



The A to Z of Global Investing

Max King, Strategist and Portfolio Manager at Investec Asset Management, looks back over some of the key developments of the past year and some areas to watch in 2010.

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Automotive industry

The US government has pumped tens of billions of “loans” into propping up the US majors, yet Japanese companies account for 40% of the US market (4.5 million vehicles of which a third are imported), which is only a little less than the market share of the American big three. Meanwhile, General Motors plans to double sales to Japan from current levels of just 2,000 a year. Does “cash for clunkers” refer to the cars or the companies?

Buffett, Warren & Bolton, Anthony

Both were widely ridiculed for turning positive on equities in late 2008, but they would now be having the last laugh if they were not both too polite to crow. Mr Buffett’s \$26 billion purchase at the age of 79 of the remaining 77% of Burlington Northern Santa Fe Railway shows that great investors never retire.

Copenhagen

The site of a much-hyped political fiesta on climate change. Increasing public scepticism appears to be the direct result of the increasing determination of the political class to bulldoze through its agenda of higher taxes, increased regulation and, of course, more junkets.

Directives

The Alternative Investment Fund Managers Directive from the European Union, which targets private equity, hedge funds and investment trusts, shows that EU directives are a continuation of war by other means. We believe the consequence of the higher tax rates and change in domicile rules in the UK will be a steady emigration of key financiers to Switzerland, the Channel Islands, Hong Kong and other jurisdictions.

Elections

Heroic attempts are underway by the UK media to pretend that next year’s election, expected in May, is not a foregone conclusion. In November, the US Democrats face their Gettysburg in the form of mid-term elections, just two years after a landslide victory.

Fixed income

On the basis of Federal Reserve estimates, the rising tide of bond issuance by western governments is expected to raise real bond yields in the US, UK and Japan by at least 1.25%. An investor who bought the UK’s 3.5% War Loan for £18 in 1974 could have sold it for £88 in early 2009, generating a compound return of 24%. However it was originally issued at par and, in 1932, was trading so far above par that the government was able to force through a cut in the coupon from 5%. Bond markets have not always been safe and low risk.

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Gideon Gono

Mr Gono is the underemployed (now that the local currency has been abolished) Governor of the Reserve Bank of Zimbabwe. Presumably, he spends his time on eBay selling spare 100 trillion Zimbabwean dollar notes to collectors for far more than they were ever worth as currency. As the trail-blazer of quantitative easing, he has also been gleefully congratulating all the other central bankers who are now following his example.

High yield bonds

It has always been right to wait for the default rate to peak before buying junk bonds, until this year. Yields, which had been discounting universal bankruptcy, have fallen from over 20% to under 10%. It is not clear that defaults have yet peaked so the run may have gone too far.

Interest rates

The rates set by central banks are virtually zero but those charged on new loans to customers are much higher so the only beneficiaries are the banks. In the UK, the Bank of England rate is 0.5% but deposits on 3 month notice can earn up to 3.36% and margins on loans have rarely been higher. As the old saying goes, a banker is someone who lends you an umbrella when the sun is shining but asks for it back when it starts to rain.

Japan

Yet again, Japan is the lame duck of stock markets and one of only six that are down on the year: the others are Iceland, Mongolia, Morocco, Slovakia and Bahrain. The Nikkei Dow is still over 75% below its 1989 peak.

Kudrin, Alexei

Veteran Russian Finance Minister who dismissed the proposal for a "Tobin tax" at the G20 summit with the quip: "Gordon Brown is well known for always raising taxes". Under his stewardship, Russian government debt has fallen from 75% of GDP to 5%, GDP per capita has multiplied nine-fold and the average wage increased from \$50 to \$650 per month. The rate of income tax is a flat 13%.

Lloyd Blankfein

The Chief Executive of Goldman Sachs, who was described by Rolling Stone magazine as "a giant vampire squid wrapped around the face of humanity," claims that he is doing "God's work." The \$85 billion bail-out of AIG in late 2008, put together by the network of Goldman Sachs alumni, fortuitously resulted in it being relieved of at least \$14 billion of liabilities. God moves in a mysterious way indeed.

Mahmoud Ahmadinejad

It's not just bankers who claim to be doing God's work. Iran's President obtained backing from the religious establishment in Iran just before elections that were clouded by accusations of vote-rigging. A good indicator of the competence of their government is that petrol costs just 11 cents a litre but a shortage of refining capacity means that half of petrol bought has to be imported. Subsidies absorb 30% of the government budget yet much of what is "consumed" is bootlegged over Iran's borders for up to 12 times its cost.

Nuclear Power

Nuclear power is undergoing a remarkable revival, partly owing to the cost competitiveness of the latest technology, partly for environmental reasons. The UK government has sanctioned ten new power stations and similar U-turns on new construction are expected in Germany, Japan, Italy and the US (France, which derives 75% of its electricity from nuclear, needs no convincing). China has 17 reactors under construction, 34 planned and up to 90 proposed. Meanwhile Brazil, Russia and India also have aggressive expansion plans. However,

bulls of uranium mining should beware: 96% of spent fuel can be recycled, so the path of prices may not be ever upwards.

Obama, Barack

His election and inauguration generated huge optimism (not least from the Nobel Foundation) but his approval rating has plummeted as a lack of progress on economic, domestic and foreign issues has led to disappointment and disillusion. Perhaps, like Bill Clinton, he needs a Republican Congress to retrieve his reputation.

Precious metals

The gold price has risen to new peaks in US dollar terms but is still only half its 1980 peak in real terms. The premium of platinum fell from over 100% to negative. "Gold is a good hedge when you don't know what you are hedging against" says one expert. We believe that the lack of confidence in monetary assets that a rising gold price represents is a headwind for equity markets.

Quantitative Easing

Described by one financial wag as "queasing," it is the process of money creation which makes everyone feel rather sick. The arguments for counteracting the fall in money supply caused by credit contraction are increasingly accepted, but nobody knows what will happen when economic recovery requires central banks to reverse the process and governments have to finance monumental deficits in the bond market.

Risk

Modern orthodoxy equates risk with volatility, but this is much less relevant for long term investors. Benjamin Graham defined it as "the danger of a permanent loss of capital." After two of the worst four bear markets since 1900 in a single decade, the risk of a third in the next ten years should be low.

Stock markets

The year started with another downward spiral, but it has been upwards ever since, with markets rising more than 50% off their March lows. The MSCI World Index has only recovered half its fall and is still significantly lower than ten years ago. Unusually strong productivity growth means that corporate earnings are expected to grow 30% in 2010 so the valuation at less than 14 times prospective earnings still looks very reasonable.

Taxes

It is widely accepted that taxes in the developed world will rise and spending will be cut to cover ballooning fiscal deficits, but the scale of the challenge is unrecognised. The UK's deficit in 2009/10 is forecast at £175 billion but doubling income tax receipts would raise only £140 billion while the rate of VAT on goods, services and fuel would have to be increased to 50% to raise £160 billion. Reducing spending by £165 billion is notionally achievable by abolishing both the state pension and the NHS, or alternatively stopping all welfare payments.

U-shaped recovery

A slow and steady recovery in the developed economies is widely expected. Since this is likely to keep inflation and interest rates low, to extend the up-cycle and encourage growth dependent on investment rather than on credit and government spending, it is the outcome which would suit financial markets best.

V-shaped recovery

Deep recessions usually lead to steep recoveries. This may be what the media and governments want but another boom-bust cycle is not going to lead to a rebalanced global economy and is hardly in the long-term

interest of the world at large. A V-shaped recovery looks far more likely in the emerging economies than in the developed ones.

Woolworths

Woolworths ceased trading in the UK in January, closing the last 200 of their 807 stores and putting 27,000 employees out of work. It was 100 years since Frank Woolworth opened his first UK store in Liverpool and 130 since the first "five and dime" store was opened in Utica, New York. In 1979, Woolworths was still the largest department store chain in the world but it had disappeared from the US by the millennium. It survives in Australia and South Africa.

Xpenses

MPs' expenses have dominated the UK news, distracting attention away from the growing fiscal crisis. "Reimbursement" (tax free, of course, for as Leona Helmsley once said "only the little people pay taxes") was claimed on everything from pornographic films to bogus second homes to cleaning a moat. "If I had a moat that small," an aristocrat was heard to say "I would clean it myself."

Year of the Ox

Sceptics of this year's bull market can't say that the Chinese didn't warn them. 2010 is the year of the tiger: expect emerging markets to boom.

Zimbabwe

The market value of stocks listed in Harare is expected to reach \$5 billion in end of 2010 and \$7 billion by 2011, compared to just \$1 billion when the market reopened in February 2009. 2009 has been the first year of economic growth for 14 years; 6% growth is expected in 2010. "The economy is on the path to recovery" says Finance Minister Tendai Biti "but much more needs to be done."

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