



22nd February 2010

Generation game

“I think it’s time we – stop, children, what’s that sound ?
Everybody look what’s going down.
There’s battle lines being drawn;
Nobody’s right if everybody’s wrong.
Young people speaking their minds,
Getting so much resistance from behind..”

- From ‘For what it’s worth’ by Buffalo Springfield.

Neil Kinnock made a speech in Bridgend in June 1983 that carries an ironic resonance for voters today. Attempting to stoke fears of a re-elected Thatcher government, his jeremiad included the following admonitions:

“If Margaret Thatcher is re-elected as prime minister on Thursday..

“I warn you that you will have poverty – when pensions slip and benefits are whittled away by a government that can’t pay in an economy that can’t pay.

“I warn you that you must not expect work..

“I warn you not to be ordinary.

“I warn you not to be young.

“I warn you not to fall ill.

“I warn you not to get old.”

Last Thursday, Britain posted its first budget deficit for a January since records began, as government spending exceeded revenues by £4.3 billion. The previous day, the number of people claiming jobless benefits rose to its highest level since April 1997 – the year that Labour was elected. On the same day, despite a government order for local authorities to disclose the earnings of all executives, those authorities declined to list the names and salaries of those employees paid more than £50,000 a year, arguing that they could be subjected to “personalised attacks and mischief making”.

Seemingly every year, employers complain that educational standards amongst school leavers and university graduates appear to be falling, even as the exam regime points to continually higher attainment. Since 1997, spending on the NHS has increased by roughly 87% in real terms, without a concomitant rise of any form in its efficiency. For those on index-linked public sector pensions, retirement carries few financial concerns. For those in the private sector, the future is altogether more uncertain – like that for Reader’s Digest UK, after the British edition of the magazine went into administration following the breakdown of negotiations over its UK pension fund and its £125 million deficit. The Financial Times on Wednesday reported a warning from David Willetts, the shadow cabinet universities and skills spokesman, that

“Baby boomers hold so much of Britain’s wealth that a prosperity gap is opening between the generations, with people born after 1970 unlikely to acquire the wealth their parents enjoy..”

So we can now add the potential for inter-generational conflict to the list of our post-Millennial challenges.

That potential is not limited to the UK, of course. In fact one of the saving graces of the widespread failure in current British education could be that today’s school or university leaver facing the dole queue is simply too ignorant or unfit to have either the awareness or the energy to riot about it.

Politics is always contentious territory for this commentary, which is why it’s normally avoided. But there comes a point when the mismanagement of economic matters so severely impacts on matters of investment that it is effectively determined by it. That is the case today, on a sovereign and international scale.

The historian Polybius wrote of what one book calls ‘Democracy: the god that failed’, as follows:

“And hence when by their foolish thirst for reputation they have created among the masses an appetite for gifts and the habit of receiving them, democracy in its turn is abolished and changes into a rule of force and violence. For the people, having grown accustomed to feed at the expense of others and to depend for their livelihood on the property of others, as soon as they find a leader who is enterprising but is excluded from the houses of office by his penury, institute the rule of violence; and now uniting their forces massacre, banish and plunder, until they degenerate again into perfect savages and find once more a master and monarch.”

He was, of course, Greek. Just as a person of finite means cannot live beyond them forever, so for governments. The first stirrings of the bond market vigilantes may now be visible. Foreign demand for US Treasury bonds, for example, fell by a record amount in December, led by Chinese selling. With the Bank of England having announced the suspension of its quantitative easing programme, and having effectively (if perhaps temporarily) retreated from the market as buyer of last resort, longer dated Gilt prices are now at seven-month lows. And of course there is the more apparent lunatic fringe in sovereign bond markets, with the likes of Greece as headliners. But does Greece really matter ? In the context of the Euro zone, it most certainly does. We use the analogy of a man-made disaster (which the mass government mismanagement of economies and budgets surely represents). The following dialogue is taken from Eric Ambler’s superb screenplay for the story of the doomed Titanic, ‘A Night to Remember’, filmed in 1958. For context, the shipbuilder and draughtsman Thomas Andrews Jr. is trying to convey the urgency of the situation to the ship’s captain following a collision with an iceberg.

Andrews: "The pumps are keeping the water down in this boiler room, but the first five compartments are flooding."

Captain Smith: "Well, what's the answer?"

Andrews: "She's going to sink, Captain."

Captain Smith: "But.. She can't sink. She's unsinkable."

Andrews: "She can't float. Look.. She could float with any three of her first five compartments flooded. She could even float with four of them gone. But she can't float with all five full up."

Captain Smith: "Yes, but.."

Andrews: [cuts him off]: "These watertight bulkheads only go as high as E Deck. The weight of the water in the bow is going to pull her down by the head. So, you're going to get the fifth compartment overflowing into the sixth; the sixth into the seventh; and so on, as she goes lower. It's a mathematical certainty. With that amount of underwater damage, she can't stay afloat.. How many people are there on board?"

Captain Smith: "2,200 or more. And room in the boats for.. ? How many?"

Andrews: "1,200."

Captain Smith: "I don't think the Board of Trade regulations visualized this situation. Do you?"

On the one hand, Germany has made it perfectly clear that it has no intention of bailing out Greece. As Otmar Issing wrote in last week's Financial Times, in such an instance, "the dam would be broken". On the other hand, the Maastricht Treaty makes no provision for a country's departure from the Euro zone, **because European currency union is irrevocable**. The third option would be for Greece to gird her loins and grasp the nettle of fiscal austerity. As the song says: Perhaps, perhaps, perhaps.. In any case, even an event of default, or a Greek "expulsion" from the Euro zone, would not be the end of the affair. As with the doomed Titanic's fifth compartment, the spillover from just the first sovereign EMU member's departure from the zone would simply encourage the market to test the political will of the next anticipated weakling, and then the third, and the fourth..

We seem to be approaching some kind of tipping point in relation to the realistic expectations we can make of our politicians, whether domestically or internationally. A gale of cold realism is required, both for voters, and for their appointees, to regain their senses. Maybe we should be kinder to our political class, given that they have only endeavoured to give us what we want, albeit through the redistribution of our own money (and by mortgaging the younger generation). Either way, electorates long used to their bread and circuses and public sector pensions will not take kindly to the inevitable hardship and spending retrenchments to come. The investment conclusion would seem to be: **purge political risk from portfolios wherever feasible**. George Bernard Shaw expressed it quite succinctly:

"You have a choice between the natural stability of gold and the honesty and intelligence of the members of government. And with all due respect for those gentlemen, I advise you, as long as the capitalist system lasts, vote for gold."

As regards the Kinnock speech, while widely regarded as one of the finest speeches made in British politics, it might have been more pertinent – from the perspective of a 2010 voter, at least – to warn of a Labour re-election as opposed to a Conservative one.

One last observation. Those believing the financial crisis is over are wrong. It has merely been transformed from a private sector to a public sector disaster, hence our ongoing selectivity with regard to government debt exposure. Notwithstanding the simplistically binary spat among the economists over the pace of returning the state finances toward balance, there is only one thing we can really say with certainty about the crisis: anything can now happen. As Second Officer Lightoller remarks at the conclusion of ‘A Night to Remember’, after an utterly extraordinary human tragedy, this really *is* different, new territory:

“Because we were so sure ! Because even though it’s happened, it’s still unbelievable. I don’t think I’ll ever feel sure again, about anything.”

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