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# PRESS RELEASE

## John Redwood- Four Different Views on the Credit Crunch

Yesterday I heard different senior economists give their views of the Credit Crunch and recession and what we could do to get out of it. They gave them under Chatham House rules, so I will call them Views 1, 2, 3 and 4, grouping opinions into the four main different positions at the meeting.

**View 1** expressed worry about extremes in policy making. Whilst they could live with a modest reflationary package, they are concerned about undue borrowing or money printing, and felt there could be an inflation problem in due course. They also believed that we had to accept a substantial one off drop in national output, reflecting the activity of banks and shadow banks that had gone over the top and could not be continued. They felt that the recession had to take its course, and that policy action of any extreme kind could cause inflation, or fail to stabilise the asset markets.

**View 2** argued that individuals and companies are very short of money. Money supply has ground to an abrupt halt in recent months. They therefore favoured the UK government borrowing substantial sums from the Bank of England or the commercial banks, to spend or give away as tax reductions so the private sector has more money to spend and repay debt. They did not agree with the recapitalisation and felt the banks had sufficient capital.

**View 3** argued that the government had been right to put more money into the banks and might have to do some more. They also felt some money printing may be necessary in current circumstances and agreed there could be a period of underfunding of the borrowing requirement for a bit to generate some more money in private hands. They felt house prices should fall another 25%, preferably quickly, so the market could then be stabilised. They favoured a medium term fiscal strategy to start to reduce the large deficits and reassure markets that in due course Prudence would return.

**View 4** argued that banks had to go back to simple banking models, relying on deposits from customers as sources of funds and lending to customers as assets. They were pessimistic about how to pull the economy out of recession, and agreed house prices had to fall further.

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From the discussion which ensued, the following points emerged which I think are correct:

- We will lose a portion of our National Output, represented by banking and related financial activities on bloated balance sheets, which will no longer be possible in current conditions. The UK will take a large hit as we have large banks and hedge funds relative to our GNP, and our growth was flattered by the huge financial service expansion in London over the last decade.
- Somehow the balance sheets of companies and individuals have to be strengthened, which means they do need more cash and income, at the same time we need more demand from their spending. Some of the extra demand will come from public spending, with tax cuts and benefit payments giving individuals more money to spend.
- Creating more deposit money in the banks by underfunding or by the government borrowing from the Bank of England is worth a try. The US is now embarking on something like this.
- Increasing future public spending on large infrastructure projects takes too long for the decision to be translated into jobs and spending. Income Tax cuts provide the fastest way of injecting the borrowed public money into the cash starved private sector.
- The government does need to construct a budget plan on spending that will start to control borrowing and outlays.
- It should remove its VAT cut, and substitute cheaper Income tax reductions. The government needs to cut its risk of losses in the nationalised banks by cost reductions, netting off futures and option positions and reducing its risk to Investment bank type activities.
- The government, now it is a bank owner, is the best place to carry out the traditional banking utility function, making its direct contribution to a reduction in Investment banking capacity to reflect the new circumstances.

What will the authorities do? In the US now we have both a stimulus package from the new President, and quantitative easing. The announcement that the authorities will buy up Treasury bills and bonds is bullish as it both directly helps those instruments with the extra demand, and as part of a policy of Federal borrowing which is underfunded directly increases the amount of money in private hands. On the other side of the market we need to take into account the rising hostility between the US and China, and the possibility that overseas buyers will not be so ready to purchase US Treasuries this year as before. The US still has pain to suffer, as housing has not yet definitely hit bottom and industry is suffering badly from reduced orders. The banking and shadow banking sector still has some way to go to reduce its activities. On balance we think there is a case for adding to US equity positions on bad days ahead of the monetary stimulus having some impact. Asia will also benefit in due course from any American recovery.

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In the UK there has been a sharp rally in bank shares from very low levels. This could go further, with forecast good results from Barclays ahead. However, we think the UK economy remains very exposed to this crisis. The IMF has now become the first official forecaster to state that the UK will suffer more than the US or Euroland. Others are likely to follow, as they do the sums on the big contribution financial services and banking have made to the UK economy in recent years, and work on how much of this activity may be lost through the need to shrink balance sheets and find profitable business. We still recommend avoiding UK shares and property.

The successful exporting economies of recent years, including Japan, Germany and China, are all suffering from the collapse of export market opportunities in the US and Euroland. It is now fashionable to point out that they need to adjust too, just as the heavily borrowed economies need to adjust. However, they can start from a stronger position than the over borrowed, as they have the savings and reserves needed to stimulate internal demand if they wish. One of the ways the adjustments will be made is by a strengthening of their currencies, which helps the sterling investor in their bonds and shares. Of course we need to recognise that they cannot make as much money as they have been doing from selling to the West, but they do have other opportunities once the shock of the collapse has been absorbed and thought through.

### Notes to editors

#### Evercore Pan-Asset Capital Management

Pan-Asset Capital Management was launched in early 2008, and in July 2008 announced a partnership with Evercore Partners. The company was set-up by three experienced investors: John Redwood (Conservative MP and former Director of Robert Fleming and NM Rothschild), the late Robert Brown (former Chief Executive of Sarasin Chiswell) and Christopher Aldous (former Chief Executive of Absolute Fund Management). Evercore Pan-Asset is unusual amongst asset managers in the UK in placing ETFs at the heart of its investment process. They have been joined by Guy Davies (former Head of Charities and Philanthropy at Barclays Wealth) who leads Evercore Pan-Asset's provision of asset allocation advisory and investment management services for charities.

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