ST. JAMES'S PLACE
WEALTH MANAGEMENT

THE INVESTOR

INVESTMENT NEWS FOR CLIENTS OF ST. JAMES'S PLACE WEALTH MANAGEMENT

OLYMPIC LEGACY
MEASURING THE REAL SUCCESS OF THE GAMES

ISSUE 74 | SUMMER 2012

WELCOME

ST. JAMES'S PLACE
WEALTH MANAGEMENT

All eyes will be on London this summer as it hosts the 2012 Olympic Games. Success will be measured by more than just the number of medals won; the economic, social and environmental legacy left behind will be even more important. In our Analysis feature, Zoe Wood looks at what has been promised and assesses how the legacy organisations are living up to those promises so far.

The China phenomenon continues to divide the investment community. Is its growth rate sustainable? Will it manage to rebalance its economy towards domestic demand? In our Interview, Jonathan Fenby, the author of *Tiger Head, Snake Tails*, an authoritative book on China's development, gives his answers to these and other key Chinese questions.

Conventional wisdom says that the US will soon run out of oil; but enormous shale gas reserves await. In our Analysis feature, Ian Fraser assesses what the exploitation of these reserves will mean for the US economy and looks at the prospects for development of shale fuels in other parts of the world.

The corporate sector has accumulated some large cash balances since the onset of the financial crisis. Our In Your Interest feature describes how these could generate dividend payments and underpin stock market returns.

Also in this issue, St. James's Place client Tony Powell shares his experiences working with stars like Rod Stewart and Bob Geldof during his years in the music industry.

I do hope the articles in this latest issue of *The Investor* will be of interest to you. If you have any queries, please do not hesitate to contact your St. James's Place Partner.

Vivian Bazalgette

Vivian Bazalgette
Chairman, Investment Committee, St. James's Place Wealth Management

▶ FOR FURTHER INFORMATION ON ANY OF THE ARTICLES IN THIS ISSUE OF *THE INVESTOR*, PLEASE CONTACT YOUR ST. JAMES'S PLACE PARTNER

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All facts and statistics in this issue of *The Investor* are correct at the time of going to press. Cover image: Jason Hawkes

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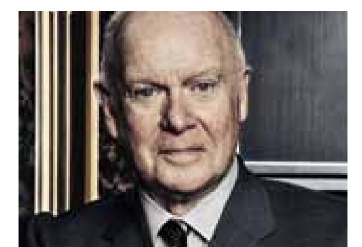

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ANALYSIS

LIFE COVER
INSURE AGAINST RISING PRICES

From 21 December, insurance companies will no longer be able to take gender into account when they are determining the price of their products. That may sound uncontroversial: discrimination on the grounds of sex has been ruled out in most other areas. But insurers treat men and women differently because the risks of giving them cover are different. If insurers have to ignore these differences, the result is likely to be higher rates for most customers.

The differences between men and women are fundamental. Life expectancy is shorter for men than for women, so the cost of insuring against their death or critical illness is generally higher. The cost of providing an annuity, on the other hand, will generally be higher for women than for men because on average it will be paid for longer. For health insurance, men tend to suffer more from heart and prostate problems, which occur later in life, while common female conditions like breast cancer occur earlier. Again this will have an impact on the price of cover.

The ban on using gender to determine pricing coincides with two other significant, although rather technical, changes to insurance companies' regulations: the introduction of a new European solvency directive, Solvency II, and a revision of the way their profits are taxed. Tony Müdd, Divisional Director, Development & Technical Consultancy, at St. James's Place, says that both these measures are likely to reduce insurance company profits and so will add to the pressure on companies to increase rates.

He expects the cost of life, critical illness and permanent health insurance to all increase, in some cases significantly. Insurance companies are already warning about these increases, although they are not yet indicating by how much.

Although the changes do not take effect until the end of the year, to take advantage of the rates available under the current system, it is advisable to act now. Setting up life, critical illness or permanent health insurance can take some time as insurers may ask for medical and other specialist reports before quoting for the business. Insurers and their underwriters may also start to adjust their prices before the implementation date.

Müdd points out that taking out insurance policies now can lock in the lower rates for the duration of the cover, as the contract will be written at a time when gender discrimination is still permitted.

If you require further information about the impact of these changes, consult your St. James's Place Partner.

NEWS

TAX PLANNING
LEGITIMATE WAYS TO REDUCE YOUR TAX BILL

HMRC takes a more rigorous approach to artificial schemes

The line between legal tax avoidance and illegal tax evasion is becoming increasingly blurred. Chancellor George Osborne made his distaste for aggressive tax avoidance clear when he labelled such schemes 'morally repugnant' in his Budget speech, while a recent court case has highlighted the more rigorous approach being taken by HM Revenue & Customs to artificial schemes.

That case, Eclipse 35, related to a scheme investing in film-making, in which members of a partnership are allowed to claim tax relief against their investment – sometimes for more than the amount actually put into the partnership. While this scheme appeared legitimate at the time it was established, HMRC successfully challenged it in court on the grounds that there was no commercial basis to the investment and that investors went into the arrangement solely to benefit from the tax breaks. The win will open the door for HMRC to challenge a number of other film partnership arrangements and, indeed, other tax schemes that operate on similar grounds. HMRC has a number of cases due to be heard, although they could take some time to get through the legal system. HMRC is, however, winning a lot more cases than it is losing as the courts apply a more purposeful approach when making decisions, looking at what Parliament intended, as opposed to applying a straight, literal approach based on how the legislation was drafted.

St. James's Place does not advocate such artificial schemes, concentrating instead on legitimate tax-planning arrangements like pensions, ISAs and enterprise investment schemes. Anyone considering investing in artificial tax avoidance schemes should be clear about the risks and understand the implications if they fail: remember that HMRC will never give advance clearance. If you do find yourself in a scheme facing a legal challenge, contact the provider for information about its defence strategy and help with the costs of defending the scheme.

ST. JAMES'S PLACE FOUNDATION
PEAK PERFORMANCE ON EVEREST

A 25-strong team from St. James's Place reaches Base Camp, with one making the summit

The experience of a lifetime – but one which they would not necessarily want to repeat. That is the conclusion of four of the St. James's Place team who have just returned from their trek to Everest Base Camp and beyond.

Roger Owen, from the Cirencester office, who climbed all the way to the summit, admits to finding it gruelling – not just reaching the summit but also getting off the mountain.

'I am proud of having got to the summit but I am equally proud of how we got off the mountain,' he said. 'I was absolutely exhausted from the summit climb but then had to deal with a teammate's snow blindness. He was blind for 24 hours at 27,000ft and I had to take care of him during that time. Adrenaline kicked in and I found the extra energy from somewhere. I am proud of the way we conducted ourselves in a very difficult situation and thankfully his eyesight returned the following day so we could descend safely.'

Simon Coll, from one of the London offices, who was part of the team that made the ascent to Base Camp, said: 'It was tough – much, much tougher than any of us had expected.' His colleague, Mike Harper, from the Bristol office said: 'It was not enjoyable but I feel a great sense of achievement – I do not regret a single moment.'

Partner Matthew Forbes found his asthma a significant handicap on the trek up to Base Camp. 'The day I was really suffering was when we walked into Base Camp and I had to give a Sherpa my rucksack for the last 20 minutes of the trek.' Once there, however, he found the two days at Base Camp fascinating, with highlights including the awesome scale of the ice flows above it as well as listening to lead guide Kenton Cool talking about the summit climb and pointing out landmarks on the route. Like Roger, however, he found the descent almost as gruelling as the initial climb.

Expedition members all struggled with the fatigue, nausea and other effects of trekking at such high altitudes – Base Camp alone is more than 17,500 feet. But they also paid tribute to the team spirit which helped them get through. 'We were already a very strong team [before we started the trek],' said Mike. 'It was good that we were able to help each other when we were feeling ill.'

The 25 members of the team have raised more than £650,000 so far for the St. James's Place Foundation, including match funding from the company. Fundraising activities are continuing until October.

www.sjp.co.uk/everest2012
www.justgiving.com/Roger-Owen

Plain Picture

DETERMINING THE OLYMPIC LEGACY

Legacy, rather than medals, will be the real measure of the success of the London Olympics. Zoe Wood looks at what has been achieved so far

Alamy, Jason Hawkes

SPECIAL REPORT

E20 THIS NEW LONDON POSTCODE DISTRICT WILL COVER FIVE NEW NEIGHBOURHOODS THAT ARE SET FOR CREATION AFTER THE 2012 OLYMPIC GAMES. THE AREA WILL THEN BE NAMED 'THE QUEEN ELIZABETH OLYMPIC PARK'.

When the Olympic flame is extinguished in London's East End during the closing ceremony of this summer's Games it will be a poignant moment for those involved in the 15-year odyssey to bring the 'greatest show on earth' to the capital.

The August finale will see the torch pass to 2016 hosts Rio de Janeiro, but for the organisers the real work won't yet be complete, as attention turns to the legacy promises that helped them to snatch the Games from favourite Paris in the first place.

International Olympic Committee (IOC) President Jacques Rogge has already hailed London as a 'legacy blueprint' for future competitions due to the 'breadth and depth of the sporting, economic, regeneration and community legacy'. The major promises include: a £3 billion 'economic boost', two-thirds from an increase in tourism and the remainder from attracting foreign investment; regeneration of London's neglected East End; and in keeping with the Olympic spirit, to 'ignite a new passion for sport across all age groups'.

At the start of the bidding process former London Mayor Ken Livingstone described the vision for East London as 'Barcelona-on-Thames', a reference to the Spanish city's transformation on the back of its hosting of the 1992 Olympics, and dramatic change has already taken place in an area scarred by centuries of industrial use. The east of London received the lion's share of the £6.5 billion transport upgrade budget – turning one of the worst-connected parts of the capital into one of the best. The new £1.4 billion Westfield Stratford City shopping complex created 10,000 new jobs on the doorstep of one of the poorest parts of the city; while the explosion in start-ups in Tech City, the development of enviro-tech industries at Dagenham Dock, is also creating opportunities.

While the official cost to the taxpayer is £9.3 billion, the government wants the whole country to benefit from the global spotlight shone on the UK by the Games. The success of the construction phase, with main venues finished on time and on budget, is seen to be an advert for British expertise and innovation. It also brought welcome business for UK companies struggling with the downturn, with 98% of the £6 billion Olympic Park contracts and 94% of the £1 billion London 2012 Organising Committee budget handed to domestic firms. 'Some people suggest all the focus is on London for the Olympics, and that the provinces are missing out. I disagree,' says Jon Dore, director of the firm Euroclad that supplied the cladding for the Olympic Stadium. 'I can't speak for the country as a whole, but several other suppliers and contractors from South Wales are playing major roles in making sure London 2012 creates a fantastic legacy for people and businesses all over the UK.'

Parliament's spending watchdog, the Public Accounts Committee, is closely monitoring progress on legacy commitments, but has warned that in the end it may be difficult to accurately assess because responsibility is shared across many different parts of government. Academics have analysed the success, or otherwise, the Games have brought previous hosts. Professor Stefan Szymanski, a specialist in the economics of sport at the University of Michigan, says they have 'shown pretty conclusively that there are negligible economic benefits'.

A recent analysis by ratings agency Moody's was cautious: 'Overall we think the Olympics are unlikely to provide a substantial macroeconomic boost to the UK in 2012.' Szymanski says hosting the Games is fantastic for a country's morale, but there is a danger that economic benefits are overstated. 'Governments host these events because they are prestigious and popular with the electorate,' he says. 'If you tell me you're going to have a party, that's great – but if you tell me you're going to get rich at the same time, then I'm not going to believe you.'

PREVIOUS GAMES

If medals were doled out for legacies, the 1992 Barcelona Olympics is the most likely to carry off gold. A massive regeneration programme saw the industrial city reclaim its seafront, with the new sweep of beach front created as part of a facelift that helped recast it as one of Europe's top destinations for culture and art. Atlanta may be memorable for the wrong reasons – the pipe bomb that killed a visitor and in-your-face sponsorship – but the Games have a solid legacy. Lucrative sponsorship deals meant no debt hangover and the venues were created with future occupants in mind: the Olympic Stadium is home to the Atlanta Braves baseball team while Georgia Tech students live in the village.

Sydney could win a gong for 'best organised' Games, but they left Sydneysiders with only memories, albeit powerful ones, such as Cathy Freeman lighting the Olympic flame. Not enough thought went into life after the Games, the organisers later admitted, with no vision for the park, which has struggled to find a purpose.

Bottom of the medal table are Montréal and Athens. It took residents of the Canadian city decades to pay off debts from the heavily loss-making Games in 1976, while Athens was a Greek tragedy. The cost spiralled out of control – it is argued they contributed to the country's current financial crisis – and the dilapidated venues are today a source of anger rather than pride for Athenians.

Balance sheet What will be the legacy of the London 2012 Olympic Games? The world's biggest sporting spectacle could ultimately help regenerate a swathe of East London, but experts remain largely unconvinced that the Games will give the national economy a boost.

FOR THE RECORD

Meet Tony Powell, the music-loving butcher's son who scaled the heights of the record industry. By Heather Connon

Alex Lake, Getty Images

TONY POWELL

When Tony Powell was a teenager, his father used to complain about the amount of time he spent listening to jukeboxes in coffee bars. But despite that early paternal disapproval, Powell's interest in music led him to develop a career as a music executive, working with star acts such as Rod Stewart, Band Aid and Elton John. Sadly, Powell's father died before his son's musical interest bore fruit. 'I would have loved the opportunity to show my father where hanging around in cafés, listening to jukeboxes got me,' Powell says.

As a 16-year-old Powell started work in his father's butcher's shop. But when his father died three years later, Powell decided to quit the business and instead began working in clubs and music halls. He then got a job as a salesman in the Midlands for Philips, the record company that became Phonogram, and in 1972, quite out of the blue, he was promoted to the new role of artist relations. His first assignment was to look after Rod Stewart.

'Rod had signed to the label, but his relationship with them in the UK needed to be cultivated,' Powell says. So the company asked if Stewart could think of anyone he would like to work with and 'my name was plucked out of the air'. The two men had previously met at gigs in the Midlands while Stewart was working with the newly formed band, The Faces, and, says Powell, 'we hit it off'.

The new job transformed his life. 'Suddenly I was in the heady heights of the music industry, working in London, going down to the recording studios, round the music clubs and so on, having the time of my life.'

By the mid-70s, having 'wined and dined and rock and rolled' across Europe with Rod Stewart and The Faces, Powell returned to Phonogram, working his way up to become deputy managing director before he moved on to become managing director of MCA/Universal. After seven years there, he took the same job at Pinnacle Entertainment. In 2003 he was diagnosed with prostate cancer – now cured 'touch wood' – which made Powell slow down and eventually retire in 2006.

Powell was also able to work with other 'fabulous artists and people' including Elton John and Dire Straits. But the highlight of his career was working on Bob Geldof's 1984 Band Aid charity single 'Do They Know It's Christmas?'. 'I was in the office one Friday afternoon when Geldof came storming in and said he was going to do a charity record. I said, "Hang on, you've got a record out already", and that we should all think about it over the weekend. On the Monday, he came back in and said, "This is what we are going to do and this is how we are going to do it." It was an experience that will stay with me for the rest of my life.'

Music may now be a global industry, but when Powell started it was 'more of a fun palace. The last thing on anyone's mind was looking to a future time when we would retire and might need some support'. It was during this hedonistic time that Powell was introduced to Peter Collins, his St. James's Place Partner, who has been a 'steady hand' ever since. 'Peter never lost sight of his role. He would turn up in his suit and tie and stick with it, while we were in jeans and T-shirts,' Powell says.

Since then the industry has become much more businesslike, a transformation that Powell witnessed from the inside. 'Suddenly, we were interviewing people and having contracts like proper companies did. Instead of flying by the seat of our pants, we had marketing meetings and budgets and planned what we would do next.

'I started to realise I could have a career in the business and that it could be lengthy and so my conversations with Peter became even more relevant. I very much value Peter's guidance and it has been a very valuable association for me. His son Paul is now working with him and it has been a nice transference from father to son.'

STEPPING STONES

Tony Powell has developed the marketing strategies for a range of famous acts, with particular emphasis on television campaigns. Here are some of the performers he has worked with:

1978-1988
Elton John
Dire Straits

1973-1988
Status Quo (pictured below)

1976-1988
Thin Lizzy

1979-1988
Def Leppard (pictured below)

1982-1988
Tears for Fears

1986-1988
Swing Out Sister (pictured below)

1987-1988
Wet Wet Wet

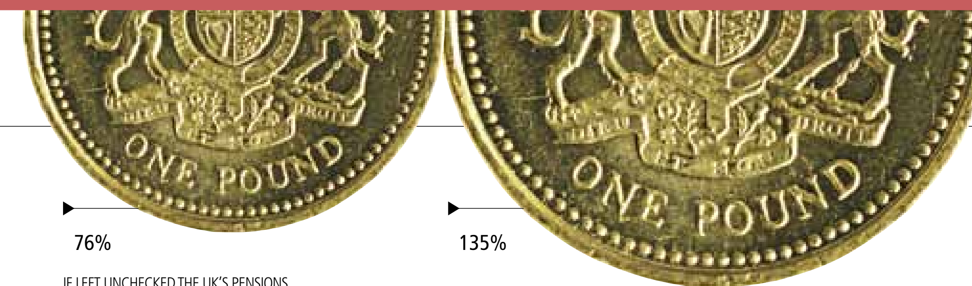
ANALYSIS

DEFUSING THE PENSIONS TIME BOMB

The UK faces a £750 billion shortfall in its funding of retirement. Edward Russell-Walling considers what needs to be done to fill the gap

Getty Images, iStockphoto

SPECIAL REPORT



IF LEFT UNCHECKED THE UK'S PENSIONS SHORTFALL COULD INCREASE PUBLIC DEBT FROM 76% TO 135% OF GDP BY 2050

We have all known for some time that we are living longer, but we – and, more importantly, our governments and actuaries – have consistently underestimated just how fast our life expectancy is lengthening. The result could be a £750 billion shortfall in UK state and public sector pensions which we, as taxpayers, would have to stump up.

This figure comes from a sobering International Monetary Fund (IMF) report which looks at the financial impact of the longevity phenomenon. It acknowledges that governments and pension providers have woken up to the financial consequences of our ageing population, but insists that most still underestimate what it calls 'longevity risk'.

Official British estimates are that boys born in 2010 will live to 78 and girls to 82. But the IMF says our forecasts have typically fallen three years short of reality. The longer we live after retirement, the more money the state has to provide for us, so it needs to get its sums right. The UK is at less risk than some – Germany and Japan are in a worse state, the IMF says – but it exhorts most Western governments to act now if their public finances are not to be devastated in the years to come.

To be fair to the UK government, it has the issue in its sights. It is raising the state pension age to 67 for men and women between 2026 and 2028, and to 68 between 2044 and 2046. Much to the anger of public sector unions, it wants civil servants to retire later and to make bigger pension contributions. To encourage more people to make their own provision for retirement, it is obliging companies to enrol employees automatically in pension schemes. Until now, employees have opted in but in future they will have to actively decide to opt out.

Chancellor George Osborne has also given the go-ahead for a new single-tier pension of around £140 a week for everyone, without means testing. The rationale is that scrapping means testing will make the scheme considerably cheaper to administer.

Most of the government's initiatives are in line with the IMF's recommendations, though the Fund thinks we could do more. One suggestion is an automatic link between future increases in longevity and increases in retirement age. The UK government is already planning such a link, in line with Denmark, France, Italy and the Netherlands. Finland, Germany, Japan and Portugal have passed laws to adjust pension benefits if life expectancy changes. The Chilean and Swedish governments have introduced defined contribution (as opposed to defined benefit) plans, where pension payments will depend on contributions and investment performance. The IMF suggests increased social security contributions as another way to ease the problem, even though this, such as any tinkering with people's pensions expectations, is politically sensitive.

These are some examples of the 'risk sharing' that the IMF is urging governments to foster, pointing out that longevity risk is simply too large to be managed by any one sector of society. The solution, it maintains, requires better risk sharing between the public sector, the private business sector and individuals.

The wholesale shift in UK company-sponsored pensions from defined benefit (final salary) to defined contribution plans is a graphic example of how pension providers are already shedding longevity risk. Insurance companies are doing the same by charging higher premiums and reducing rates for annuities.

Like it or not, we as individuals are going to have to shoulder a bigger portion of this risk by providing for our own income in retirement. Those who already have financial plans should make the fullest possible use of their annual pension allowance – now reduced to £50,000 or 100% of salary, whichever is the lower. Anyone who hasn't started planning for their retirement should consider doing so without delay.

GILTS DEVALUED

The Bank of England may or may not have rescued the British economy with its programme of quantitative easing (QE), but it has certainly made life more difficult for pension funds. They are large holders of gilts and, as QE has pushed down yields, so it has widened pension fund deficits.

With QE, the Bank has bought quality assets from banks and financial institutions, paying for them with newly created money which it hopes will be put to more productive work. It has pumped £325 billion into the economy in this way, most of it spent on gilts. This has forced their prices up and their yields down – by at least one percentage point, according to Bank researchers. Gilt yields are used to calculate pension fund solvency – the assessment of whether their assets cover their liabilities – and the fall has widened that gap by £270 billion for final salary funds, according to the National Association of Pension Funds.

The QE programme is not necessarily over. That, coupled with a continued appetite for safe assets, suggests that gilt yields are unlikely to rise again soon. Investors in search of superior yield should consider a well-diversified portfolio, including equities of various types, higher-yielding corporate bonds and commercial property.

Balance sheet With UK longevity on the increase governments have woken up to the financial consequences of our ageing population. However, the IMF says that the UK is still underestimating the size of the challenge. The result is that individuals must contribute more to their pensions.

CHINA UNVEILED

China has become a crucial player in the global economy. Jonathan Fenby's book *Tiger Head, Snake Tails*, gives the background to its recent growth and highlights the challenges it now faces. He spoke to Heather Connon

> Around one million Chinese are estimated to be millionaires in sterling terms

China produces more in two weeks now than it did in a whole year in the 1970s; it is the world's largest manufacturer of steel and the biggest energy consumer. The average annual income per head has soared from 528 yuan (£50) in the early 1980s to 19,100 yuan (£2,000), in urban areas, in 2010. Its companies operate ports in Greece and wind farms in Romania. It has stakes in iron ore deposits in Sierra Leone, diamond mines in Zimbabwe, and cobalt and copper reserves in the Democratic Republic of Congo.

These are just a few of the facts that pepper Jonathan Fenby's book, *Tiger Head, Snake Tails: China Today, How it Got There and Where it is Heading*, in which he describes China's transformation from communist backwater to economic powerhouse, and outlines the challenges it faces.

While the story looks like an economic one – it has climbed rapidly up the GDP league tables and is likely to surpass the US to become the world's largest economy within the next two decades – Fenby says: 'The basis of its economic growth is political. When Deng Xiaoping [leader of the People's Republic from 1978 until 1992] came to power, he saw that China was in a terrible state and the Communist Party was in danger of imploding. He wanted to build China and the weapon he chose was economic growth. The question for the new leadership, as it takes power this autumn, is whether it has the political will to move the economy ahead.'

The challenges facing it are well known: to rebalance the economy away from fixed asset investment (the current five-year plan envisages infrastructure spending of seven trillion yuan between 2011 and 2015) by stimulating domestic consumer demand, to increase productivity and to encourage private enterprise and private financing. 'All of these come with a price and, because the country is doing so well now, it is not keen on change. Will the new leadership be willing to take the risks? I do not know and I suspect the new leadership doesn't know either.'

He is confident that China's economy will not collapse, as some fear. However, he points out that no other global power has been so dependent on international competitors for its success: on European and US consumers to buy its products; and Russia, Latin America, Australia and Africa to supply its raw materials.

The dependence is mutual: China is effectively financing the US deficit through its enormous holdings of Treasury bonds. The two countries do snipe at each other but, Fenby says: 'They need each other. It is the most important relationship in the world economy.'

Fenby first visited China in 1995, just after he became editor of the *South China Morning Post* in Hong Kong. The biggest change, he says, has been brought by the huge infrastructure investment and urbanisation that has taken place since. His book also offers an insight into the tensions the explosive growth has caused.

While Chinese generally have become much wealthier, inequality has also increased: around one million Chinese are estimated to be worth more than 10 million yuan, making them millionaires in sterling terms, but more than 20 million live in absolute poverty, on United Nations definitions.

'Social issues are generally underestimated by those who look at China,' says Fenby. 'But that is where the real test is going to come. People have far more freedom than they had in the Maoist era. They can travel abroad freely and have access to consumer goods. They have got used to these freedoms, the younger ones especially, but they also throw up real difficulties. Wealth is very unevenly distributed, a lot of services don't work very well, water and food quality can be poor and building standards are low.'

While older Chinese may appreciate the improvement in living standards since the Mao era, younger ones do not have those memories. 'A 35-year-old Chinese will always have known increasing wealth and increasing materialism; they will never have experienced a property crash. Their expectations are built on that continuing.'

AN AUTHOR'S INSIGHT

A newspaperman's understanding of the Chinese economy

Jonathan Fenby, former editor of *The Observer* and a former journalist at both Reuters and *The Economist*, has written a total of six books about China. He also edited the *South China Morning Post* between 1995 and 2000.

Six years ago, Fenby co-founded Trusted Sources, a research company that initially concentrated on the BRIC countries – Brazil, Russia and India as well as China – but which now covers emerging markets across the globe.

Gallery Stock

SPECIAL REPORT

FUEL FOR THOUGHT

Is shale oil an answer to the energy question or a bubble waiting to burst?

Across a southern swathe of the United States, many thousands of oil wells have sprouted in the past five years. Some 45,000 oil wells were drilled last year alone at a cost of $200 billion – ten times the activity seen in Saudi Arabia. But these are not conventional wells; they're 'tight oil' wells, drilled to exploit reserves of shale gas and oil, an unconventional fuel that can be upgraded to meet crude oil refinery specifications.

This hive of activity is changing the dynamics of the US energy market and reinvigorating the US economy. If fully developed, European deposits of shale gas could make Europe virtually self sufficient in energy.

US shale production today accounts for 20% of US natural gas production, according to the US Energy Information Administration, up from 1% in 2001, and should rise to half by 2035. In his State of the Union address, President Barack Obama predicted shale would provide 100 years of natural gas supply and create 600,000 jobs. However, in a nod to environmental concerns he also pledged to ensure it is done 'without putting the health and safety of our citizens at risk'.

Some analysts predict that because it has caused natural gas prices to tumble, the shale revolution will transform the US economy. Andrew Liveris, chief executive of Dow Chemical, recently said: 'Shale gas... makes America a low-cost jurisdiction for any energy-intensive manufacturing of the value-add kind.'

Andrew Smithers, chairman and economist at London-based research firm Smithers & Co., said: 'For the US, the big growth in the production of shale gas and unconventional oil is likely to eliminate net energy imports over the next two decades. In the absence of any other changes the US fiscal deficit could be cut by 1.8 percentage points of GDP without any adverse impact on the private sector cash flow.' Shale is less good news for the US's renewables sector. The Global Clean Energy Index slumped by 50% last year and there have been a number of bankruptcies in the solar sector.

The European Union is still debating whether to engage in large-scale extraction from its own vast deposits, estimated to contain 22 trillion cubic metres of recoverable underground shale gas.

Production costs in Europe are likely to be three times higher than in the US, partly because, unlike the US, Europe lacks a network of domestic pipelines and oilfield service companies. Europe also has more obstructive land ownership laws and a louder environmental lobby. This explains why France, Bulgaria, Romania and the Czech Republic have all introduced bans or moratoriums on 'fracking'. The impact on drinking water is the primary concern.

Targeting offshore fields removes such obstacles. Nigel Smith, a geophysicist at the British Geological Survey, recently told a parliamentary committee that the UK's offshore recoverable reserves are ten times greater than its onshore reserves, and that the UK could become energy self-sufficient if it exploited them. But the economic viability of shale oil production depends on the oil price, and if the recent weakness continues there is no guarantee that offshore production is going to become commercially viable any time soon. Even in its US heartland, some suspect shale energy's bubble could burst. Writing in *Petroleum Economist*, energy consultant Ruud Weijermars said: 'As the US shale-gas sector shows, energy producers can't guarantee returns when prices tumble, and easy credit evaporates. It is an imbalance that could get much worse before it gets any better.'

He predicts that oversupply and low and volatile prices in the US market, together with the over-indebtedness of many of the firms involved, will push US and Canadian shale-gas producers to the brink of collapse. If the shale bubble were to burst as Weijermars predicts, he says it would leave the US vulnerable to a dangerous 'energy crunch'.

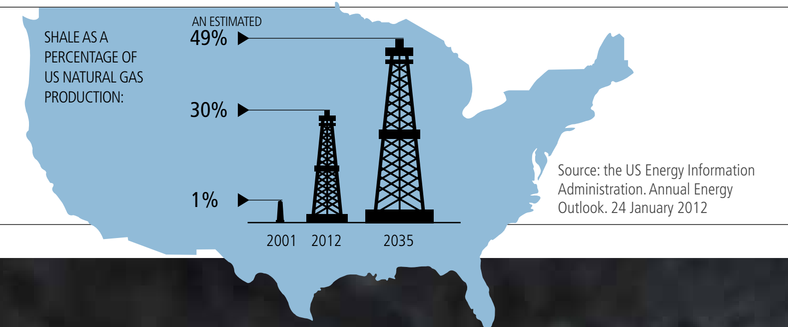
FRACKING EXPLAINED

Shale oil and gas are extracted from underground rocks using a process known as hydraulic fracturing, or 'fracking'. A slurry of water, sand and chemicals is pumped into underground shale beds at high pressure, in order to fragment the rock and open fissures that allow oil and gas to escape. Wells can drop 7km, before turning horizontally through gas-bearing strata, with waste water pumped back to the surface to be processed and stored.

The full ecological fallout has yet to be fully quantified, though there is scientific evidence to suggest that 'fracking' can cause ground-water pollution and trigger earthquakes. The US Environmental Protection Agency is examining fracking's impact on drinking and ground water, with a report due in 2014.

Last year the US Energy Information Administration identified Argentina, Australia, China, South Africa, Norway, UK and France as the non-US countries with the largest reserves of shale gas, along with the regions of North Africa and Eastern Europe. However, exploration has yet to begin in earnest in these regions. In Poland, fewer than ten drills have been sunk; China also has sunk fewer than ten, while in Argentina there has been only one. China recently claimed to have 25.1 trillion cubic metres of recoverable shale gas, enough to feed its energy needs for two centuries. However, it is unlikely to start large-scale drilling before 2016.

Balance sheet On the face of it shale oil appears to be a likely successor to crude oil, with domestic reserves likely to satisfy US demand for many years, creating may thousands of jobs. However, with environmental concerns over extraction methods and shale's economic viability the jury is still out.



Source: the US Energy Information Administration. Annual Energy Outlook. 24 January 2012

Getty Images, Corbis Images

IN YOUR INTEREST

SITTING ON A FORTUNE

Cautious companies have amassed cash reserves worth many hundreds of billions of pounds. What does this mean for investors?

For companies, cash seems to be everywhere. An analysis by Ernst & Young's economic Item Club suggests that British companies are sitting on £750 billion. That, as Ernst & Young pointed out, is more than half the UK's GDP. Meanwhile a study undertaken by Moody's, the credit rating agency, found that non-financial US companies were sitting on a similar sum – $1.24 trillion (£775 billion).

Yet corporates don't seem to be doing very much with these pools of liquidity. Ten years ago companies with cash would have tackled ambitious mergers and acquisitions. But in 2012, mergers and acquisitions have slowed to a trickle. Thomson Reuters' data for the first quarter shows that the value of worldwide deals was 35% down on the previous year, back to around the levels seen at the depths of the financial crisis in 2009.

In the early noughties corporates would have gone further than spending cash: they'd have borrowed in the confident expectation that the cost of this debt would be well covered by returns on investing it. Now the reverse is true. Research by analysts at investment bank Morgan Stanley indicates that companies are using cash to reduce debts, rather than take them on.

In the past, companies might also have used these funds for share buyback programmes. But the Morgan Stanley research suggests that this was the least likely option that companies would follow. According to this study companies were far more likely to use the cash to increase dividends or increase capital expenditure on business already owned.

That should be good news for investors. The global financial crisis is making investors nervous and stock markets uncertain; the FTSE 100 has been trading in a fairly narrow range for much of the past two years. Income from dividends has, therefore, been providing a large part of equity returns – and the amount of cash currently in corporate bank accounts should be able to fund dividend payments for some time to come.

But while the overall numbers indicate healthy balance sheets, it is unwise to make sweeping generalisations as the cash tends to be concentrated in particular companies and sectors. The Moody's research identified technology companies Apple, Google, Cisco and Microsoft at the top of the cash-rich list in the US, while pharmaceutical giant Pfizer was also in the top five. Those five companies account for 22% of the cash balances while half the $1.24 trillion was held by just 50 companies.

Nick Purves, an investment manager with RWC, is among those who think investors should look more deeply at the implications of the cash balances. 'We hear a lot about companies sitting on piles of cash and see the comments that this could be good for markets because they will spruce up growth with investment in organic growth, mergers and acquisitions activity and share buybacks,' he says. 'We are actually pretty circumspect.'

He adds: 'Accurate figures are hard to come by. There are behavioural aspects to this as well. When Lehman went down, companies went into panic mode. Disaster was avoided thanks to the actions of central banks and because corporates strengthened themselves. But having seen the risks up close, finance directors may remain much more cautious.'

Purves agrees that tech stocks, with scant need of physical capital, feature prominently among the cash rich. Though research and development is vital, overall labour costs are relatively light too. Meanwhile European banks, in particular, are suffering financial strains to counterbalance the amount of cash held by companies in other sectors. So while some companies have lots of cash, the overall picture may be somewhat different.

'Clearly there are exceptions in the technology and pharmaceuticals sectors. But across the market as a whole we don't see leverage in what you might call median companies reducing markedly,' says Purves. 'Besides, if we look harder at individual companies' characteristics rather than the market as a whole, it is the strengths and weaknesses of specific companies that we think is more important.'

There is no guarantee that large cash balances will fuel investment returns. Some cash-rich stocks may boast good share price track records – Apple, which has just announced its first dividend since 1995, is a particularly good example. But that is because they are strong companies with good products and healthy profits rather than simply because of their cash holdings. With interest rates as low as they are, the poor returns available from cash can actually depress company returns unless the cash balances are carefully managed. Stock selection, as always, is the key.

There is however plenty of evidence that the high cash reserves are financing rising dividends. The Dividend Monitor report, published by Capita Registrars, pointed to a 25% increase in dividends paid by UK corporates in the first three months of 2012. That record figure, admittedly, includes some chunky one-off payments that may not be repeated; but it is forecasting a 12.2% rise for the year as a whole. That gives investors some reason to be cheerful.

Balance sheet Market analysis shows that caution is resulting in British companies holding record amounts of cash on their balance sheets. However, the good news for investors is that these reserves provide strong cover for future and increasing dividend payments.

Getty Images

WHO IS THE RICHEST?

In a report entitled 'European strategy: What will European corporates do with their cash?' Morgan Stanley identified information technology companies as the most cash rich.

The research found that the biggest balances of cash – sums equivalent to 20% of companies' market values – were to be found in the utility sector, but this was balanced by high levels of debt, net of cash balances. The Morgan Stanley data showed that utilities companies have debt equivalent to more than 100 per cent of their equity base.

Behind IT, those companies with the greatest net financial strength are in the consumer discretionary, healthcare and energy sectors.

MY BIGGEST INFLUENCE

George Luckraft of AXA Framlington shares the lessons he learned from his first employer and mentor, John Carrington

Who is the person who most influenced your career?

John Carrington, the person who first employed me in the City. He was a friend of my parents who ran his own investment management business, John Carrington & Co. I worked for him during vacations from university and then he offered me a job in investment management when I graduated on the condition that I didn't get a first. He said that getting a first would mean I had no common sense. I didn't get a first and I started work there in July 1980.

How did he influence you?

He taught me all I know about investment management. Key lessons included: if you are investing in a company, you are lending money to its management so it is important to meet the company and get to know it; and if in doubt, cut your losses. He also used to say: 'Water your flowers, not your weeds.'
He was a great believer in fund managers investing personally in the companies they bought so they knew what it was like to lose money. I still remember the profit I made on my first investment, Rockware. It was £9.99; not much, but I was very pleased with it. I also remember a time when housebuilders' shares would rise strongly after they announced their results, so I just looked at the next one due to announce results and bought it. In fact it did badly and I lost money. That was because I had failed to do my homework.

How has this influence affected the way you run your investment portfolio?

I still believe that, as he taught me, it is important to invest across the size spectrum. The best way to earn money is to identify small and medium-sized companies and buy them at low valuations. As they expand, you not only get the growth from the underlying company, you also benefit from the fact that their ratings increase as other investors get to know about them. He was very good at that: he was one of the earliest investors in Williams Holdings, taking a significant stake early and holding it until it became a FTSE 100 company. He is a great traveller and a talented linguist; he speaks about 12 languages. He was one of the first western investors to meet the management of Nintendo, the Japanese electronics company, and he made clients a lot of money from his investment in the group. He was also an early investor in Nokia, the Finnish mobile phone business.

Some of my own successes mirror that approach. One of my core holdings is the sausage-skin manufacturer, Devro, a company that plays to the secular growth theme of increased food consumption. Anglo Pacific is another long-term holding. It owns royalties over mines owned by commodity companies like Rio Tinto. The financial crisis meant there was limited availability of finance for miners; so Anglo Pacific managed to get some new royalty agreements by providing capital. It is 30 to 40% cheaper than American and Canadian rivals, but has just got a listing in Canada so that could change.

What would Carrington think of your career?

I carried on working with him until 1997, when he retired shortly after the company was acquired by Dutch bank ABN AMRO, but I still see him socially. I think he would be pleased with how my career has progressed. He left the City shortly after that acquisition. We had to work in a non-smoking office and he had a pipe permanently attached to his mouth, so it was never going to be a very suitable environment.

Would these lessons hold for someone starting out now?

Yes, I think they would. Investment is all about common sense. Now, fund management is more structured and you have to take more exams, but it is still all about meeting companies and seeing how they develop.

> **"He taught me that it is important to invest across the size spectrum"**

Please note these views are the fund manager's own and St. James's Place accepts no responsibility for the information contained.

WHAT DOES RETIREMENT LOOK LIKE FOR YOU?

Millions of us will be spending around a third of our lives in retirement. Nearly three-quarters of people believe retirement, as we currently understand it, will not be possible in the future.*

For help in building the pension fund you need to help make your retirement plans a reality, speak to your St. James's Place Partner.

An investment with St. James's Place will be directly linked to the performance of the funds you select and the value can therefore fall as well as rise. You may get back less than you invested.

* Source: BBC Newsnight 07/09/10

ST. JAMES'S PLACE
WEALTH MANAGEMENT

AWARD-WINNING
WEALTH MANAGEMENT EXPERIENCE

At St. James's Place we are committed to helping our clients manage their wealth in a way that reflects their personal circumstances.

We are therefore delighted and proud to receive recognition of the face-to-face service we provide by winning these awards.

FT & INVESTORS CHRONICLE UK WEALTH MANAGER OF THE YEAR 2012

WINNER

Readers were invited to take part in a detailed questionnaire about their wealth managers and asked to assess them on a range of criteria including performance, fees, range of investment options and tax solutions, trustworthiness and overall competence

UK STOCK MARKET AWARDS 2012

WINNER

St. James's Place was selected to win this award by an impartial judging panel of equity participants/commentators under the 'Best Insurance Company Category' for demonstrating commercial success, effective innovation, financial soundness and clarity of strategy

CITY OF LONDON WEALTH MANAGEMENT COMPANY OF THE YEAR 2012

WINNER

In its inaugural year, the City of London Wealth Management Awards asked the public to cast their votes based on their personal experiences of the quality of advice and service they have received.

THANK YOU TO EVERYONE WHO HAS VOTED FOR US.