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Offshore Holding Advisory

Wednesday, 7<sup>th</sup> April 2009

## Offshore Holdings Advisory April 2009 Newsletter

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### Market and Currency Update – 2<sup>nd</sup> April 2009

(A personal view by R.B. Skepper)

(for professional investors and business men/women only)

FTSE100: 3955 – 2<sup>nd</sup> April 2009

Capitalism is going through one of its biggest crises in free market history. It's worth looking at its history, as the way out will lie in reaffirming its core benefits, but with a better understanding of the desirable checks and balances to keep the system on the rails.

The great ideological struggle of the 20th century has been between Collectivism and Liberalism (the free market economy).

Collectivism was defined 80 yrs ago by English jurist Albert Dicey as:

“Government for the good of the people by experts or officials who know or think they know what is good for the people better than any non official person or than the mass of the people themselves.”

It is now generally accepted that Collectivism - the belief that the state knows better than the market, has been the biggest economic disaster of the twentieth century.

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Historically there is no recorded example of any Collectivist society (except perhaps the INCAS) ending other than in failure. Both France and Spain - the two greatest powers in Europe in 1500 - then became Collectivist economies managed from above by state direction under the monarch.

By 1800, England, which in 1500 had been a very minor peripheral power on the edge of Europe, and Holland, had become by far the two richest and economically successful nations in Europe. They diverged by operating on a free market, largely laissez faire economic system, with, in both cases, a well defined rule of law independent of the state.

In the Twentieth century all Collectivist societies except North Korea have already collapsed. The lure of life in North Korea does not make a compelling case for Collectivism.

Frederick Hayek, the modern high priest of free markets and capitalism, maintained that such collapse was inevitable as prima facie

“the human mind cannot comprehend something more complex than itself”.

A modern economic society comprising the daily individual decisions of millions of economically active people is far beyond the comprehension of any single mind or expert however brilliant.

“Prices”, liberals would argue, “are a better regulator of human energy than any centralised planning authority.”

Keynes described the Collectivist as:

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“someone who wanted to replace private choice by government choice.”

Popper rejected the “planning society of Marxism”, claiming that the future is open, and follows no predetermined path. The future depends on how we behave. This certainly is very relevant to achieve our recovery from the present economic predicament.

Popper believed it was impossible for the state to have the knowledge to undertake holistic planning. He maintained that “attempts to remodel society end with planners being driven to transform human nature to fit their plans, rather than adapting their plans to fit human nature.”

Hayek argued that the planning authority lacked the information to solve the vast number of equations needed to coordinate the demand and supply of millions of products.

Adam Smith, the father of modern Capitalism, insisted that The State should only raise revenue for the State’s necessary functions: Defence, Law and Order, and the provision of public goods needed to facilitate commerce in general.

The architect of the Collectivist system, though he never lived to see it in operation, was Karl Marx. He claimed that capitalist accumulation took place by depriving workers of the fruits of their labour - and in this unjust investment mechanism lay the doom of the system. He also predicted that capitalism would collapse as a result of its own greed and corruption. Shades of our current troubles unfortunately.

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Churchill put the contrast between Collectivism and Capitalism succinctly by stating:

“Capitalism is the unequal sharing of benefits, Socialism (collectivism) is the equal sharing of miseries”.

The current NHS is a good example of the latter. Of course he put his finger on the vulnerability of capitalism Viz that if the sharing of the benefits was too unequal, the system politically would implode. Indeed that is what happened in Russia, then China etc.

The instability of the old Latin American dictatorships sprung from the inequity of 97% of the nations' wealth being held by 3% or less of the population. The republic of Bolivia had 187 “military coups” in 188 years since independence, with little discernible improvement in GDP.

Modern Capitalism, is now anyway, as a result of that unfairness of income distribution in late 19th century, and early 20th century, (see Titanic - contrast of 1<sup>st</sup> class with steerage) a mixture of collectivism (state control) and free markets.

In 1866 in the six leading industrial nations, the state's share of the economy was under 10%. By 1985 it had risen to 47%. This then proved to be a bridge too far in state control, as sclerosis set in, and a backlash occurred.

It was then that Ronald Reagan, along with Maggie Thatcher began a crusade against the collectivist public sector, and set about rolling back the state. They provided the ideological drive and personal leadership which made

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anti-collectivism a cause, and paved the way for two decades of impressive wealth creation.

Reagan famously stated:

“In the present crisis government is not the solution to our problems, government is the problem”. Perhaps Brown, as he saves the planet, could reflect on this.

According to Strumpeter, Capitalism is “creative destruction”. The problem under Communism was that the creativity was stifled by bureaucracy and regulation, but the destruction happened anyway. They still had the Brabant when the Morris Minor had moved off the road into a motor museum. Bravo to President Obama for not pouring more good money after bad with GM and Chrysler.

According to Vaclav Klaus, the charismatic Czech leader;

“the enduring question facing modern economies is the extent to which The State should be allowed to interfere with the freedom of the individual”.

He strongly believes in this respect that Brussels has gone much too far. Red tape is estimated to cost British industry £77bn a year.

He has emphasised that under the current six month Czech presidency of the E.U. they will seek to free private enterprise from yet more controls as the best response to the current economic crisis.

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Unfortunately whenever Capitalism runs into a crisis and we are certainly in one now, all the crypto collectivists come out of the woodwork.

No woodwork is fuller of them than our very own BBC. Their financial commentators, headed by “Engels” Peston have been revelling in every scrap of bad news that occurs, magnifying it to the skies. The old bully’s instinct of “kick your opponent when he is down” has really come out - Carole Thatcher being thrown to the wolves in glee. But their only utterly negative solution is the Gulag for everybody.

Luckily the News is a turn off for the vast majority of the U.K. population, who switch to football. Otherwise the economy would have probably ground to a complete halt. It hasn’t. At ordinary family level, a sensible effort to get their own balance sheets in better order has been taking place. Credit card debt is down, savings have risen, and all those on long term variable rate mortgages are significantly less stressed.

Meanwhile the 30% devaluation of Sterling has been a highly beneficial stimulus, undoubtedly at the expense of our trading partners. London is the only European city with retail sales rising. The housing market, which in Continental and U.S. currency terms has halved, is showing signs of picking up quite well.

With the approaching end of the viciously extreme destocking of October to January, commercial activity is unfreezing. The authorities have done much more for the banks than the banks have so far done for their customers, the U.K. banks apparently less accommodating than their

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Continental counterparts. But great pressure is on them to loosen up.

All is not so gloomy as it was. Meanwhile, in the stock market there is a growing indication that sellers are getting exhausted. Bull markets are born in seller exhaustion not buyer enthusiasm. The latter is where bear markets begin.

Steve Ballmer, head of Microsoft said:

“We are certainly in the midst of a once in a lifetime set of economic conditions. The perspective I would bring is not one of recession/Rather the economy is resetting at a lower level of business and consumer spending based largely on the reduced leverage in the economy.”

This certainly goes for both Anglo Saxon economies, but the process is well on its way. By contrast Asia and Latin America are significantly under-leveraged - Chile has no net government debt and both a current account and budget surplus - likewise Hong Kong, Singapore, and China. They must help by stepping into the breach, but at least they are capable of it.

Not all is black as the media would have us believe. The free spirit of Capitalism is beginning to work its way through this crisis.

Leaders, whilst hands on for the macro, must keep their hands off the micro. More statism and interference, as Klaus warns, will only delay the recovery.

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**R.B. Skepper**  
**2<sup>nd</sup> April 2009**  
**Brewin Dolphin Securities**

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- Brewin Dolphin is a founding member of the London Stock Exchange and has over 250 years of experience in managing private client wealth
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