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Evercore Pan Asset

Keeping it Simple

**John Redwood PanCOMMENT**

# Keep it Simple

by John Redwood

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Sometimes the obvious gets ignored. It may be ignored for a long time. People can suspend disbelief. Markets can overshoot. Money drives asset prices, and we are living through a period when there is plenty of money around to buy risk assets. That is why we have been recommending investing this year in a range of risk assets, despite the poor economic background.

It is also perhaps time to remind ourselves of the obvious. The US and the UK are going to take time to recover from the excess debt they allowed to build up in their banking systems and the wider economy. They both experienced property bubbles which have burst painfully. They both have overstretched consumers and some over-gearred companies. They both have some large banks that need to rebuild cash and capital.

In the UK the government has focused on getting through until May 2010, the likely date of the next general election. They have decided to spend, borrow and print what it takes to limit the downturn and engender some kind of recovery in due course. In the USA a new President came to office pledged to a bi-partisan policy of spending, borrowing and printing more. Once in office he decided to increase the amounts in each of those categories, hitching his fortunes to an additional spending package. Some Obama representatives are already talking of the deficit and spending problems being second term issues, as if they will wait that long.

Both administrations are fighting fire with fire. They both think the answer to too much borrowing in the private sector is more borrowing in the public sector. Their answer to heavy losses in the financial world is to nationalise the losses. Their answer to insufficient demand is to try to stimulate extra demand by more public spending.

The problem with this approach should be obvious. Every extra dollar or pound spent in the public sector has to come from the private sector (once money printing is over). It either comes in the form of extra taxes immediately, or in the form of tax increases subsequently to service and repay the debt. If it is borrowed in the short term the private sector has to lend them the money, which is money the private sector cannot then spend itself. Every dollar borrowed or taxed transfers spending from private to public, it does not create new demand.

More public borrowing will squeeze out the private sector recovery. We can see this very directly in the UK. Most of the extra borrowing is being paid for by the banks lending money to the government. This means the banks have insufficient money left over to lend to the private sector. UK businesses are starved of access to credit on any terms, or on low interest rate terms in the case of the bigger and stronger ones. In

due course, once quantitative easing is over, we may well experience further increases in interest rates, which are already well above the highly notional low base rate if you want to lend or borrow.

The UK authorities are creating a money-go-round. The banks are made to lend huge sums to the government under the new rules requiring them to keep much more liquidity. The regulators define liquidity to include government bonds.

The simple truth is this. If excess lending and borrowing were wrong for the private sector prior to the 2007 crunch – and they were – they are also wrong for the public sector. Indeed, it is even worse when the public sector does it, as the rest of us have no choice. We will just have to knuckle down and pay it off sometime. The longer the US and UK delay bringing the public accounts in to shape, the bigger the problem will be when the adjustment does start. If they do not show willing to do it in a reasonable time frame, the markets will do it for them. That will make us all poorer, as it will start with higher market interest rates, and continue with a further squeeze on the private sector.

In the meantime there is no substitute for sorting out the banks. Subsidising them is not a good idea. They need to write off the bad, and get on with the new. There cannot be decent growth without expanding banks. The danger is that some of the “rescues” will delay the sort out.

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If you would like more information, or to schedule an interview with John Redwood, please call Hilary Power on 020 7398 5840 or email Hilary at [Hilary.Power@pan-asset.co.uk](mailto:Hilary.Power@pan-asset.co.uk).

For John Redwood’s twice-weekly blog visit <http://www.pan-asset.co.uk/news-and-opinions-jr-comment.htm>

## 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 asset allocation and index-tracking with 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 to charities.

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