spare OPEC production capacity."

OECD oil stocks are currently equivalent to 58 days' world demand, which is a high level. OPEC, the oil cartel, has the capacity to start pumping extra, up to an extra 5 million barrels a day, equivalent to about 6 per cent of global consumption. That leaves a comfortable cushion to deal with supply shocks. In fact OPEC has already started to supply more.

It was noticeable that when the political crisis in Egypt burst into the news, with speculation both about closure of the Suez pipeline and the longer-term threat to Mideast stability from rising Islamic fundamentalism, oil prices only popped up a few dollars.

All this suggests that recently oil prices have been driven too hard than warranted by fundamentals. One indication of heavy speculation is that record sums have been pouring into US oil futures.

There is potential now for a significant correction in oil, taking prices back into the low 80s or even down into the high 70s.

What could trigger that?

Perhaps political moves in the US to curb speculation in commodities generally, given the impact of rising prices on consumer inflation, especially if oil stays above $100. Perhaps an economic outlook shock in America or China, suggesting there's going to be an unexpected slowdown in oil demand growth.

At this stage I favour taking some profit out of oil-related investments. Use the time to investigate my recommendations and other oil stocks that interest you, to prepare to buy into this strategic-resources play at lower levels.

Longer-term, I remain confident about oil.

Inflation: a Menace or a Mirage?

An inflation panic is under way, sending the prices of even the safest bonds into free-fall. Ten-year US Treasuries have fallen 7 per cent in value since late last year, ten-year German Bunds by 9 per cent since mid-2010. Are we really heading into a period of strongly rising prices, and how ought this to affect our personal investment strategy?

The panic has been triggered by strong industrial commodity prices and an explosion in the prices of basic foodstuffs such as wheat, corn and soybeans. The Food & Agricultural Organization recently warned of a global "food price shock" as its index of farm prices hit a new record.

These are driving up consumer prices. This is especially so in emerging economies, where because of still-low incomes, food is a major part of families' spending. It accounts for one-half of the index basket of consumer spending in India and one-third in China, compared to just one-tenth in Britain and Germany, even less in America.

But the bubble in food prices is largely due to crop failures brought about by adverse weather conditions in Russia, South America and the US, in particular the Pacific warm-ocean cyclical phenomenon called La Niña, which has been at its strongest in 30 years.

Although there will be other crop failures in future, and there is reason to believe that long-term growing demand for food is likely to be price-supportive, it's a near-certainty that as more normal conditions return to the farmlands, prices of agricultural commodities will fall, deflating the bubble.

Industrial commodities are less important as a driver of inflation. As the inputs of heavy industry (iron ore and coking coal for steel), transportation and petrochemicals (oil and gas used as fuel and feedstock), and construction (copper and aluminium), go up they do raise costs – which eventually have to be passed on to customers.

But with few exceptions, they are a relatively small proportion of costs compared to those of labour and capital.

Central bankers fear what are called "second-round effects" – that higher prices for food and industrial inputs will feed through to raise prices generally, which in turn will drive workers to get compensating rises in their incomes, the start of what could develop into a spiral of rising prices.

That looks very unlikely to me.

When there is a pool of unemployed and/or inexpensive workers on which employers can draw, or they can substitute technology for human input, they are under no pressure to raise their labour costs, no pressure to pass on those costs in their prices.

The effect of rising prices for food (or one-off factors such as rises in sales taxes) is to squeeze consumer spending-power. They destroy demand. Far from being inflationary, they are deflationary.

Now it's true that in some parts of the emerging world – China's industrialized coastal areas, for example – labour costs are rising and they are inflationary. But those are the exceptions.

In the advanced economies the impact of recession, including the continuous pressure on businesses to sustain or improve profitability by tight control of labour costs, seeking growth through greater use of low-cost offshore factories and of infotech, means there is a huge pool of unemployed or under-employed.

In Britain workers' incomes have only risen on average by 2 per cent over the past year, or well below the increase in retail prices. Unemployment has reached 8 per cent and is likely to worsen as jobs are shed in the public sector.

In the US the squeeze is even greater. Average pay in the private-sector has been contracting at an annual rate of 1 per cent, while employment in state and local government also faces contraction because of the dire state of public finances. Official figures show joblessness stuck at 9 per cent. The effective figure is probably much higher.

The *FTfm*'s commentator John Dizard reports: "Where there are shortages of particular skills that force some compensation increases, employers seem to offset the costs by cutting pay for new entrants, or just hire 'interns' for little or nothing. Direct labour accounts for the biggest share of total costs, and its price is not going up."

In some emerging economies central banks are raising interest rates because they fear general inflation. There is overheating in some (China, South Korea, Argentina) and no spare capacity in others (Brazil, India, Poland).

Foreign money not welcome

CLSA-Pacific's economics team estimates that this year inflation will rise to 7 per cent in China (compared to 3 per cent last year) and 9 per cent in Indonesia (from 5 per cent). Next year they estimate inflation will hit 10 per cent in the Philippines and 8 per cent in Thailand.

However, in many emerging economies central banks are unwilling to increase interest rates through fear that that will attract even more of the unwelcome foreign hot money that puts upward pressure on their currencies. They are suffering from importing the infection of the US's low-interest and money-printing policy.

They are also nervous about over-reacting to inflation and so damage the high rates of economic growth to which their societies are wedded. Most experts reckon that tightening will continue in China, for example, but remain cautious and steady. Beijing is more worried about slowdown than about inflation and focuses its tightening on asset-speculative sectors such as property.

In the much larger group of advanced economies there is still so much spare capacity in factories and in labour pools that central banks resist pressure to start raising interest rates, which they know they will have to do eventually because of fast-growing official debt, and because they fear the dangers to economic growth from the shock of higher costs of servicing debt.

The bankers, seeing the excess capacity in their economies, believe that the current inflation pressures are not dangerous because they're temporary and won't spread significantly into prices generally. Levels of "core inflation" – the concept that excludes prices of major items such as foodstuffs and oil on the grounds that their rises are largely temporary – remain at very low levels in the advanced economies.

I agree with the central bankers' caution, at least this time around. I reckon that the current panic over inflation is a short-term phenomenon. It's likely to persist for some months, but then fade as food prices fall and industrial commodities lapse into at least medium-term corrections.

The inflation fear could disappear quickly if there is some major deflation shock such as a generally-unexpected slowdown in major economies such as the US or Europe. As George Gonsalves of Nomura Securities International says: "There are still a lot of risks out there that are unresolved."

There are already several indications that the inflation fear is excessive. One scarcely-mentioned sign is that risk-aversion, which reflects fear of deflation rather than inflation, remains strong, as can be seen from the continuing strength of the currencies that are the biggest beneficiaries of that aversion, the yen and the Swiss franc.

Besides, it can be argued that recently much of the increase in the prices of industrial commodities has been driven by speculation, and that could quickly go into reverse if there is a change in general business optimism about economic growth. Or speculation is restricted by political action.

There are already early signs that prices could be topping out. One of the most obvious is the way oil – which incidentally accounts for about half the total weighting in all-commodity indexes – has struggled to reach and stay around $100 a barrel.

For the moment, it makes sense to be wary of fixed-interest securities and emerging-market equities sensitive to interest-rate increases. But Dizard advises: "We are in a slack tide between deflationary and inflationary forces in the world, which means you shouldn't overpay for inflation protection."

The Other Yellow Metal

According to a new report on uranium by Jackson Wong of Investors Intelligence, current bullishness stems from several factors:

• The annual requirement to fuel nuclear reactors is forecast to increase over the next four years from 68,000 tons to about 90,000. Current mine output is no more than 55,000 tons. New production from countries such as Namibia, Niger and Uzbekistan "takes time" to bring on stream and requires "huge up-front capital expenditure."

• The gap between newly-mined supply and demand has been bridged by dismantling 12,000 nuclear warheads and converting their highly-enriched uranium into low-enriched reactor fuel. But the Megatons-to-Megawatts agreement between the US and Russia for releasing their military stockpiles is set to expire in 2013.

Although the new START agreement provides for the two nations to scrap a third of their strategic warheads, Wong suggests Russia may decline to extend M2M provisions because of its own growing uranium demand, thus removing significant supplies from the market. The rundown of civilian inventories, which currently provides about 10,000 tons a year, is expected to be exhausted by 2013.

• There is a growing shift towards kinds of energy not generated from oil, gas and coal, especially nuclear-generated electricity, which is the cheapest (Wong points to a study showing production cost in the US in 2006 averaging 1.72 cents per kilowatt hour, compared to 2.37 for coal, 6.75 for gas and 9.63 for oil) – and has the lowest carbon emission. China , other Asian countries, and also some Central/East European nations, are building many more reactors.

• Energy security – less dependence on imported resources – is getting more priority. In China the government has directed its utility firms to stockpile uranium.

• Uranium prices are in a secular bull market. Investors increasingly see more upside potential here than, for instance, in precious metals mining.

Wong lists these ways of investing in the nuclear/uranium sector:

• Uranium infrastructure, a conservative option. He likes atomic power station engineering groups Toshiba Plant & Systems of Japan and the Shaw Group in the US.

• Established uranium producers, also a conservative option. The preferred plays are Canada's Cameco and Australia-listed Paladin.

• Uranium explorers and new producers – more speculative. Wong highlights US-listed Uranium Energy and Uranerz, and Canada-listed Denison Mines, UEX and Mega Uranium.

• Highly-speculative junior uranium explorers such as Canada-listed Laramide Resources, Rockgate, Titan Uranium, Mawson and Strathmore Minerals.

• Physical uranium. Uranium Participation Corp. owns stocks of uranium oxide.

Long-term Lock-up Investments

My neighbor in Chiangmai, the well-known investment adviser Marc Faber, recently asked a panel in Moscow: "If tomorrow you were supposed to go to jail for ten years and were allowed to make only one investment, which you would not be able to touch for this period, what would you choose?"

High-profile American commentator Nouriel Roubini opted for a basket of stocks of Western multinationals geared to benefit from emerging markets. Nassim Taleb (he of "black swan" fame) suggested land in his native Lebanon, a country he said where every political party respects property rights. Scott Minerd of Guggenheim

Partners chose works of art. Maria Gordon of the giant fund manager PIMCO preferred some large, high-return emerging-market stocks. Russel Napier, the well-known CLSA strategist, went for a basket of Asian currencies. Another UK figure, Hugh Hendry of Eclectica Asset Management, opted for tobacco stocks. Faber himself stuck with his favourite investment – gold.

My choice for a ten-year lock-up? Gold is tempting, but my choice would be Industrial & Commercial Bank of China , which is accessible to international investors through a listing in Hong Kong (the ticker is 1398).

It's the world's biggest bank by market capitalization, and is still largely owned by the Chinese government – so there's no default risk. It currently offers a dividend yield of around 3.4 per cent, nearly three times covered, in the Chinese currency, which seems destined to be one of the strongest over the next ten years.

Unlike just about any of the world's other major banks, it has had a strong and consistent record of earnings growth.

Tailpieces

Buy-backs: American companies have announced share buy-backs on the greatest scale since 2007 as their preferred means of deploying their record cash holdings. Last year buy-backs rose to $357 billion.

But Allen Brooks, MD of energy investment bankers PPHB, is not convinced that this is a good idea.

When it comes to dividends and share repurchases, understanding the role each plays in rewarding shareholders is important, he says.

Buying back shares is a way to shrink the denominator in the earnings per share calculation.

The theory is that when cash is used to repurchase shares, the lost interest earnings will be more than made up for by the boost in earnings per share from fewer shares, and the resulting company valuation will increase.

In theory this exercise should lead to a higher stock price. But in practice share prices often do not benefit from the shrinking capitalization.

What happens is that shareholders seeking to exit from their holdings are rewarded as the stock price paid often does not appreciate sufficiently to offset the lost income from the cash used to effect the transaction.

Another negative about stock buybacks, Brooks says, is that managers elect to do them when they have excess cash. That often occurs at or near the top of business cycles when share prices tend to be highly valued.

The small-cap effect: Many commentators, including myself, favour large, well-established companies in the current uncertain global economic environment, where growth is likely to be weighed down by the burden of debt for a long time to come. But there is another point of view.

Although smaller companies are more volatile, they tend to outperform over time. Ruth Sullivan reports in the *FTfm* that over the past decade the world's smaller

listed companies have provided annualized returns that were 7 percentage points higher than large ones.

This is believed to be because they are better at identifying business opportunities and have more entrepreneurial managers, often with a major stake in their firms.

Last year the small-caps were huge outperformers in countries such as Brazil, France, Switzerland, Germany and Hong Kong.

Dangers: “There is little evidence that the multiple leverage problems we face [in the US] are easing,” says commentator Tom Coyne of Index Investor.

“Indeed, the evidence points to worsening problems in many areas, from household debt and the residential property market, to commercial real-estate debt to financial-system debt to municipal and sovereign debt.

“These data suggest that the US housing crisis is far from over.

“Moreover, the presence of banking and financial-system crises very substantially increases the probability that an ‘ugly’ deflation episode will occur, due to political pressures in the US, not to mention pressures from the bond market.”

The probability of policy errors that will sharply increase the risk of deflation, such as premature reductions in fiscal and monetary stimulus measures, is “very high.”

Toxic debt: “Germany’s unique brand of state-owned hedge funds, otherwise known as *landesbanken*, remain seemingly as unreformed as ever despite the huge losses they sustained in the US mortgage-backed securities market,” comments CLA-Pacific strategist Christopher Wood.

The nine publicly-owned regional banks had a total debt of €1.7 trillion (about $2.4 trillion) at the end of 2009. “These fundamentally politicized entities still have incredibly leveraged balance sheets,” Wood says.

They have “been responsible, to the delight of debt floggers everywhere, for some of the most idiotic leveraged yield-seeking investing in asset-backed securities and related debt instruments in recent years.”

Wood doesn’t say so, but keeping alive these dodgy banks rather than sending them to the knacker’s yard is probably one important reason why the German government has been trying so hard to prevent Greece, Ireland and the rest from defaulting on their government loans, because the *landesbanken*’s balance sheets are loaded with the toxic euro paper.

Another mistake: President Barack Obama has appointed the chief exec of General Electric, Jeffrey Immelt, to lead his new jobs council.

But his giant company, *The Wall Street Journal* points out, hardly has a track record that suggests it was wise to choose him. During the bubble years its focus moved away from the products that made it famous – jet engines, gas turbines, consumer appliances – and into finance. Nearly half its earnings came from its finance business when the bubble burst. Without massive government assistance, “GE Capital might well have taken the entire company down.”

What policy is Immelt likely to promote in his new job?

His particular goal, the Journal says, “is to promote policies and subsidies that aid green energy, in which GE is deeply invested.

"But if wind turbines are a good business, they will find a market on their own. If wind power turns out to be an uncompetitive bust, then the government will have misallocated hundreds of billions more dollars that could have found more productive purposes."

Large-caps: According to Credit Suisse the free cash flow of companies outside the financial sector in the four biggest developed economies now account for 4.3 per cent of GDP, a record level and double that of ten years ago. In an uncertain environment, this encouraged firms to cut costs, hoard cash and raise money cheaply in the corporate bond market.

British investment adviser Brian Durrant suggests that two developments will follow…

One is that companies that have been able to borrow cheaply are likely to buy back their shares, which are expensive to fund. The other is that they will be under pressure from shareholders to pay out more in dividends.

Possible outcomes: "The mountain of government and financial sector leverage built up before the recession has hardly shrunk," says the *FT* in its Lex column. "The combination of more rapid growth and higher inflation (food and energy prices are up sharply) could now produce a healthy global deleveraging. But another combination of high debt levels and minimal or negative real interest rates makes the world vulnerable to uncontrolled inflation, speculative bubbles and sudden debt crises. This year is starting well. It could easily end badly."

Political investing: Funds focused on investing in environment-friendly companies such as those involved in renewable energy are consistently underperforming funds that invest generally without such ideological restraints, and are losing money, according to a study by *Money Management*.

Undeserved bonus: Did you see that Goldman Sachs has awarded its chief exec Lloyd Blankfein a 43 per cent increase in his share-based bonus for last year, worth more than $12 million? It must be a reward for not doing even worse. The bank's profits fell 38 per cent last year. Is that how reward-for-performance works in the crazy world of banking?

UK dottiness diary: A grandmother was fined for littering a public place in Coventry when she bent down to recover a cigarette wrapper that had fallen out of her pocket.

A popular teacher at a school in Wales has been fired for failing to carry out a formal risk assessment for encouraging pupils to test a snow-sledge on a nearby hill as part of teaching them the principles of design, despite receiving support from the boys' parents.

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