

Economic review of:

June 2010

Our monthly economic review is intended to provide background to recent developments in investment markets as well as to give an indication of how some key issues could impact in the future.

It is not intended that individual investment decisions should be taken based on this information; my colleagues and I are always ready to discuss your individual requirements. I hope you will find this review to be of interest.



Paul Smith

June was dominated by the run up to the Emergency Budget and its aftermath.

Overall, this was well received despite hikes in tax on capital gains and VAT. The former will largely affect higher earners, whereas the latter will affect us all and is probably a regressive tax in that it hits the less well off progressively more than the wealthy. On the other hand, the increase is only 2.5%, so it should not have an inordinately large impact on spending overall. In fact, we may see a mini boom towards the end of this year as people try to get their discretionary spending in ahead of the increase. At least children's clothes and food are not affected; they could so easily have lost their exempt status.



The first Budget for a coalition for many years

One positive result of the Budget was that the credit rating agencies appear to be satisfied that we are heading in the right direction, as they have left our AAA rating in place. Had they not done so, the cost of our massive national debt repayments could have sky-rocketed, making it far more difficult for us to dig our way out of the hole.

Welfare; victim of the cuts

Welfare spending appears to be one of the largest of the targets that George Osborne has hit - alongside many other forms of government spending. But the fact is that we have to cut our spending if we are to survive and everyone has to share the pain. Unfortunately, there are too many people who have, over the past thirteen years, been encouraged to consider that the state will look after them whatever. In reality, the welfare state was established to provide security for those who



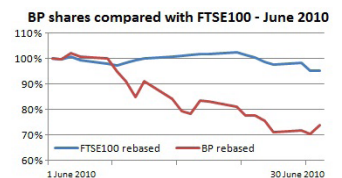
Those in greatest need must be provided for

cannot provide for themselves, not to become an alternative source of income for those who will not (as opposed to cannot) work.

While it is incumbent on any civilised society to look after those who cannot provide for themselves, building up an underclass of people who have no experience of work is not only bad for them, it is bad for society as a whole; and the economy needs everyone who can, to join in and work in order to generate tax revenue to help us out of the mess more than a decade of profligate spending has got us into as a country.

Markets (Data compiled by the Insurance Marketing Department Ltd.)

June was another disappointing month for world stockmarkets with the FTSE100 shedding another -5.23% making it just over 9% lower than at the start of the year, but 15% higher than twelve months ago. There



BP shares picked up towards the end of June

were a number of reasons for this, not least of which has been the impact of BP on the index of which it is a significant constituent. However, that company's shares took an upwards turn at the end of the month, seen as an attractive takeover prospect; not that this helped the FTSE100 at the end of the month, which was plagued by fears over weak economic performance in the Far East. The FTSE250 also fell during the month, losing -2.81%, while the Dow Jones finished June -3.58% lower and the Eurostoxx50 lost -1.42%. The Japanese Nikkei225 was -5.36% down on the month, ending the half-year almost 13% lower than its value at the start of 2010.

Oil rose by 1.34% in June to end at US\$75.01 per barrel for Brent Crude 1-month futures, but is still some 3.8% below its price at the start of the year. Sterling rose 2.8% against the dollar and 3% against the euro.

Inflation and interest rates

With May consumer price inflation running at about 3.4%

(down from 3.7% in April) there are no real indications about how it will go in future. The VAT increase in January will certainly have an impact, but this may not be significant. The big news in June was, however, that one of the Monetary Policy Committee members, Andrew Sentance, actually voted for an increase in interest rates to 0.75% - the first such vote since August 2008.

Interest rates round the world		
UK	0.50%	No change for 15 months
USA	0.25%	No change for 18 months
Europe	1.00%	No change for 13 months
Japan	0.10%	No change for 18 months

Views are mixed on what impact an interest rate rise might have. On the one hand, anything that increases costs to industry can be expected to push factory gate prices up, thus increasing inflation; on the other hand, the Bank of England argues that low interest rates can make it more difficult to control inflation. It is largely relying on overcapacity to prevent price rises at the moment, but others feel that this is not the case.

G20 - Toronto 2010

In what appears to have been a more or less positive meeting, world leaders have agreed to halve their deficits within the next three years. However, as the International Monetary Fund points out, it is not quite as simple as that; the stronger economies must support the weaker ones. After all, the entire world cannot survive on exporting to other countries; someone has to be the net importer.



World leaders' meeting

Both India and China (which latter recently relaxed its currency's link to the US dollar, before suddenly re-establishing the link at its highest level since July 2005) are massive potential markets with pent-up domestic demand for goods that could act as a boost for the rest of the world, if it is allowed to mature. Relatively weak sterling could help the UK if exporters are prepared to address these markets in the right way.

The G20 leaders decided that there would be no global levy on banks, but that each country should make their own decisions. However, it was agreed that the question of capital requirements should be addressed at the November meeting in Seoul.

The Economy

According to the Bank of England Agents' summary of business conditions for June, retail sales value grew steadily

throughout the first half of 2010 - although England crashing out of the World Cup may cool things down a little. Business investment continues to recover, but with a focus on cost cutting and increased efficiency. Unfortunately, it appears that exporters have not taken advantage of a weaker pound to cut overseas prices and thereby increase market share, thus apparently boosting short term margins at the cost of long term potential.



The Bank is confident

According to the National Institute of Economic and Social Research, the economy grew by 0.6% during the three months to May, compared with 0.7% during the three months to April. While this indicates a slowing of growth even before the Emergency Budget, and there are still concerns about the impact that Greece's financial problems are having on the Eurozone, which is a major market for us, there are few commentators who appear to be predicting the much feared double-dip recession. What we are more likely to see is a slowing of growth even to zero. Provided this is not accompanied by higher inflation there is no reason to fear that we will suffer a move into negative territory.

BP

Since the Gulf oil spill started, BP shares have fallen by more than 50%. It should be remembered, however, that this is a massive company with immense reserves and it has probably only suspended its dividend under political pressure from the US. Despite adverse publicity after its CEO was seen sailing on the Solent a week or so ago, it seems that Barak Obama has agreed with his new best friend, David Cameron, that neither the US nor UK would benefit from a weakened BP.



Wisdom for future Budgets

In any event, the impact on UK pension funds could well be limited to the loss (or deferral) of dividends for some time; there is no reason to believe that the capital value of its shares will not recover over time, especially if it is successful in suing Transocean, owner of the Deepwater Horizon rig, over a £470m insurance claim; and in closing off the leak during July as now seems possible. In any event, important as BP is to many investment portfolios, it has been pointed out that while US pension funds have some \$1.4 billion worth of shares in the company, the total shareholdings of the top 10 pension funds alone amount to \$2.4 trillion. If this proportion were to be reflected in the UK, then the impact would not be significant.

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