Monetary and fiscal policy is a zero summation

Wealth is created by man and while money is considered by many to be a measure, in reality, it is only pricing purchasing power which counts. In overall terms, the increase in annual world gross domestic product is this new creation of wealth and while governments and central banks look to maintain a steady course by the utilisation of fiscal and monetary policy, it must be stated that this is solely a zero summation in terms of producing prosperity.

It is simple to consider the effects of inflation over the years to know that the value of money has depreciated and often the currency of the sovereign country concerned. This diary has often stated that one man’s asset is another man’s debt and when governments either expand debt or curtail the money supply, then this will have a direct effect on the economy and it is important that investment managers look to be on the right side of the equation.

Following the banking crisis, the reaction of the principal central banks and governments is well known, with monetary expansion, in which quantitative easing is a central measure. In 2007/8, we drew our readers’ attention to the problems of bank leverage with the creation of artificial fiscal vehicles such as securitised investment vehicles, built on highly risky collateralised debt obligations based on sub-prime mortgages.

Effectively, central banks have bailed out the retail banks and it is now sovereign debt which essentially is the leveraged debt and given the state of many of the economies concerned which already had debt levels well in excess of 60% of GDP, together with a multitude of off balance sheet items as set out in last week’s diary. While it is considered that governments cannot go broke, there is no problem to them creating high levels of inflation and deflate their currency and while there are numerous examples, some of the most noticeable are the German Weimar Republic, Argentina and Zimbabwe.

Bill Gross of Pimco, in his March ‘Investment Outlook’ asked the question, “Can you get out of a debt crisis by piling on another layer of debt?” Noting that while it depends, he also stated that based on existing deficit trends and the expectation that not much progress will be made by reducing them, markets are raising interest rates, either in anticipation of higher future inflation or credit risk, or both. Also, in order for the medicine to have worked, it needs to be shown that aggregate demand has increased in order to sustain upward GDP growth. Unfortunately, most economists and central bankers when questioned (including Mervyn King) have concluded that the recovery is patchy and with options to continue further quantitative easing running out, the forward indications are not good.
In the opinion of the Margetts Fund Management team, it is essential that deficits are surgically cut as soon as possible, given that in most cases there is more than enough fat for this to occur, following the huge expansion of non-productive labour, principally in government and local authority departments. At the same time, they should adopt the policy applied by Margaret Thatcher of squeezing the money supply and essentially depriving the banks of the easy money they are making through fixed interest investments from the cheap money supplied through quantitative easing and effectively ‘zero interest rates’ with an emphasis that they now resume lending to industry, while giving decent returns to depositors.

It cannot be over-emphasised that when normal levels of government debt are above 90% of GDP, then the National Bureau of Economic Research has shown that growth rates fall to mean levels of less indebted countries, by almost 4% lower. The lessons of Greece, Portugal, Iceland and Ireland come to mind and inevitably, rating agencies will cut the AAA ratings, making it even more difficult to raise the essential finance needed by government for the day-to-day running of the organisation.

No doubt as we head for the election, the political parties will set out their agenda with regard to the UK economy, but it would certainly seem that on the balance of probability, in view of lack of action, we are heading for the scenario outlined and remembering the ‘zero summation’ the bets should still be kept towards the strong industrial economies and inflation-busting sectors.

**Strategy**

In line with our themes, we remain committed to the strong geographical areas and sectors, which we believe to be in the best interests of our clients. While taking into account risk and income-producing assets, we would continue to state that Margetts are predominantly risk-averse and look to invest with managers who consistently show that they can produce better returns for lower risk, which on a graph is known as the top left hand corner.

**Award**

Margetts are delighted to announce that we have been awarded the *Lipper Best Overall Group* in the Non UK Equity Small Category – over three years. This builds on Margetts’ recent achievements which are detailed in full on our website.
Providence

The portfolio is performing well, benefiting from a bounce in stock markets and its overweight equity position. In addition, the overweight overseas weightings have benefited the portfolio over the previous quarter, as sterling has depreciated.

Select

Following a decision to hold the First State Asia Pacific fund, the fund has provided the strongest return over the last week, significantly outperforming its benchmark. The other holdings are generally performing well and the team are confident that the asset allocation is appropriate for this part of the economic cycle.
**International**

The fund is performing well ahead of its sector during the last 12 weeks, which has been principally driven by the increased US exposure and underweight European equity position. The team are pleased with the fund’s selection, which is performing well.

![Asset Allocation Chart]

**Venture**

The fund has performed strongly across the board with the exception of the Old Mutual UK Select Smaller Companies fund, which remains under review. Last week’s purchases have benefited the performance and Venture remains the top-performing multi-managed fund within the active managed sector.

![Asset Allocation Chart]