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Offshore Holdings Advisory December 2008 Newsletter
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Market and Currency Update – 30th December 2008

(A personal view by R.B. Skepper)

(for professional investors and business men /women only)

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IS THE £ STERLING IN DANGER OF BECOMING THE NEXT PESO?

The collapse of a nation's currency is an unmitigated disaster for the "owning" classes who tend to keep a substantial portion of their savings or assets in the domestic currency, either as deposits, or government securities or domestic bonds.

The poor Icelandic people are now enduring the grim misery of the collapse of their currency; and such was the impact that the "WEIMAR" hyperinflation made on the psyche of the German people that still today more than 80 years later they have a horror of allowing any "money" to be printed before it is earned. Hence the recent determination of the German Bundesbank to hold back the "pump priming" plans of the European Central Bank.

After a decade when U.K. citizens have been lured into a very false sense of security about our own currency as a result of what now turns out to be "bogus" financial profits for the nation made in a manner little better than what Mr. MADOFF did, people are particularly ill - prepared to grasp the dangers of a "Flight from Sterling".

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Now, worse still, these bogus financial profits have got to be paid back. It's rather as if Mercedes and BMW were now forced to buy back all the cars they had sold to the world in the last three years because it turned out their engines were plastic replicas.

Then the influx of oligarch and other foreign money into London property helped shield our steadily deteriorating balance of payments from vision. Both events boosted the short term value of the £ sterling, and has made it correspondingly more vulnerable.

However, even all this pares into relative insignificance when one clinically analyses the absolutely unconscionable damage Brown's decade as chancellor has done to the public finances of U.K. P.L.C.

He has undermined both the balance sheet of the nation and its longer term ability to cover its costs - the costs of the public sector. If this persists, we relapse into a state of permanent insolvency.

That can only lead to one thing - a collapse in the international confidence in Sterling, and then the arrival of the men from the I.M.F. with some very unpleasant medicine to right the ship.

Here is the approximate record of what he has done:

- On coming to power in 1997 he inherited a government surplus of approx £30 Billion a year and a public sector costing about £375 Billion a year representing at the time approx. 37% of G.D.P.

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- Since then a decade of steady 2-3% annual growth has increased the tax take to the government (on that original level of taxes) of approx 30% bringing the annual tax revenue up to about £500 Billion.

- On top of that he got a £30 Billion tax windfall in year 2000 from the sale of G3 licences to the telecoms industry. He also “stole” £5 Billion a year from the pension funds by removing their dividend tax credit. He also scooped a “windfall” £5 Billion tax from the British utilities industry. That over 10 years has added a further £85 Billion to his tax grab.

To digress slightly, the “punitive” tax on our then-burgeoning private utilities industry makes an excellent example of just how wealth destroying bad taxes can be.

By 1998 our utility industry was advancing worldwide into a global winner in that growing and vital industry. Then suddenly its investable surplus was snatched away. The weakened industry could no longer expand overseas. At that point we were the leaders in newly opened up Eastern Europe, which required its entire utilities industry revamped. Instead, our industry became victim to our competitors with stronger balance sheets from their retained profits. These had been snatched away from ours. Now most of our utilities are in the hands of French or German companies. They are now grabbing for themselves the growth potential of that industry world wide.

----- However, not satisfied with this increase in tax revenues, he has significantly increased the overall annual tax burden as well. NATIONAL INSURANCE has risen to 12% from 10% (making U.K. workers the highest starting

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tax rate payers in Europe at 32% - after a mere £6500 basic earnings free), and a host of other stealth taxes adding about another £20 Billion a year.

Not only has he managed to pour ALL this extra money into an explosion in the public sector, but has converted an annual surplus of £30 Billion, which he inherited, into an annual £30 billion deficit - I.E. £60 Billion a year more on top as well.

This has ballooned Public expenditure from an inherited figure of £375 Billion to the current £635 Billion (That is the figure before the crisis pump priming and bank rescuing.)

The U.K. is the only major economy in Europe to have raised its budget deficit during the decade of Boom.

Germany used the boom to eliminate hers; likewise Spain, which by 2007 was running a 2% govt. surplus. And France has reduced her former deficit.

All these countries have more real ammunition to address the economic downturn than the U.K.

The head of the I.M.F. confirmed that it was necessary for the U.K. government to put at least £20 Billion extra into the economy to kick start it now, but gave a warning that the level of the debt was “concerning” - a coded message that the credibility of the currency could be the undermined.

Brown’s decade has left Britain with an insupportably large public sector overhead, for the reduced wealth creating sector to finance.

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He has diminished our wealth creating sector both in size and in potential by his hefty taxation levies.

It turns out, on top of this, that one of our former apparent significant wealth creators - The CITY - was a partial PONZI. That wealth has now got to be created elsewhere against a much more challenging economic background. The U.K. was more dependent on financial services than any other European economy, and doubly so compared to the U.S.

The paucity of benefit to the nation of this massive transfer of assets from the wealth creating sector to the wealth consuming public sector is all too visible to everyone who experiences our public services.

The raw statistics of halved productivity in the one compared to the other, and the doubled number of “sick days” taken annually in the one compared to the other, simply confirms what everybody knows.

Whilst undoubtedly there are many, many able people working in the public sector, their ability to do so effectively has been hopelessly compromised by this government.

Their predilection is to micromanage everything with a plethora of their own expensively created quangoes, extra regulatory bodies, exaggerated health and safety, an army of interfering inspectors etc. (117 different inspectorates for the N.H.S. alone) - a literally communist command style top down management which negates any kind of responsibility taking at any level for anything. The consequence is, as the communists finally found out - after it had destroyed them,

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catastrophically low performance, and very often the wrong objectives pursued.

A tragic example, which has cost us all very dearly, was the tripartite regulatory regime for U.K. banks created by Gordon Brown in 1997. He removed the longstanding sole authority of the Bank of England for the supervision of the banking system, and shared it between The Treasury, The Bank and The FSA. So when the Bank of England's own financial stability report warning two years before the Northern Rock collapse that a dangerous funding gap was opening between what the banks were lending on mortgages, and what they held on deposit from savers, it just fell between three stools. When three different people are responsible, nobody takes responsibility - and nobody did.

This managerial overlay and regulatory explosion has spilled over heavily into extra costs too for every private sector industry - adding quite pointlessly to their costs.

All this has really done is add 900,000 jobs to be paid for in the public sector - a large number of which are non jobs - everybody has their favourite but the recent advert for "Assistant Director of Human Rights, salary £75k," at NHS Trust in Nottingham is a typical example.

The ominous omission from Brown's latest pre-budget £20 billion economic boost is any hint of tackling this "Empire of waste", and this will not go unnoticed by Sterling watching foreigners. All the pain of ultimate repayment is to be borne solely by the private sector.

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A new Christmas joke is doing the rounds: that the Lawrence Livermore Research laboratories have discovered a new “heaviest” element - which they have called “THE GOVERNMENTIUM”

The new element has one neutron, 25 assistant neutrons, 88 deputy neutrons, and 198 assistant deputy neutrons giving it an atomic mass of 312. These 312 particles are held together by forces called Morons.

Since “Governmentium” has no electrons, it is inert. However it can be detected as it impedes every other reaction with which it comes into contact.

Alas, “Governmentium” does not decay, but instead undergoes a reorganisation in which a portion of the assistant neutrons and deputy neutrons change place, actually increasing the mass over time, as more morons become neutrons forming isodopes.”

As the French say: “il faut rire pour ne plus pleurer”

Returning to Sterling, Terry Smith, head of Tullet Prebon and the man who blew the whistle on the “creative accounting” of the conglomerates like Hanson and B.T.R. in the 90’s - for which he was sacked from Warburgs - writes in The Telegraph this month:

“The contrast with the last recession of 1990-1992 could hardly be starker. The Thatcher government came close to REPAYING the national debt. This time they were out of ammunition before the battle started.”

The government deficits also coincide with the assumption of massive financing to support the banking system with capital and liquidity, and in many cases blanket guarantees of deposits and other bank liabilities, such as Ireland has put in place.

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THIS IS WHY THE NEXT BATTLE WILL BE OVER THE CREDITWORTHINESS OF GOVERNMENTS AND THE STRENGTH OF CURRENCIES.

It must be feared that in the absence of a massive program to rebalance the U.K. economy away from the public sector and back into the productive sector, confidence in Sterling will continue to ebb further and further away.

The progressive impoverishment of the U.K. economy will then be expressed in the only possible way it can be - the continuing devaluation of its currency.

This labour government certainly neither has the stomach nor the desire to drastically prune its own creation.

It is of concern that so far the shadow Conservative team appear not to fully appreciate that necessity, nor to have the ruthless determination it will require to cut down this now strongly entrenched province within our economy.

R.B. Skepper
30th December 08
Brewin Dolphin Securities

To view this online please go to <http://www.investrightnow.com/news.htm>

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- Personalized service – each portfolio is managed individually according to client risk profile and investment objective(s).
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- Lower client costs – Brewin Dolphin accesses global markets directly to eliminate charges levied by fund management companies and life insurance firms - i.e. 'no middlemen costs'
- The team at Brewin Dolphin headed by Robert Skepper and has expertise in managing expatriate and overseas investors' wealth
- Robert Skepper graduated from Cambridge in 1961 and was trained at Buckmaster & Moore, then a leading stock brokerage which is now part of Credit Suisse First Boston. He joined Brewin Dolphin in 1986 as a private client portfolio manager.
- Brewin Dolphin is a founding member of the London Stock Exchange and has over 250 years of experience in managing private client wealth
- Brewin Dolphin is the leading private client stock brokerage in the UK and currently manages over 21 billion GBP for over 100,000 clients
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