

**K A LINCOLN > INVESTMENTS**

# **NEWSLETTER**

**By Kim Andrew Lincoln Cert PFS CeMAP**

## **PREDICTIONS FOR THE ECONOMY, INVESTMENTS & SAVINGS IN 2009 & BEYOND**

---

### **INTRODUCTION**

I began preparing for the 'economic meltdown' in December 2003, when following 9/11, stock markets and interest rates had reached a low point. The primary roots of this crisis, however, go back much further, to the time of the Napoleon, when the famous banker A. M. Rothschild established the 'fractional reserve' banking system. He perverted 'sound money' by creating a money making machine based on debt. And it is this banking system, used by most countries in the world today, which is the cause of all our economic problems. Two centuries later this debt based 'pyramid selling scheme' has reached its mathematical limits as we have become 'all borrowed up'. Credit is scarce because banks fear to lend, knowing that too much of our income is already taken up with debt repayments.

The long term solution is to pay off debt so that we have more money to spend and redesign the money system so that the amount of spending power in the economy is never more than the value of goods and services produced. This would purge the system of inflation (and deflation) and facilitate sustainable economic growth.

The government's preferred option, however, is to bail out the very system that created the problem. This will prolong and deepen the recession and – in some respects - make it even more severe than the Great Depression. If the fractional reserve banking system is not replaced with sound money and the banks taken into public ownership so that the money supply can be controlled then the economic destruction we are seeing now will only get worse.

**However, I am optimistic that common sense will eventually prevail and that out of all the economic destruction a Golden Age economy will arise that is in alignment with the natural laws and that will enable all people to share in the fruits of prosperity.**

## **MANAGING THE ECONOMY**

Once government acknowledges that you cannot eliminate inflation and deflation without first establishing a pure money system then we will have arrived at the point where we can have sustainable economic growth. But I do not think this will happen until about 2014/15 when a Golden Age of enlightened politics will replace the present perverted and corrupt system which was designed to benefit the few at the expense of the many.

## **GOVERNMENT BORROWING**

I believe that the government has grossly underestimated the scale of the economic problems we face and will borrow about two and a half times more than they budgeted for in the pre budget statement. This will lead to even higher taxes and/or big spending cuts.

## **THE COST OF LIVING**

We are entering a period of protracted deflation where the average price of goods and services will keep falling. I foresee prices going down by about 5% in 2009, 2010 and 2011 and by a lesser amount in 2012 and 2013. From 2014 I forecast stable prices. This means that on average what cost £100 to buy today will cost only £80 in 5 years time.

## **UNEMPLOYMENT**

In 2003 I said: "Unemployment could hit 25% or more" – that's about 7 -8 million. I am sticking to that figure which I think could be reached by 2011 if the government continues with its current policies.

Unemployment is the last indicator of economic decline, as firms will only shed labour when all other cost cutting measures have been exhausted. What we do know is that unemployment is rising fast and that the building, retailing, financial services and manufacturing sectors have been hit very hard. Unemployment is currently 6.3%.

In 2009 the professional services sector, which includes people like me, is likely to fall on hard times. I estimate that about three quarters of Independent Financial Advisers and half of mortgage brokers will go bust or leave the industry.

## **HOUSE PRICES**

House prices peaked in October 2007 along with the stock market. A £200,000 property then has fallen in value to about £168,000 now. My view is that the market will hit bottom by mid 2010 when that same house will be worth £120,000 - a drop of 40% from its peak. I do not see a return to house price inflation beyond 2014.

## **MORTGAGES**

In 2003 I said that “The cheapest mortgages will be lifetime trackers. But once it is clear that interest rates are likely to fall significantly, lenders will make them less attractive or withdraw them completely”.

This prediction has come true as there are now only a few lenders offering Lifetime Trackers - albeit on terms which are much less favourable than I was getting for my clients only 2 years ago. Clients for whom I arranged mortgages/remortgages since 2005 are paying around 2% interest or less now and I expect this to fall to about 0.5% by the summer of 2009! As the base rate is likely to go to zero, Lifetime Trackers are still probably the most suitable type of mortgage for those people who can come up with the large deposits and fees that lenders are now demanding.

## **BANKS / INSURERS/INVESTMENT MANAGEMENT COMPANIES**

Since the credit crunch started the banking sector has been decimated and a country, Iceland, has gone bust. UK taxpayers have bailed out the weakest banks which surprisingly included the Halifax – the biggest deposit taker and mortgage lender.

In 2003 I said that: “only the strongest banks and insurance companies would survive and that several small building societies would fail” and, as far as the banking sector is concerned, that has happened, though I think that more banks will fail. Several small building societies were recently taken over by the Nationwide as they were so financially weakened by the economic crisis that they could not continue to trade in their own right.

In 2008, AIG, was the first major insurer (the world’s largest) to fall victim to the crisis - needing \$78 billion from US taxpayers to keep it afloat.

No UK insurers have failed yet, though many are in terminal decline. Those who have taken over the liabilities of company pension schemes and/or are big providers of annuities are at most risk of insolvency if investment markets collapse. I have no confidence in the ability of the Pension Protection Fund to adequately recompense those who could find that they will no longer receive their retirement pensions if the insurer responsible for paying them goes bust. There just isn’t sufficient funding in the scheme to deal with a large number of claims - unless the government steps in.

In 2009 I expect to see most British household name insurers going down. And I do not think the government will prop them up. As a result of the shortage of insurance underwriting capacity I expect to see general insurance premiums rise substantially.

In 2008 we saw the collapse of many multi - billion pound ‘Hedge Funds’ and three of world’s largest investment banks. This year I expect to see more of the same and the demise of the majority of investment fund management companies in the City of London and elsewhere. These firms manage Stocks & Shares ISAs, Unit Trusts, OIECS, Investment Trusts and Pension Funds.

In short, I expect to see all the remaining ‘towers of Babel’ that make up the financial system fall.

## **CRIME**

In 2003 I said: "There will be a big increase in crime - especially crimes like muggings and burglaries. There will be a resurgence of interest in people growing their own food in order to save money".

There have been stories of an increasing number of thefts of food from allotments and I would expect the number of 'hardship' crimes to soar.

## **THE STOCKMARKET**

I see the FOOTsie 100 index of leading UK Companies falling by 60-65% to 1650 by the middle of 2010, at the latest, and staying at around that level for many years to come. I do not think it will recover.

I predicted this in December 2003 - although I thought then - that this low point would be reached by June 2008. My other prediction - that the FTSE 100 would not exceed 6750 - was spot on, as it actually peaked at 6732 in October 2007.

Stock markets will become increasingly volatile. Daily swings of 10% or more in the FTSE 100 and other share price indices will become common place as markets are driven more and more by an emotional sea of greed, anger and fear.

I do not see a future for speculative investing, as, following falls of the magnitude I envisage, I believe that stock markets will eventually die out through lack of investor support. This is already happening as the number of private investors in the stock market is at an all time low.

I do, however, see a glowing future for companies that are wholly owned by their employees, like the John Lewis Partnership and organisations whose commercial activities are of benefit to all life.

## **PENSION SCHEMES**

Occupational Pension Schemes had a tough year in 2008 with most generating sizable deficits. The fund managers for these schemes are still putting too much faith in a recovery of the stock market, when in my view, a wholly 'Safety First Strategy' - using certain types of gilts - is needed. Without changing course I can see bigger losses and many schemes going bust.

In 2005 I predicted that the Pension Protection Fund would be drained of cash from claims. So unless the government underwrites future losses many pensioners could find that their private pension income falls, or that it is lost altogether. It has been reported that the PPF is having trouble balancing its books.

On a more positive note, I think that when we have reached the depths of this depression the government will relax their pension rules so that unemployed people with a personal pension plan will be allowed to draw a temporary income from their fund without having to buy an annuity.

## **'MANAGED' FUNDS**

Managed Funds have been especially popular with people who have Personal Pension Plans because, like With Profit funds, they have a broad spread of investments allocated by an investment manager. However, this 'eggs in different baskets' investment approach has not worked in the current economic climate as most asset classes (the different baskets), with the exception of gilts and cash, have suffered large losses.

Consequently the Managed Fund sector is down in value by between and 20 – 30% from its peak (October 2007) with most of that decline occurring since October 2008.

The investment management industry is currently spinning the line that once the recession is over investment markets will recover and everything will be rosy in the garden. I do not agree. My prediction is that Managed Funds will carry on falling - 25% to 50% by June 2010 at the latest.

This means that someone who had £100,000 in their Managed Pension Fund in October 2007 could potentially see its value plummet from £70 - 80,000 now to £35 - 60,000 within the next 18 months - with little prospect of the fund recovering!

## **'WITH PROFIT' FUNDS**

I have stopped recommending 'With Profit' Funds as they lack transparency and because I am no longer convinced that insurance companies always have the best interests of their policy holders at heart.

Furthermore, I do not think it is currently possible to manage a With Profit Fund, using a balanced spread of investments, without losing money. This is evidenced by the fact that With Profit annual bonus rates have been low for a long time now and most insurers (e.g. Norwich Union, Prudential and Legal & General) are applying Market Value Reductions (MVR'S) of up to 30% when people surrender their policies. They are doing this because the shares and commercial property that make up a large slice of these funds have fallen in value by around a third. The only asset classes that have made money over the last 15 months are gilts and cash.

Consequently my prognosis for With Profits Funds is that they have a bleak future. I believe that prospective investment returns range from poor to appalling and that most of the insurers who operate these funds will go bust. Therefore, with some notable exceptions, investors who stay invested are likely to lose money.

## **CORPORATE BONDS**

With savings rates low and falling, the high income streams available from corporate bonds look attractive. However, given the risk of capital loss due to the increasing number of corporate insolvencies, I say why take the risk, when the potential total return (income plus capital growth) from some gilts is so much higher? Gilts are regarded as the safest of investments – particularly when interest rates are falling or stable.

My prediction is that Corporate Bonds will fall in value by an average of 40 - 60% and not recover.

## SAVINGS/INTEREST RATES

The Bank of England (BoE) reduced the base rate by 0.5% from 2% to 1.5% on 8/1/2009. This is the lowest rate since the BoE was founded in 1694. In the USA the base rate is 0-0.25% and in Japan it is 0.1%! My prediction is that the rate could be zero as early as March/April this year and could stay there for 5 years or more!

In 2003 I said: "The Bank of England (BoE) base interest rate is unlikely to exceed 4.5%. If it does it will not stay there for long. It will most likely fall to 1 - 1.5%, but could easily hit zero". Clearly I was right!

My 'Safety First Strategy' – which uses gilts to protect income and capital, was based upon this prediction.

It is great news for borrowers but calamitous for savers whose income from savings accounts has plummeted, with **many accounts now paying less than 1% interest**. A recent survey revealed that most savers think that they are getting much more interest than they are because they had not kept up with the very large monthly drops in the base rate since October 2008. In fact most people thought that they were getting about 4% on their savings!

It is therefore inevitable that the interest rates payable on the best savings accounts are likely to fall to virtually nothing within the next 3 - 6 months. However a viable long term and low risk alternative to savings accounts is our 'Safety First Strategy' which uses gilts to provide a guaranteed income plus the potential for capital growth – please see the gilts section on the next page.

## GOVERNMENT BONDS (aka GILTS)

- Gilts are fixed interest securities issued by the UK government and therefore guaranteed by the taxpayer. Gilts and cash are the only two major asset classes that have weathered the financial storms.
- We consider certain types of gilts to be the safest of investments in these deflationary times.
- The increase in new gilt issues to fund the ballooning the public sector borrowing requirement, has put downward pressure on gilt prices, but we believe that this will be offset by a wall of money that is likely to hit the gilt market soon.
- The Bank of England's (BoE) policy of 'quantitative easing,' is having a positive effect on gilt prices now that it is spending its £150bn budget on gilts and other securities, in a bid to boost the money supply. With this policy the BoE plans to force the price of gilts up. Higher gilt prices reduces gilt yields (interest) enabling the government to borrow more cheaply as it can offer lower interest rates on future gilt issues.

- We believe that a 'bubble' in gilts is likely to occur when the base rate and stock markets have fallen to their lowest points and enough private and institutional investors acknowledge that this economic crisis is much more than a short term 'correction' and that we are in fact witnessing the collapse of the 'fractional reserve' banking system and all the 'towers of Babel' that have been built around it.
- If/when this gilt bubble occurs our plan for clients invested in our 'Safety First Strategy' is to sell their gilt holdings at what we judge to be the top of the market and then buy them back again once the price has fallen to a sustainable level. In this way income will be boosted - in absolute terms - and clients will also benefit from an increase in their wealth. The directors of K A LINCOLN > INVESTMENTS have invested all of their own money in gilts via the 'Safety First Strategy'.
- Gilts provide a guaranteed level of income – up to 2055 - with easy no penalty access to your money.
- Gilts provide tax free capital growth potential because they are the only investment not subject to Capital Gains Tax.
- Gilts benefit from an unlimited guarantee of security - provided by the taxpayer - against default. With most cash deposit account - except National Savings and Northern Rock - the Financial Services Compensation Scheme limit is £50,000 per person, per institution.
- In summary our prognosis for this asset class is extremely positive because taking everything into account we do not know where income seekers can get a better deal.

**NB:** Even though gilts are one of the safest investments they are not completely risk free. Therefore we strongly advise you to visit our 'What are Gilts' page for more information.

(C) COPYRIGHT 2006, 2007, 2008, 2009 K A LINCOLN > INVESTMENTS & MORTGAGEMAUDE LIMITED

THIS DOCUMENT MAY CONTAIN INFORMATION & DATA WHICH IS NOW OUT OF DATE AS IT WAS WRITTEN

ON: 01/01/2009

**THE VALUE OF INVESTMENTS CAN GO DOWN AS WELL AS UP. CASH DEPOSITS ACCOUNTS ARE NOT REGULATED BY THE FINANCIAL SERVICES AUTHORITY. IF YOU ARE UNSURE ABOUT THE SUITABILITY OF INVESTMENTS**

**PLEASE CONTACT US FOR ADVICE**

K A LINCOLN > INVESTMENTS is a trading style of MortgageMaude Limited  
 Registered office: 11 Leeses Close, Shawbirch, Telford, Shropshire TF5 0NN.  
 Registered in England and Wales Company No. 4946156.  
 Authorised and regulated by The Financial Services Authority No. 303708

**t:** (01952) 249737  
**f:** (01952) 416867  
**e:** kim@kalincolninvestments.co.uk  
**w:** kalincolninvestments.co.uk