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8th August 2011

A Modest Proposal..

'GONE BUST? Is that the tour operator or the country?'

With thanks to The Daily Telegraph.

..For Preventing Bankers From Being A Burden To Their Country, And For Making Them Beneficial To The Public

It is a melancholy object to those who walk through this great town or travel in the country, when they see the streets crowded with bankers, all in rags and importuning every taxpayer for alms. These bankers, instead of being able to work for their honest livelihood, are forced to employ all their time in money printing, speculation or in sponging off the state.

I think it is agreed by all parties that this prodigious number of bankers is in the present deplorable state of the kingdom a very great additional grievance; and, therefore, whoever could find out a fair, cheap and easy method of making these bankers sound, useful members of the commonwealth, would deserve so well of the public as to have his statue set up for a preserver of the nation.

But my intention is very far from being confined to provide only for commercial bankers (i.e. professed beggars); it is of a much greater extent, and shall take in the whole number of investment bankers and central bankers into the bargain.

The number of souls in this kingdom being usually reckoned some sixty million, of these I calculate there may be about five hundred thousand bankers. The question therefore is, how this number shall be reared and provided for, which, as I have already said, under the present situation of affairs, is utterly impossible by all the methods hitherto proposed. For we can neither employ them in handicraft or agriculture and they are useless for anything else. They can very seldom pick up a livelihood by stealing, at least till they arrive at adulthood.

I have been assured by a very knowing American of my acquaintance in London, that a young healthy banker well nursed is at thirty years old a most delicious, nourishing and wholesome food, whether stewed, roasted, baked or boiled; and I make no doubt that he will equally serve in a fricassee or a ragout.

The following types may be considered variously tasty and will suit a range of household budgets.

Commercial banker

Not being built for speed, the commercial banker is a somewhat fatty concoction, but may go some way towards the feeding of a large family. Especially having devoured so many himself over recent years.

Investment banker

A leaner form, if not outright stringy, having been starved of business of late.

Central banker

a) **The Ben Bernank**

The Ben Bernank is a fibrous if not grizzled sort, but on the positive side requires little cooking preparation, being mostly hairless. Unfortunately the Ben Bernank has also been inflating for years, and has resorted to all sorts of unnatural stimulus in his search for growth, so cannot be considered organically sound.

b) **The Mervyn King**

The Mervyn King can be easily captured, as it can normally be found in a nervous flap most of the time, rushing around in ever-decreasing circles, and is invariably caught slowing down badly. The Mervyn King has also been trying to inflate but with mixed results to date. The Mervyn King contains particular fleshy delicacies just below the ribs, known to expert chefs as the Penfolds. Both the Bernank and the King central bankers are prodigious devourers of currency.

I profess, in the sincerity of my heart, that I have not the least personal interest in endeavouring to promote this necessary work, having no other motive than the public good of my country, by advancing our trade, providing for infants, relieving the taxpayer, and giving some pleasure to the rich. I know no bankers by which I can propose to get a single penny; all of my friends are productive members of the community.

(with apologies to Jonathan Swift.)

So with traditional media trampling over each other to put the fear of God into investors, it is worth stepping back from the hurly-burly of the markets for a second and to try and assess things from a cooler-headed, macro perspective.

Here is what we think is going on.

Conventional thinking has it that the financial crisis began in September 2008 with the failure of Lehman Brothers. We believe that conventional thinking is missing the point. As economist Tim Lee of pi Economics indicated several years ago, subprime, for example, was never THE problem, it was merely the first and worst part of the debt edifice to collapse. The reality, we would suggest, is that the world is drowning in debt of dubious provenance which will never be paid back in full. Instead of addressing the debt burden, the politicians of the western economies (where most of this debt is sitting) have repeatedly tried to kick the can down the road, because they are more in thrall to the electoral calendar than to a day of reckoning they are trying to hospital-pass down to the next generation. At the same time, since 1971 the world's central banks have operated to a purely fiat money system, in which currency is backed not by precious metal but by faith in government and nothing more. We believe that this experiment in unbacked currency may be moving to some form of ultimate resolution or recalibration. Having the US dollar as the global reserve currency is incompatible with having US Treasury bonds representing the de facto risk-free rate, given that the accumulated debt burden of the US is bigger than that of any other sovereign power, and is still expanding when it should be contracting. Meanwhile the euro zone for the last decade has attempted its own science project, of trying to operate a common currency bloc without full political or fiscal union. This is unworkable.

In supposedly 'rescuing' the banks by gifting their bad debts to the taxpayer, western governments merely converted a private sector solvency problem into a public sector solvency problem. Whereas banks were too big to fail, governments and their finances are now probably too big to save. The problem of debt service would have been problematic even if western economies were growing at something close to their pre-crisis rate, but with austerity having become the new black, it is now closer to being an existential problem eroding public confidence in both markets and money, because at near zero GDP growth, governments will soon struggle just to service their historic debts, let alone take out new ones or undertake new bail-outs, which we should perhaps call fail-outs, in that they are now predestined to fail.

It has taken just a few reported instances of sub-par growth in the western economies for the marginal investor to grasp the situation. It is not a subprime debt crisis or a euro zone debt crisis or a US debt crisis. It is a global sovereign debt crisis and since government bonds are the largest asset class in the world, there will inevitably be fall-out in other markets when a sufficient number of investors starts to appreciate that the emperor is wearing no clothes. Equity markets have been pumped up by otherwise ineffective money printing, given the spurious quasi-scientific gloss of quantitative easing, which has done precisely nothing to improve the economy on the ground. Investors have been conditioned to call for more, even as the process has been revealed to be an exercise in magical thinking, whereby temporarily boosted financial assets somehow mysteriously trickle down wealth into the real economy. Quantitative easing has one specific side-effect, which is to savage the currencies of whichever administration practises this dark art. Choose your poison. Global investors have a fairly limited choice: they can hold US dollars (with a reserve currency status that the Fed is doing its damnedest to destroy), or they can hold euros (a currency that may break apart if euro zone politicians continue to avoid taking hard choices, and with other people's money). Rational investors have been voting in favour of harder currencies, in the form of gold, for roughly the last decade and the logic for that currency preference is as indisputable now as it ever has been. Gold is the premier stateless currency and is guaranteed to see its supply rise at a slower rate than that of any paper currency, which is what the trend of the last decade really represents. Other than gold and silver, investors have so far correctly identified the superior currencies of the world as stores of value on a relative basis, a club that includes the Japanese yen and the Swiss franc.

The West seems destined to dip back towards recession (assuming that it ever really left that condition, which we very much doubt). The question is whether otherwise fast-growing markets are dragged down too, or whether they can maintain their own economic growth velocity.

For several years we have advocated investment across the following asset classes or investment structures as a means of achieving broad portfolio diversification and, ideally, a degree of capital preservation:

i) High quality sovereign debt, issued by objectively creditworthy countries as opposed to malodorous G7 trash;

ii) Defensive equities, not least as represented by non-financial businesses with sound balance sheets, little or no leverage and exposure to faster growing economies;

iii) Absolute return funds, funds managed with an explicitly unconstrained mandate to preserve capital using strategies uncorrelated to stock or bond markets;

iv) Real assets, notably the monetary metals, gold and silver.

We remain wholly committed to this approach, which we believe is both intellectually robust and capable of preserving valuable capital amid an extraordinary and arguably unprecedented global financial crisis.

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8th August 2011.

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