

Triumph of hope over adversity

Those of you who are skiers may have been at the top of a slalom course where the mist or falling snow lets you see the near posts but the far ones are dim and seem to be moving. This could be likened to George Osborne's current sentiments as he surveys the problems before him.

He has set out an extremely brave and ambitious plan to reduce government debt, reduce the state's share of the economy and produce growth in the economy through exports and investment. This has come in two distinct attacking prongs although plans are not yet spelt out for the second prong. However they will be as those further posts come nearer.

The first prong is through increases in taxation. The VAT increase seemed obvious, and the Income Tax rules for this year inherited from Labour have been maintained. Investors have come off lightly as the increase in Capital Gains Tax from an unusually low rate of 18% has been increased to 28% for Higher Rate taxpayers, only slightly more than the best rate in a somewhat complicated formula introduced by the Labour Government before Alistair Darling's surprising reduction of it to 18%. Importantly, the personal allowance of £10,100 of capital gains free of tax for each individual has been maintained.

The second prong is through reductions in Government expenditure, and this is where the monumental problem has been met by a gobsmacking reduction which could be described as somewhere between "challenging" and "impossible". Because of the commitment to maintaining health expenditure and overseas aid, the cuts must fall on other departments in Government, so on average they will have to reduce their expenditure by 25% over 4 years. Margaret Thatcher tried to reduce Government expenditure but only managed to stop it increasing. This is a mammoth task. One would hope it could all come from efficiency savings, undoubtedly including lost jobs, but intricate planning will be required if front line services are not going to be affected. Probably, more importantly to you is how will this affect the economy?

The slalom course involves achieving this reduction in expenditure at the same time as keeping the economy growing including no significant increase in unemployment and controlling inflation. If the economy does not grow, then the planned tax receipts won't materialise. Interest rates are planned to stay low to encourage companies' capital investment, and any sustained increase in inflation requiring an increase in interest rates would produce another slalom post slap in the middle of the course. How does all this affect investments?

The stock market and fixed interest market took it all well. If it all works then stocks in 2 or 3 years' time could look cheap today, but, as I have said before the main UK index is much more affected by international concerns and trading, not just what happens in the UK.

So to the next saga which was the subject of my last Insight, the Euro area. Whilst the underlying companies within Europe are doing quite well, the Euro itself is losing value, especially against the Dollar, and the Sovereign debt (like our Gilt market) is behaving very differently depending on which country issued the debt albeit in the same currency. I have heard two opposing views, one that the Euro will hold and there will be no default by Greece or anybody else, and another view that Greece and perhaps others will default in some two years. A default would produce huge losses in many European (and British) banks, producing a further liquidity crisis.

In fact a compromise will possibly come about in that some countries' debts will be restructured which is a euphemism for writing off some of the debt, but not all - a serious haircut in other words. Once there is some certainty about this, I would expect the Euro to ride again and European investments to rise in value too.

What will happen to your investments? The dividend yields on equities are not unattractive at this stage, but volatility is bound to be around whilst there is the Euro uncertainty. Thus combinations of funds designed to be quick in movement amongst a variety of assets, as well as equities in parts of the world where good growth is likely over the longer term, is a very good diversified aim. We hope we give you that.

Interaction

In the film "The Graduate", a friend of his father says to the young Dustin Hoffman "I just want to say one word to you: 'plastics' ". Dustin Hoffman was on a different plane of ambition and blank incomprehension was writ all over his face.

Phases of industries with sudden success have occurred and then have fallen from their heights, often within decades, from pop music to technology, internet start ups, hedge funds and banking. What will be the spectacular growth industry of the next decade? I have one idea, but what may you be thinking?

It would be interesting to know these, so answers if you wish please to andrew.roberts@robpar.co.uk. Anonymity guaranteed and none will be ridiculed, because that would be far too dangerous.

Best wishes

Andrew Roberts