The return of thrift

Who’s making money from penny-pinching consumers? page 20
New Accelerated Trackers provide the opportunity to boost profits when markets rise and the potential for capital protection if they fall.

Accelerated Trackers are securities linked to a range of Global Indices and Commodities. Unlike many investments that track an underlying asset, the new Accelerated Trackers have the potential to boost your profits as the price of the underlying assets rise and offer some protection to your capital if they fall.

Accelerated Trackers are listed on the London Stock Exchange and can be traded in your share dealing account at any point throughout their investment term.

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Make it happen
from the editor-in-chief

‘Buy and hold’ won’t work

The back page of last week’s National Enquirer ran a very tempting advertisement indeed. A mystic offered to grant all the wishes of every reader. For free! You just had to fill in a form giving your personal details and listing the five things you most wanted (a specific amount of money within a specific amount of time, a new boat or house, a holiday of a lifetime or just “financial security”), send it off — with no cheques or cash enclosed — and wait.

I’m pretty sure MoneyWeek hasn’t much of a cross-over readership with the National Enquirer, but I think this proposition may remind you all of something. Yes, it’s the financial services industry. Financial advisers don’t use quite the same wish-fulfilment methods. But most make much the same promise — list your financial goals, do as they say, and a better life will appear. Sure, they won’t promise a set amount of cash on any given day, but they do suggest that you’re likely to get an average amount of time, a new boat or house, a holiday of a lifetime or just “financial security”), send it off — with no cheques or cash enclosed — and wait.

Most investors, having invested mainly over the last 25 years or so, or are heavily infected with “recency bias”, and so don’t really get this. Tell one today “that there was a realistic chance that he could be invested for two decades and still be out of pocket, and the chances are he’d laugh at you”. Tim’s conclusion is that we have to “stock pick for absolute returns”. It should also remind us that history suggests that the top investment strategy of the 1980s and 1990s, buy and hold, doesn’t work. However well picked a stock or a market is, odds are that if you hold it for too long, you’ll end up losing money.

Merryn Somerset Webb
email: editor@moneyweek.com

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10 Who’s tipping what The one British high-street retailer to buy now.
12 Strategy How to spot overpriced stocks and profit by shorting them.
16 Briefing Has foreign aid helped or hindered Africa?
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www.moneyweek.com
China

Will the flood of new money do any good?

Another month, another lending bonanza in China. Banks issued RMB1.53trn ($224bn) in new loans in June, bringing the total for the first half to RMB7.3trn, up 32% year-on-year. Boosted by all that new money, the economy is accelerating. Consensus forecasts for GDP growth in the second quarter are 7.1% year-on-year, according to Bloomberg.

What the commentators said

“Few economists will take [China’s forthcoming GDP] report at face value,” said John Foley on Breakingviews. Hitting the government’s 8% growth target for the full year is too important politically for the headline GDP number, said John Foley on Breakingviews. Few economists will take [China’s forthcoming GDP] report at face value,” said John Foley on Breakingviews. “If that means hosing the economy with more credit than it knows what do to with, so be it.” However, as the “increasingly fretful banking regulator” is pointing out, rapid loan growth poses risks to the financial system. Inevitably, some of the cash will end up “on the blackjack tables of Macao – or that other casino, the Shanghai stock exchange”.

Even assuming most of it has gone where intended, there are still reasons to worry. It’s not clear China needs more investment, said Edward Chancellor on The Economist. “There has been little new spending in industries with overcapacity, such as steel.” Meanwhile, infrastructure spending is focused on less developed regions, “where the benefits promise to be greatest”; investment in the poorer western provinces this year grew at twice the rate for eastern ones. Some money will be wasted, but the rest will create jobs and support future growth.

What next?
In any case, like it or not, China won’t clamp down on lending yet, said Stephen Green of Standard Chartered. Tighter policy is only likely next year, if inflation picks up. “There is little political upside now in constraining local governments’ investment boom.” And that means GDP growth should stay strong.

Banking

Goldman Sachs’s bonus bonanza

Banking bonuses returned with a vengeance this week as Goldman Sachs reported record profits in the second quarter. Despite the worst banking crisis since the Great Depression, the Wall Street bank managed quarterly earnings of $3.44bn – almost double its healthy returns for the first quarter – suggesting the bank has turned by the clock to its salad days of 2006. The firm has already set aside $11.3bn to hand out to its employees for their work over the last six months. The average pay per employee looks set to come in at around $1m this year, according to City AM.

What the commentators said
Is this the return to the bad old days of banking? Absolutely not, said David Wighton in The Times. The “great vampire squid on the face of humanity” – as Rolling Stone journalist Matt Taibbi termed it – is now in constraining local governments’ investment boom”.

The bottom line

£40,000 What a Mini Cooper driven by Peter Sellers in a Pink Panther film is expected to fetch at auction this week.

£1,508,679 How much sports presenter David Vine left in his will. The former Match of the Day presenter died in January.

£1m What a ‘Facebook for civil servants’ is set to cost taxpayers. The ‘Civil Pages’ site will provide social networking solely to civil servants.

£90,000 What a 6kg piece of meteorite, found four years ago near Thirsk, is expected to fetch at auction next month.

£2,865 The donations that charity cyclist Jamie Barton has received after being fined £60 by Scottish police for accidentally straying onto the motorway during a charity cycle ride. A large proportion of donations have come from Scots who are embarrassed by the treatment that Barton received from the police, who have since cancelled the fine.

£250,000 Boris Johnson’s (pictured) annual salary from The Daily Telegraph. Johnson writes one column a week for the newspaper and described the pay as “chicken-feed”.

£18,114.50 What the average British household spends on bills each year. The figure includes £6,182 for mortgage or rent payments.

£80,000 What the Cornish beach that inspired Virginia Woolf’s To The Lighthouse has sold for.
**Companies**

**Credit cut sees giant CIT Group flounder**

If you’ve never heard of CIT Group, now may be a good time to correct that. The US firm is the third-biggest aircraft financier, the third-largest railcar leaser and its $76bn loan book provides funding to one million businesses. And it’s in very serious trouble. CIT needs to raise $10bn by March 2010 to pay off maturing debt, yet its credit rating has been slashed to CCC, meaning it can’t access the credit markets without a government guarantee.

**What the commentators said**

CIT is “on the wrong side of the velvet rope” as the Federal Deposit Insurance Corporation (FDIC) plays bouncer, said Damian Paletta and Serena Ng in The Wall Street Journal. “Investment banking now looks like one of the world’s least competitive industries.”

But don’t be deceived, said the FT’s Lex column. This squid is swimming with one powerful arm. Trading in fixed income, currency and commodities generated half Goldman’s record revenues. That can’t last. Competitors will return and clients will lose enthusiasm for trading as the rally runs out of steam. And as investors lose their appetite for government debt, Goldman will also struggle to continue earning fees by finding buyers for this. Then there’s the problem of public opinion. Goldman has $171bn in excess liquidity burning a hole in its pocket and as is again paying out big bucks. The government could easily opt to cut this sucker down to size. “Calamari anyone?”

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**Vital numbers**

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**Best and worst-performing shares**

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**Weekly change to FTSE 100 stocks. Prices as of 15/7/09**

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### Debt: it’s worse than you think

“It’s not easy to say no to the Chinese government,” says John Foley on Breakingviews. “Unless you’re a bond investor.” Last week, the ministry of finance suffered three ‘failed’ or ‘uncovered’ bond auctions (a failed auction is one in which the government is unable to sell as much debt as it intended).

While this occurs quite frequently in some countries because of the way the auctions are structured – nine out of 37 German auctions failed in 2008, according to Moody’s – they’re rare in China, says Wang Ming on Dow Jones; the last time it happened was in 2003.

China’s auction failures were down to two factors, says Foley. One is tough competition – this week will see the first Initial Public Offering (IPO) on the Shanghai exchange since September. The second is concern about higher inflation on the back of soaring lending. Both make yields of around 1%-1.25% on bonds look “paltry” and suggest that China may eventually have to offer higher rates to shift debt. Even so, it is in a better position than much of the world.

Many governments have a “serious problem”, says John Mauldin on Investors Insight. Total sovereign debt issuance this year alone is projected to be $5.3trn, or around 9% of global GDP, according to Hayman Capital. America alone needs to raise $3trn to replace falling taxes, fund stimulus spending and meet off-budget items, such as supporting the financial sector. “There is simply not enough available capital under current conditions to do it all.” Yet encouraging higher household savings to mop up the debt, for example, will mean lower consumption and a slower recovery.

Making matters worse, the biggest holders of US debt are government welfare programmes, such as Medicare, says Jeremy Batstone-Carr of Charles Stanley. These invest all the social security contributions they receive in Treasuries. Unfortunately, Medicare is now becoming a net seller of bonds, since its premium income of $14bn is easily outstripped by expenditure of $348bn. And other buyers such as central banks, mutual funds and state and local governments are turning net sellers, forcing the Federal Reserve to buy up the surplus. With funding issues such as central banks, mutual funds and state and local governments are turning net sellers, forcing the Federal Reserve to buy up the surplus. With funding issues like this, “the US economy is in far worse health than most investors, or the media, would care to imagine”.

### Investors prefer long shots to a rational bet

Economists like to think that investors are rational people, carefully sifting through the evidence and weighing the probabilities to make the most sensible decisions. Reality suggests otherwise.

Take what’s known as the ‘favourite long-shot bias’. This effect was discovered in 1949 by Richard Griffiths, a US army psychologist observing his patients at the local racetrack, says Robert Blincoe in the FT. Griffiths found that punters tended to overvalue long shots and undervalue favourites, given how likely each was to win. In short, they were not being rational and pricing their gambles correctly. The same error occurs in all other sports and – more importantly – in financial markets. Buyers of S&P 500 and FTSE 100 options are biased in favour of deep out-of-the-money (long shot) options and against deep-in-the-money options, according to a 2002 study by Stewart Hodges, Robert Tompkins and William Ziemb.

Still, to behaviouralists it’s no surprise to find investors behaving irrationally. James Montier, formerly of Société Générale, points to an experiment he took part in involving over 1,000 players who were asked to pick a number between 0 and 100 that they believed would be close to two-thirds of the average number picked. There’s no correct answer – it depends on what others do. But there is a clear maximum answer: 67, which would require every other player to have chosen 100. What was “more than slightly alarming” was that there were a large number of answers above 67. All 1,000 players were professional investors.
Export boost will not help Poland in the long run

“Poland provides a reminder that central and eastern Europe’s economic outlook is not entirely dismal,” says the FT’s Lex. After reports that at least ten governments are in talks with the International Monetary Fund (IMF) for aid programmes, the fact that Poland managed to sell $2bn of government bonds at a relatively low premium to US Treasuries was a rare piece of good news from the region.

Altogether, Poland is in better shape than many of its neighbours, thanks to “prudence and a dash of good luck”. To some extent, it avoided their worst excesses, such as profligate public spending and runaway credit and housing bubbles. A sharp slide in the zloty has made its manufacturers more competitive in the export market. In particular, a government-backed scrapping scheme has sent car sales in Germany up 40% since March, to the benefit of Polish factories.

“The fashionable cars of the austere moment are small and economical,” says Ian Campbell on Breakingviews. “These are the cars Poland produces.” Thanks to this export boost, it may be the only European economy to grow this year, although a small contraction is more likely.

But investors shouldn’t get too carried away. Following a 35% rally in the WIG20 index since March, we should expect some weakness, says Maciej Bombol of ING on Bloomberg.com. Banks may be “among the key drivers behind a correction” as non-performing loans rise.

More worryingly for the long-term, Poland’s strength may mean it puts off much-needed fiscal reforms, creating a drag on future growth, says Capital Economics. While Hungary, Romania and Latvia had to agree to tough conditions to get IMF aid, Poland (and the Czech Republic) didn’t. So while the recession will be worse in the former group, they may emerge in “better structural shape than their supposedly less-risky peers”.

Has India hit bottom?

India’s slowdown “seems to have been a short pause rather than anything more serious”, says Kevin Grice of Capital Economics. Quick action by the central bank, a cautious approach to globalisation and resilient spending by rural households all helped to insulate it from the worst of the global recession. Now the economy is picking up and solid growth looks likely, even if government targets of 9% in 2010-2011 look “too ambitious, given the continued acute infrastructure constraints”. The wildcard is the monsoon: the rains are 36% below normal so far this year and agriculture, which still accounts for 17% of GDP, could be a drag on growth if this doesn’t improve.

Still, corporate profits have been cut significantly by the slump. Earnings for the Sensex benchmark this quarter are set to fall 14% year-on-year, say Aditya Narain and Tirthankar Patnaik of Citigroup. Worst hit is real estate (down 87% amid the bursting real-estate bubble). Oil, metals and autos are also down. These results are probably close to the bottom, but investors should remain cautious: an earnings slump like this “is usually fairly challenging to reverse” quickly.

A false dawn for shipping rates

The spectacular rise in freight rates this year could be coming to a swift end, says Amrita Sen of Barclays Capital. Chinese commodity buying has helped lift the Baltic Dry Index (BDI) – which measures the cost of moving dry raw materials such as iron ore by sea – up by 350% from its December lows (although it’s still down 75% from last year’s peak).

Gold watch

Gold has held above $900 an ounce, despite downward pressure from signs of a stronger dollar and broad-based commodities weakness coming out of uncertainty about possible US moves to clamp down on speculation in energy and metals markets. But conditions for other precious metals have been less robust; the gold/silver ratio rose to 73 from 62 in early May after concerns about demand from the electronics industry sent silver to a ten-week low of $12.44 an ounce.
Pampered pooches will survive recession

by Eoin Gleeson

At the age of 14, Chuckie the cat developed diabetes. Then a thyroid problem. Then he started having seizures. Soon he was surviving on a cocktail of drugs and knocking into furniture as he struggled to keep his balance. It was no life for a cat. So his owner faced a dilemma. Keep paying for hugely expensive procedures to prolong the life of her beloved cat – or let him go?

It’s a dilemma faced by thousands of households. It may seem incredible to non-pet owners, but consumer spending on pets has nearly doubled over the last decade, with the US (perhaps predictably) leading the way. All that lavish spending means cats and dogs, just like humans, are living much longer, and running up major medical bills in the process. In 1987, about 32% of America’s dogs were over the age of six, according to the American Animal Hospital Association. Now 44% have passed that threshold. Pet owners are taking full advantage of advances in medical technology, meaning that detecting illness in pets regularly involves MRIs, ultrasound and CAT scans. Even kidney transplants and chemotherapy are now viable options for a sick pet.

That spending is being driven by a kind of money has attracted a lot of new interest in the industry. Big marquee suppliers and over-the-counter medicines. Mass-market pet food accounts for 40% of industry sales. Medical bills account for another hefty chunk of that spending – last year $9.8bn went on supplies and over-the-counter medicines.

That kind of money has attracted a lot of new interest in the industry. Big marquee retailers, such as Wal-Mart, Target and Costco, have all recently made room for new lines of pet products. Wal-Mart is developing more profitable product services spending will grow 4% in 2009 and 8% in 2010 to reach $16.4bn by 2011,” says Michael Dillon of Pet Industry Weekly. We look at the best stock to buy in the box below.

But the big retailers will find it hard to muscle in on the medical upkeep market, which requires a lot more specialist knowledge. Sales of veterinary services and medicines are expected to remain strong. Owners feeling the squeeze might scale back on cosmetics and prime cuts of cat and dog food sourced from New Zealand, but they’ll still make emergency trips to the vet when their puppy eats a pound of fertiliser in the shed.

And even though Chuckie’s owner decided to let him go in the end (“I have limited resources”, she told The Washington Post), pets in less critical condition will still get their drugs during the recession. “We estimate veterinary services spending will grow 4% in 2009 and 8% in 2010 to reach $16.4bn by 2011,” says Michael Dillon of Pet Industry Weekly. We look at the best stock to buy in the box below.

The best bet in the sector

Petmed Express (Nasdaq: PETS) is a screaming bargain, says Jake Lynch on The Street. The Florida-based business operates under the name 1-800-Petmeds. It’s a mail order company that markets prescription medications for dogs, cat and horses via catalogues and the internet.

Most pet medications (about 70%) are sold by vets. Another 17% are sold by retailers, and 11% are bought online. Petmed controls more than 50% of the online market. The group faced a slew of lawsuits when first set up, as it undercut vets and sold controversial treatments. But it has since cleaned up its act and now works with vets, generating much of its business from repeat prescriptions, which it sells for about 15% less than the typical surgery. The group has enjoyed eight straight quarters of double-digit growth in earnings. Revenue for the last quarter rose 19% to $48m, and earnings per share climbed 25%, as its customer numbers grew to 802,000, from 710,000 in the previous year. It’s also in good financial condition, with no debt and more than $30m in cash. “A quick ratio (defined on page 36) of 4.72 indicates it’s sufficiently capitalised to withstand a significant decline in business,” says Lynch. The stock trades on a forward p/e of 12.3.

$45bn will be spent on pets in the US this year, up 9% on 2008

Pampered pooches will survive recession

by Eoin Gleeson

At the age of 14, Chuckie the cat developed diabetes. Then a thyroid problem. Then he started having seizures. Soon he was surviving on a cocktail of drugs and knocking into furniture as he struggled to keep his balance. It was no life for a cat. So his owner faced a dilemma. Keep paying for hugely expensive procedures to prolong the life of her beloved cat – or let him go?

It’s a dilemma faced by thousands of households. It may seem incredible to non-pet owners, but consumer spending on pets has nearly doubled over the last decade, with the US (perhaps predictably) leading the way. All that lavish spending means cats and dogs, just like humans, are living much longer, and running up major medical bills in the process. In 1987, about 32% of America’s dogs were over the age of six, according to the American Animal Hospital Association. Now 44% have passed that threshold. Pet owners are taking full advantage of advances in medical technology, meaning that detecting illness in pets regularly involves MRIs, ultrasound and CAT scans. Even kidney transplants and chemotherapy are now viable options for a sick pet.

That spending is being driven by a kind of money has attracted a lot of new interest in the industry. Big marquee suppliers and over-the-counter medicines. Mass-market pet food accounts for 40% of industry sales. Medical bills account for another hefty chunk of that spending – last year $9.8bn went on supplies and over-the-counter medicines.

That kind of money has attracted a lot of new interest in the industry. Big marquee retailers, such as Wal-Mart, Target and Costco, have all recently made room for new lines of pet products. Wal-Mart is developing more profitable product services spending will grow 4% in 2009 and 8% in 2010 to reach $16.4bn by 2011,” says Michael Dillon of Pet Industry Weekly. We look at the best stock to buy in the box below.

But the big retailers will find it hard to muscle in on the medical upkeep market, which requires a lot more specialist knowledge. Sales of veterinary services and medicines are expected to remain strong. Owners feeling the squeeze might scale back on cosmetics and prime cuts of cat and dog food sourced from New Zealand, but they’ll still make emergency trips to the vet when their puppy eats a pound of fertiliser in the shed.

And even though Chuckie’s owner decided to let him go in the end (“I have limited resources”, she told The Washington Post), pets in less critical condition will still get their drugs during the recession. “We estimate veterinary services spending will grow 4% in 2009 and 8% in 2010 to reach $16.4bn by 2011,” says Michael Dillon of Pet Industry Weekly. We look at the best stock to buy in the box below.

The best bet in the sector

Petmed Express (Nasdaq: PETS) is a screaming bargain, says Jake Lynch on The Street. The Florida-based business operates under the name 1-800-Petmeds. It’s a mail order company that markets prescription medications for dogs, cat and horses via catalogues and the internet.

Most pet medications (about 70%) are sold by vets. Another 17% are sold by retailers, and 11% are bought online. Petmed controls more than 50% of the online market. The group faced a slew of lawsuits when first set up, as it undercut vets and sold controversial treatments. But it has since cleaned up its act and now works with vets, generating much of its business from repeat prescriptions, which it sells for about 15% less than the typical surgery. The group has enjoyed eight straight quarters of double-digit growth in earnings. Revenue for the last quarter rose 19% to $48m, and earnings per share climbed 25%, as its customer numbers grew to 802,000, from 710,000 in the previous year. It’s also in good financial condition, with no debt and more than $30m in cash. “A quick ratio (defined on page 36) of 4.72 indicates it’s sufficiently capitalised to withstand a significant decline in business,” says Lynch. The stock trades on a forward p/e of 12.3.
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who’s tipping what

Tim Price, award-winning investment manager, picks the best tips from the press and brokers’ reports, and suggests a share for the brave

Mothercare: a healthy bloom on a sickly high street

Tip of the week:
Mothercare plc (LSE: MTC), rated a BUY by KBC Peel Hunt

The British economy shrank by more than 2% during the first quarter – the biggest such decline in 51 years. House prices are still falling. Unemployment is rising. Consumers have retreated to their foxholes and are unlikely to come out soon. And now the recent stockmarket rally looks as if it’s coming off the boil. Where on earth can a British equity investor find something worth buying?

Perversely, perhaps, on the British high street. If there’s one thing that childcare retailer Mothercare has got going for it, it’s visibility. “Visibility beats frothiness,” writes KBC Peel Hunt retail analyst John Stevenson. While the shares of several general retailers have powered ahead, based on a largely illusory recovery story, there are still “a handful of genuine growth retailers [who] continue to deliver rising cash balances and earnings momentum, with excellent visibility on future plans for the next three or more years”.

Mothercare is one of them. The British birth rate is a fairly unimpressive 0.5% of global births a year. But as Stevenson points out, Mothercare expects to open more than 100 new international sites over the next 12 months and enjoys useful franchise relationships in India, Saudi Arabia and elsewhere. KBC Peel Hunt expects international earnings to generate around half of the group’s operating profits by 2011.

Another attractive factor is that, even in a recession, discretionary spending on young children is always among the last things to be cut. KBC Peel Hunt expects compound earnings growth of above 8% a year over the next three years, whereas the average UK retailer can expect to see “material profit declines” for two to three years from 2008.

With cash balances rising, earnings growth ongoing, and clear visibility on management’s strategy, Mothercare probably deserves to trade on a decent premium to the retail sector. The forward p/e ratio stands at just over 15, a modest premium to the wider sector, at some 13 times. The shares have already bucked a poor overall equity market by around 50% so far this year, giving the group a market capitalisation of over £440m. This may be a little ahead of events, but the stock is worth buying for the long term.

Recommendation: a long-term BUY at 532p

Turkey of the week:
Barclays plc (LSE: BARC), rated SELL by Panmure Gordon

Should you buy bank stocks? It really depends on whether you think the banking crisis is closer to its end than its beginning. On that front, my fellow MoneyWeek writer James Ferguson has analysed prospects for the sector and his conclusions make for gloomy reading. A Bank of England study of 33 systemic banking crises between 1977 and 2002 suggests that the average duration of a banking shock is around 4.3 years – so arguably we’re not even halfway through yet. Given that this crisis is global and much more severe than more localised outbreaks in the past, it seems reasonable to assume that the average figures will be trumped by the current debacle’s severity.

Yet bank stocks have enjoyed a huge rally from their recent lows. Barclays’ stock has jumped by well over 400% from its January low of just 51p. But is this justifiable? There has been no shortage of suspicion over whether Barclays has been entirely up-front about the extent of its liabilities. A number of analysts found its 2008 results a little baffling, including Panmure Gordon’s Sandy Chen.

Trying to make sense of a still-opaque operating environment, Panmure believes Barclays will be vulnerable if corporate default rates rise and structured credits suffer another wave of downgrades, leaving the structure of Barclays’ counterparty swaps vulnerable to unravelling. Panmure highlights a £20bn rise in Level 3-type assets (those that can’t be priced by the market, basically) and a
doubling of net derivatives exposures. Since the credit ratings agencies have recently warned on collateralised loan obligations and have downgraded the ‘monolines’ (insurers focusing solely on guaranteeing bond repayments), the fundamental outlook for much of Barclays’ debt exposure is not promising. Sandy Chen expects impairment charges of around £13bn for the bank in 2009 and 2010, against management guidance of £7bn-8bn. He expects the bank as a whole to incur major losses for both years. If Barclays decides not to participate in the government’s asset protection scheme, Panmure foresees further dilution risk for equity holders.

My own concerns about the bank focus on the cost of this independence – the sale of its crown jewels, notably its BGI investment management unit for $13.5bn to rival BlackRock. Barclays may have secured its freedom, but at what price to future earnings – given that its (more cyclical and risky) capital markets activities are now even more concentrated?

In short, I think the market is in denial about British banks’ growth prospects, particularly about Barclays’. Thirteen brokers rate the stock a ‘buy’ and eight give it a ‘hold’. Five, including Panmure’s Sandy Chen, believe it is a ‘sell’.

Recommendation: the banking crisis is not over – AVOID at 313p

Tim Price is director of investment at PFP Wealth Management. He also edits The Price Report investment newsletter. For more, visit the shop page on MoneyWeek.com, or call 020-7633 3637.

- Paul Hill is away

Gamble of the week:
Faroe Petroleum plc (LSE: FPM)

The oil price isn’t exactly stable, and a global recession isn’t a great backdrop for the energy markets. Yet I remain bullish on the long-term prospects for both oil and for Faroe Petroleum, a junior exploration and production firm that floated in June 2003. The company focuses its exploration and drilling efforts on the Atlantic Margin; in other words, the Faroe Islands and the area west of the Shetlands, the North Sea and Norway. The company has six licences in the Faroes, eight west of Shetland, 14 in the North Sea and 20 around Norway.

Oil partner Encore recently confirmed that, along with Faroe, it is in exclusive talks with a third party for a sale of 70% of the Breagh gas discovery. Brokers McCall Aitken McKenzie point out that several European utilities are stalking gas assets, and that Britain is now a net importer of gas; by 2020, 80% of the UK’s gas will be imported. Faroe’s share of the Breagh discovery could potentially net the business, capitalised at £71m, something close to $50m.

McCall sees Faroe’s stock price trading in line with its current net asset value of 73p, “which implies the considerable exploration portfolio remains free”. For investors with sufficient risk appetite for small-cap exploration and production stocks, Faroe looks extremely interesting. McCall’s price target is 95p a share.

Recommendation: BUY at 66.5p

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How to make money in falling markets

by Tim Bennett

The spring stockmarket rally seems to have petered out – both the S&P 500 and the FTSE 100 are down nearly 5% in the past month. With investors realising the global economy has a long way to go before it’s anywhere near back to health, stocks could fall a lot further. That means the time is right for adventurous investors to profit by shorting overpriced stocks.

How shorting works
A City trader might borrow, say, 10,000 Tesco shares at 350p, in return for a fee paid to the lender (often a pension fund). He sells the borrowed shares and waits. Say that two days later, Tesco shares fall to 330p. He buys back the 10,000 shares, making a profit before trading costs of £2,000 – ie, (3.50-3.30) x 10,000 – then returns the 10,000 shares to the original lender. That’s if all goes according to plan.

The biggest risk is a ‘short squeeze’. Imagine our trader had borrowed a relatively illiquid share. But having sold the stock, the price then rises sharply. Our short seller still needs to buy 10,000 shares to return the shares he borrowed. That could prove difficult and very expensive if there are few sellers around.

How you can go short
Going short by borrowing individual stocks isn’t practical for retail investors. But there are two ways it can be mimicked. For speed and flexibility, spread betting is best. You could open a down bet (‘sell the spread’) on Tesco at a spread betting is best. You could open a...

“Stocks could have a lot further to fall”

“The time is right for adventurous investors to profit by shorting”

£10 a point (where 1 point equals a 1p change in the share price) when the quoted spread is 349p/351p. If the spread when you close out has dropped to 229p/331p, you make 18 points – ie, 349-331, or £180 at £10 a point. Always take out a guaranteed stop-loss to ensure you don’t make huge losses should the price rise – you’ll pay a little more for this, but it’s worth it.

Secondly, there are put options. An NYSE Euronext equity option might give you the right to sell 1,000 Tesco shares before the end of September at a fixed ‘strike’ of 350p. You pay a non-refundable premium of 12.5p a share, or £1,250, to buy ten (12.5p x 1,000 x 10).

Always take out a guaranteed stop-loss to ensure you don’t make huge losses should the price rise – you’ll pay a little more for this, but it’s worth it.

Spotting short targets
So what do you short? James Montier at Société Général suggests that you screen firms and weed out those with the “very unhealthy combination” of high price and “worrying accounting”. High price here means a high price-sales (p/s) ratio – Montier suggests 1.5 or above. As Sir Alan Sugar once commented on The Apprentice, a business selling £10 notes for £9 could generate lots of sales (and by extension a decent p/s ratio), but it’s pretty obvious why it isn’t a good bet.

As for the “worrying accounting”, leaving aside pure fraud, there are several ways a firm can stay within the rules but “ensure it can beat analysts’ quarterly forecasts”. Watch out for a growing gap between operating profits and the cash flow from operations. Cash flow is hard to manipulate. A big gap might mean that in arriving at the profits figure a firm has used some “highly subjective estimates” to its advantage – for example, understating bad debts and overstating expected pension fund returns.

Also look for debtors (‘receivables’) and stocks (‘inventory’) rising faster than sales. The former suggests a firm is desperately trying to boost turnover by shifting stock onto customers (‘channel stuffing’), while the latter can flag slowing sales.

Beware of falling depreciation (the accounting charge against profits made to reflect asset wear and tear) as a percentage of total fixed assets. By lengthening the expected life of an asset to reduce depreciation, a firm can boost profits. The last red flag is fast asset growth. Acquisitions can be used to boost short-term revenue and earnings without adding much long-term value.

What to short
“The last time developing countries got this expensive was October 2007,” says Adria Cimino on Bloomberg. The MSCI index trades at 15.4 times reported earnings, compared with 14 for the S&P 500. Meanwhile, current prices put a typical MSCI stock on 1.7 times its net assets – “the highest on record” – and above the MSCI World average of 1.5.

In short, says Matthieu Guilanni, a Palantine fund manager, “emerging market stocks are at risk”. With that in mind, two emerging-markets-focused stocks that pass the Montier screen are South African miner Lonmin (LSE: LMI) – with a forward p/s ratio 2.7 – and Far East Asian plantation investment group MP Evans (LSE: MPE) on a forward p/s of 1.39.
There’s trouble down in the Balkan regions, do you:

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<td>a)</td>
<td>Arrange a private screening with your GP, just in case.</td>
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Better value spread betting
A professional investor tells MoneyWeek where he’d put his money now. This week:

**Sebastian Radcliffe**, manager, Jupiter North American Income fund.

**Personal view**

**Three American bargains**

**What I would invest in now**

Mixed economic news is rocking the US equity market. Although it has rallied strongly from its March low, employment figures in particular have shown significant weakness. However, given the plethora of leading indicators that have improved, I believe the American economy is still on its way to recovery. Reflationary pressures are rising worldwide, mainly thanks to large-scale stimulus programmes and the collapse in global short-term interest rates.

Meanwhile, money-market funds ballooned to $4tn in March as investors sought safe places to stash their cash. Even after the recent equity market rally, much of this is still sitting on the sidelines producing almost no returns for investors and is poised to re-enter the equity markets. Add in the fact that valuations are still low at a time when many companies’ balance sheets are strong and I think the US market still offers many excellent investment opportunities. Here are three.

Despite its bullet-proof balance sheet with $30bn net cash, Microsoft (Nasdaq: MSFT) shares hit their lowest level in decades earlier this year. They have performed well since on the back of the better economic outlook, but Microsoft still looks undervalued given its improving earnings prospects.

Microsoft is launching its new operating system, Windows 7, in October and this should allow the company to overcome recent sales weakness. Windows 7 doesn’t require new hardware to install, so we expect it to sell well even in the current weak economic environment. That’s in part because Windows 7 suffers from fewer problems than the company’s current premium system, Vista – it is compatible with netbooks, for example. Microsoft’s new Bing search engine has also been well received.

ConocoPhillips (NYSE: COP) has been a clear laggard in the oil sector, which has benefited from the recent recovery in the oil price. One of the reasons was Burlington Resources, which it bought in December 2005 for $35.6bn. ConocoPhillips had to write down a significant part of Burlington’s assets in 2008. As a result, investors have lost confidence in its strategy.

Yet the firm is increasing its own exploration activity this year, rather than expanding via acquisitions. Some exploration projects are already proving successful. It also wrote down its stake in Russia’s Lukoil in 2008. Lukoil shares recovered recently as its earnings rebounded. So ConocoPhillips’s balance sheet and earnings could both benefit in 2009.

After its merger with Allied Waste in 2008, Republic Services (NYSE: RSG) became the second-largest waste-management company in the US. The industry has seen substantial consolidation in the last 12 months, which should support prices for the remaining players, especially given the difficulty in building new capacity, such as landfill sites.

This year, the company’s earnings are being hit by one-off restructuring costs. But otherwise underlying earnings are growing strongly, boosting Republic Services’ cash flow. As a result, the stock still looks undervalued in terms of the price/free-cash-flow ratio. With the benefits of the merger coming through, we believe the stock has further upside potential.

**The stocks Sebastian Radcliffe likes**

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Aid: does it do any good?


Why is the aid debate hotting up?
In a speech critical of Africa’s dependence on international aid, US President Barack Obama told an assembly in Ghana this week that “Africa’s future is up to Africans”. Declaring that “Africa doesn’t need strong men, it needs strong institutions”, he asked why it is that South Korea is now far richer than Kenya, even though the opposite was true 50 years ago. His speech comes on the back of a raft of recent books and studies suggesting that international aid to Africa is stifling economic growth.

So aid does more harm than good?
So critics say. They’ve long argued that aid fosters dependence on rich donors, stifling entrepreneurship. It also props up corrupt governments who “interfere with the rule of law, the establishment of transparent civil institutions and the protection of civil liberties, making both domestic and foreign investment in poor countries unattractive”, argues Dambisa Moyo, in her book Dead Aid. As Obama pointed out in his speech, “No business wants to invest in a place where the government skims 20% off the top.”

What does the aid community think?
Many African countries can’t reach the bottom rung of the economic ladder because they lack the most basic infrastructure, says economist Jeffrey Sachs, author of The End of Poverty. He says the aid taps should only be turned off once poor countries have had a sufficient leg up. This would involve more than doubling global foreign aid to $150bn a year. Do that, he says, and extreme poverty (that’s the 1.1 billion people in the world who live on less than a dollar a day) would be eliminated by 2025. More money really does help, says Paul Collier, director of the Centre for the Study of African Economies in Oxford. “A reasonable estimate is that over the last 30 years [aid] has added around one percentage point to the annual growth rate of the bottom billion,” he says in his book, The Bottom Billion. According to the International Monetary Fund, Sub-Saharan Africa will grow by 1.7% this year as much of the rest of the world contracts.

What do Africans think?
Many are starting to support more trade. The free market isn’t perfect because it’s not free. As Moyo says, Western sugar subsidies have cost Ethiopia, Mozambique and Malawi $238m in total since 2001. But it’s not just international trade barriers. As Franklin Cudjoe, of Ghanaian think-tank Imani: The Centre for Policy & Education, says: if Africa scrapped regional trade barriers, it would earn an extra $1.2bn a year. It costs $1,500 to ship a car from Japan to the Ivory Coast, but another $5,000 to move it to Ethiopia from there. What’s more, a wealthier Africa could turn to international bond markets to raise money instead of requiring aid. Zambia did this in 2007. Looking for $750m, it was heavily oversubscribed to the tune of $5bn.

So is trade growing?
The picture is mixed. Rwanda and Burundi recently joined the five-nation East African trade community, giving them access to 120 million customers. But elsewhere protectionist forces are growing amid the global slump, The African Competitiveness Report 2009 has warned. However, Africa’s leaders seem to be coming round. Liberia’s Ellen Sirleaf-Johnson has called for her country to become self sufficient; Rwandan President Paul Kagame reportedly bought every member of his cabinet a copy of Moyo’s book. “No country can depend on development aid forever,” Kagame recently told Fast Company. “Such dependency dehumanises us and robs us of our dignity.”

Does aid work?

Yes
1. Opportunities for trade are often limited because of regional and international trade barriers.
2. Many African countries lack the basic infrastructure, such as roads and telecommunications, required to trade successfully.
3. Targeted aid, such as that for treating HIV/Aids, can help where governments lack money and skills.

No
1. It fosters dependence, and props up corrupt regimes. Aid can end up in the pockets of corrupt government officials, as when Congo’s President Mobutu Sese Seko used aid money to hire Concorde for his daughter’s wedding in the 1980s.
2. Aid is often misspent, even when distributed honestly.
3. Free trade has been proved to work in southeast Asia.
Business schools and MBAs must take part of the blame for our current crisis

Greedy, bonus-chasing bankers, asset-inflating monetary authorities, and bubble-blowing politicians have all, with some justification, been blamed for the credit crunch. But perhaps we should pin it all on the MBAs, those impeccably trained young men and women, babbling jargon, and flashing Powerpoint presentations, who in the last decade have taken over the world’s leading banks, our biggest corporations, and increasingly governments as well.

Some MBA factories certainly seem to think so. Students at the most prestigious, the Harvard Business School, have launched the ‘MBA oath’, a managerial equivalent of the Hippocratic Oath, which tries to make sure the graduates don’t repeat many of the mistakes made over the past year. The mere fact the oath has been launched at all raises the question of how far the MBA can be blamed for the global economic crisis. Certainly, many of those who steered our leading banks onto the rocks had received the best business education that money can buy. Andy Hornby, the head of HBOS when it collapsed, had been trained at Harvard Business School. Peter Wuffli, whose management of UBS was so reckless he practically bankrupted Switzerland, had been to that country’s most prestigious business school. Richard Fuld, chief of Lehman Brothers when it went pop, was another MBA. So were Fuld, chief of Lehman Brothers when it went pop, was another MBA. So were most of the Wall Street players who led the financial system into crisis last year. The mere fact the oath has been launched at all raises the question of how far the MBA can be blamed for the global economic crisis.

Certainly, many of those who steered our leading banks onto the rocks had received the best business education that money can buy. Andy Hornby, the head of HBOS when it collapsed, had been trained at Harvard Business School. Peter Wuffli, whose management of UBS was so reckless he practically bankrupted Switzerland, had been to that country’s most prestigious business school. Richard Fuld, chief of Lehman Brothers when it went pop, was another MBA. So were most of the Wall Street players who led the financial system into crisis last year.

True, an MBA is just a stepping stone. But if a pilot school was resulting in that many crashes, we’d ask some tough questions about what was being taught. There’s no reason why business schools shouldn’t be subject to the same kind of criticism. It’s not hard to see the flaws in their methods. Over the past 20 years, business schools have pushed a quasi-scientific approach to business that has turned out to be catastrophic. They have taken something that was essentially unknowable – risk – and persuaded a generation of bankers and managers that it could be easily quantified and traded away. They failed to teach people about the whiplash of the business cycle, and bred an over-confidence in their methods that in many cases turned out to be fatal. The one thing most bankers needed to take to work was humility, but they weren’t learning that at business school.

Worse, they have ramped up expectations unrealistically. Graduating from an elite business school won’t leave much change from £100,000. With those sorts of debts, students have little choice but to get on the banking bonus treadmill. There was a bubble of inflated pay-outs, private jets and lavish contracts at the top of business, and it started inside the MBA schools. Even if it’s unfair to blame the MBA for the credit crunch, the course has become synonymous with a greedy, asset-stripping, bubble-inflating approach to management.

It’s hardly surprising that at least some business schools think a re-balancing is needed. The oath is a start. You can read the whole thing at mbaoath.org, but it starts: “I will act with utmost integrity and pursue my work in an ethical manner... I will manage my enterprise in good faith, guarding against decisions and behaviour that advance my own narrow ambitions but harm the enterprise and the societies it serves.” It carries on through eight core principles.

There’s some recognition of past sins in there. Not many bankers could honestly say they’ve always put their company and the economy ahead of their own self-interest. Nor could every director say they’ve always presented their financial data with complete honesty, as the code will require them to do. But it’s hard to escape suspicion that the pledge comes straight out of the textbook titled ‘How to Re-Brand a Tainted Product’. Most of the clauses look like the kind of guff you see in the corporate social responsibility pages of annual reports. It’s hard to take seriously a promise to “create sustainable economic, social, and environmental prosperity worldwide”. These are just words, designed to make the person reciting them feel good about themselves.

The MBA courses need to change what they teach and how they teach it. There should be less emphasis on financial engineering, and more on real engineering; less focus on slick marketing, and more on building decent, good value products. They should drop the pretense that anyone with the right sort of MBA can be dropped into any company and run it properly, and put more emphasis on the enduring culture of a company that has been built up for decades.

And they should cut fees so students weren’t so indebted that they have to work for an investment bank. And they should remind students that risk can never be eliminated in business, merely planned for; that the business cycle will always re-emerge, and catch out anyone who hasn’t prepared for it; that mergers and de-mergers are just a costly distraction from actually creating products; and that the best companies are built patiently over years by people who love the product, not assembled overnight according to a textbook.

If a generation came out of business school equipped with some of those lessons, who knows, we might even avoid another credit crunch.
best of the financial columnists

We should buy Afghan opium

Why are we paying our farmers to grow poppies in Oxfordshire, and our soldiers to destroy them in Afghanistan? asks Boris Johnson.

At “direct government urgings” poppies are being cultivated in this country in order to meet the NHS demand for opiates. Yet in Afghanistan, Allied forces are eradicating crops in an attempt to destroy the illegal opium trade, which accounts for about 52% of the Afghan economy and about 90% of the global heroin supply. It also provides the Taliban with a ready source of financing. The destruction of the crops, however, risks deepening local poverty and losing the ‘hearts and minds’ our troops are there to win. Surely the solution is to align our strategy more closely with the country’s real economic interests by helping the Afghans to develop a legitimate market for their crops. It would offer the world cheaper pain relief, the Afghans a legal source of income for their harvest, and stop illegal production from funding the killing of British troops.

Boris Johnson

The Daily Telegraph

The plan to turn desert into power

The idea of building solar power stations in the Sahara desert, and then transporting the electricity produced to Europe using efficient high-voltage cables, is simple in theory, says The Economist. But it’s hard – and very expensive – in practice. Undeterred, Munich Re, the world’s largest reinsurer, “might get the ball rolling”.

It has invited 20 large companies, including power supplier EON and Deutsche Bank, Germany’s biggest, to join it in forming a consortium called Desertec. If all goes according to plan, it will build a “legion of solar power stations” in Africa and Arabia and connect them to Europe. Rather than converting the sun’s rays directly into electricity using photovoltaic solar cells, these plants would be likely to use cheap metal mirrors to focus those rays onto boilers that make steam to drive turbines. If successful, the scheme could have a big impact. It would be a “carbon-dioxide-free way of making a lot of electricity, and a collecting area the size of Austria could supply the world”.

Editorial

The Economist

China breaks from the greenback

In a closed economy, quantitative easing can cause inflation, says Stephen King. In an open economy, it can just as easily result in a fall in the exchange rate (a rising supply of dollars should cause the value of the dollar to fall). This is bad news for nations with dollar assets – in effect, the US is defaulting on its debts. So why don’t its creditors get out of dollars? That’s easier said than done – mass offloading by US creditors would send the dollar into free-fall, destabilising the whole financial system. But China, which holds over $1.2bn in dollar assets, is taking small steps towards breaking away. It’s negotiated bilateral currency swaps worth $650bn with other nations (normally Beijing would swap Chinese renminbi into US dollars and then swap those for, say, Argentine pesos). If such deals proliferate, China will be able to conduct more and more trade in its own currency. America may eventually find “that living beyond its means through the sale of dollars to foreign countries will no longer be quite so pain-free”.

Stephen King

The Independent

Public-sector pay: it’s time to get real

The “outraged reaction” to the head of the Audit Commission’s suggestion that a year’s pay freeze for public-sector workers could help to save Britain from bankruptcy “shows a fascinating disconnection with reality”, says Camilla Cavendish. Public-sector union bosses “noisily protest” that their workers ‘should not be punished for private-sector greed’. But that misses the point – “there is no money”. The private sector pays the public sector’s wages, and you can only “stiff the private sector” – a third of whom have already suffered pay freezes – for so much. Besides, with civil servants quietly planning possible 20% cuts in public expenditure, it would be odd to ignore pay that constitutes 25% of the government’s outlay. The public-sector wage bill has risen by about £7bn a year for the past five years; a year’s pay freeze could reduce public-sector debt by £5bn. Hostility has sent politicians into a spin, but the nettle must be grasped. “If it’s not pay restraint, it will be job losses.”

Camilla Cavendish

The Times

Money talk

“If work was a good thing, the rich would have it all and not let you do it.”

Writer Elmore Leonard, quoted in Forbes

“Don’t believe the shroud-wavers who tell you grannies will die and children starve if spending is cut. They won’t.”

Steve Bundret of the Audit Commission, as politicians argue over Britain’s public finances, quoted on BBC Online

“This is not so much a White Paper as a blank paper.”

Vince Cable (above), the Liberal Democrat Treasury spokesman, on the government’s banking reform proposals, quoted in The Times

“Nothing more than spray-painting a rust-heap.”

Finance expert David Kuo on Alistair Darling’s plans to clean up the finance industry, quoted in The Mail on Sunday

“No matter what Michael wanted, someone would give it. The very rich, the very poor and the very famous get the worst medical care.”

Dr Arnold Klein, Michael Jackson’s dermatologist, quoted in The Sunday Times
Afghanistan: a "Prada war at Lidl prices"

by Emily Hohler

Gordon Brown’s critics say he is trying to “fight a Prada war at Lidl prices” in Afghanistan, says Mary Riddell in The Daily Telegraph.

In 40 years the defence budget has fallen from 6.5% of GDP to 3%, even as Tony Blair committed troops to four wars. Our Afghan death toll now stands at 184; 15 died this month alone. Brown’s parsimony with our armed forces is “criminally negligent”, says Richard Littlejohn in the Daily Mail. He’d “rather rain money upon the heads of his client electorate, creating hundreds of thousands of exciting non-jobs… than fritter away his bounty on fripperies like helicopters, flak jackets and armoured cars”.

The failure to provide the armed forces with proper equipment and political leadership is the “greatest scandal of the war”, says The Sunday Telegraph. But it doesn’t mean the war is wrong. As the foreign secretary, David Miliband, reminded us, we must stop Afghanistan from becoming a safe haven for terrorists, as it was before the 9/11 terrorist attacks.

The idea of a resurgent Taliban, free to focus on taking over Pakistan and its nuclear weapons, is a “nightmare”. Withdrawal would “destabilise the region profoundly”, discredit Nato and show terrorists everywhere that the West won’t persevere when its soldiers get killed.

The presence of British troops in Helmand province since 2006 has reduced the threat posed by “Al-Qaeda remnants who stayed behind after the Taliban was toppled in 2001”, says Michael Evans in The Times. But Al-Qaeda has moved its terrorist operations centre to Pakistan.

Besides, no one, apart from then-president George Bush in a speech several years ago, “believes the Taliban is threatening British towns and cities”. The war suffers from “mission creep”.

When Blair was prime minister, he said the troops were also there to tackle the heroin trade, spread good governance and help the Afghans improve their lives. Quite, says Littlejohn, hence no one knows what they’re fighting for any more, “other than fierce loyalty to their mates and their regiment”.

But by “stirring up trouble for the government, the generals and the Tories risk peddling a delusion”, says Riddell. Extra helicopters may save some lives, but “injections of money, hardware and manpower would not, by themselves, subdue the Taliban or procure victory. A political solution is the only guarantee of success, yet that objective is barely spoken of”, even though extra UK troops are being provided for next month’s presidential election.

The current incumbent, Hamid Karzai, who “boasts of being Washington’s man”, presides over the world’s fifth most-corrupt government, turning a blind eye to last year’s alleged loss of two-thirds of Afghanistan’s annual revenue. Should he win (as he’s likely to), we are left with a campaign whose military and political objectives are “hazy” and which costs $20bn a month. Our soldiers deserve good equipment and the “guarantee that they are the brave architects of a better future… No civilised nation should ask its soldiers to die for less.”

Sarah Palin: could she really be the next US president?

Sarah Palin’s resignation as Alaska’s governor was a “stunning example of poor leadership”, says The Philadelphia Inquirer. She cited a “higher calling”, suggesting she’s thinking of running for the presidency in 2012. But this move “practically disqualifies her”. Her CV now reads like this: “small-town mayor; governor for less than three years of a remote state with fewer people than Delaware; failed national campaign for vice president; quit governor’s job.”

Whatever Palin said, the real reason she resigned is cash, says Kathleen Parker in The Washington Post. Her book deal alone reportedly means she’ll never have to worry about money again. She may yet achieve her ambitions, says Frank Rich in The New York Times. A poll taken after she stepped down showed that 71% of registered Republicans would vote for her to be president. “She’s not just her party’s biggest star and most charismatic television performer” – she’s the only one.

She has a genuine following: a white non-urban America that feels “disenfranchised” by a hateful media, immigrants, and the “African-American who has ended a white monopoly on the White House”. Palin’s ‘real America’ is “demographically doomed”, but it’s an emotional constituency. Palin “puts a happy, sexy face on ugly emotions”. She’ll “flake out” long before the White House, says Eugene Robinson in The Washington Post. She articulates a (far-right) political vision and inspires people to believe in it. But realising that vision requires discipline, persistence and rigour – attributes she lacks. It’s ridiculous to imagine primary voters giving the nomination to a “folksily illiterate, bone-idle chancer who takes direct instruction from the Lord”, says Matthew Norman in The Independent. But in this desert of confusion the one oasis of certainty is that Palin sees herself atop that ‘city upon a hill’: “God have mercy on our souls if that doesn’t prove a mirage, but it would be dishonest to deny a frisson of excitement at the prospect of finding out.”
A seismic shift is starting, both in Britain and America, in the way that people spend – or save – their cash. And it could flag the biggest change in consumer behaviour for 50 years.

“I’ve often written that the four most dangerous words in the investment world are ‘This Time It’s Different’. It almost never is,” says John Mauldin of Millennium Wave Advisors. “And yet – I’m going to make the case that it really is different this time.” Mauldin is one of the sharper fund managers around. So it’s worth taking notice when he says: “We’re on a track that looks far more like the Great Depression than the recessions of our lifetimes. We’re hitting a massive reset button taking us to a new and lower level of consumer spending and leverage, etc. No one knows what the new level will be.”

At first glance, that may look a bit over the top. Yes, consumers are cutting back as house prices fall and job losses mount. But isn’t this just a temporary round of belt-tightening before things ‘return to normal’ any day now?

We don’t think so. Consumer confidence – despite rebounding a little from its lows – remains very fragile on both sides of the Atlantic, even compared to previous recessions. And small wonder. Not only have dole queues grown fast in both Britain and the US, but they’re also set to get a lot longer. At 7.6%, British unemployment is already at its worst for 12.5 years and is likely to move towards 10% next year, says the Confederation of British Industry. In May, the US jobless rate hit 9.5%, its highest point in no less than 26 years. Again, it’s likely to head even higher in 2010.

It’s not just rising job losses that will force consumers to cut back. Household wealth has taken a pasting, meaning less money will be available to spend. For example, the collapse in property and share prices has sheared $11trn off the value of US families’ net assets – about 18% of the total (more on this in a moment).

Surging borrowing was a crucial factor in fuelling the consumer boom. But the ‘inverse wealth effect’ has slashed the collateral consumers can borrow against.

If you’re expecting a brief round of belt-tightening before things return to normal, you’ll be disappointed. It’s time to get defensive, says David Stevenson. Thrifty buying means finding lower prices, cheaper alternatives, or patching up the present version until you’ve saved enough for a replacement. When it comes to keeping the car going for another year, or switching to pedal power, one share tops the list: Halfords Group (LSE: HFD, 320p). Halfords has a market cap of just £680m, but it’s Britain’s leading retailer in car maintenance, enhancement and leisure. The latter includes bicycles, cycle accessories, child car seats and outdoor leisure kit. Earnings per share rose 8.5% for the year to 3 April 2009. Like-for-like sales fell by 3.3% because of falling satnav prices. But the dividend was raised by 5.3%, reflecting management’s “confidence in... near and long-term prospects”. Halfords is “one of the few general retailers we expect to grow earnings in 2010,” says John Stevenson of KBC Peel Hunt. The price/earnings ratio (p/e) for the 12 months to April 2010 is ten and is forecast to drop to 9.6 for 2011, while the forward yield is almost 5.5%. With bicycle use growing and the firm’s international expansion and cost-cutting programmes on track, Halfords is worth buying.

Another area set to benefit is gardening, particularly as unemployment rises and “more people stay home and tend to their greenery,” says Reshma Kapadia of Smart Money. In the US, lawn and garden product maker Scotts Miracle-Gro (NYSE: SMG, $36.39) could be the stock to own. It’s selling on 15 times net profits for the year to September 2009. But earnings are expected to climb 15% both this year and next, and should get a boost as Scotts gains business from the recent demise of a rival company, says Sam Yake at BGB Securities. That should cut the forward p/e to around 13 times. And with sales up 17% in the year to end-May, Yake reckons company guidance is still too conservative – ie, profits could prove higher than forecast. He has a target price of $47, almost 30% above the current price.

The UK’s garden centres could also flourish. Unfortunately for investors, Tesco (LSE: TSCO, 359p) has now taken over the once-quoted Dobbies. But that’s another good reason for buying into Britain’s biggest retailer, whose tills take one in every three pounds spent in this country’s supermarkets. Despite the
In other words, falling house prices mean there’s no more equity for consumers to ‘withdraw’ from their homes. And that’s at a time when consumers are in no position to borrow more. Personal debt as a share of disposable income in the US now stands at 130%, more than twice the 1980s peak. In Britain the figure is over 170%.

That’s all scary enough. But there are two other key issues that will force ‘Anglo-Saxon’ consumers to save rather than spend. Firstly, they could soon have even less cash in their pockets as their pay packets come under threat. American average hourly earnings were unchanged between May and June, cutting the annualised rate of earnings growth to the lows last seen in late-2003.

It’s only a matter of time before Americans see an actual drop in hourly earnings. Average earnings growth has already turned negative in the UK, says Capital Economics, and looks set to weaken further. Outright pay cuts, temporary periods of unpaid work or sabbaticals are becoming more common.

Secondly, there’s the demographic factor. During the ‘baby boom’ years between 1946 and 1964, 76 million Americans were born. As of late-2008, they held the US purse strings, controlling 50% of the nation’s entire discretionary income, purchasing 43% of all new cars, accounting for 79% of all leisure travel spending, and eating out four to five times per week. That all stacked up to the baby boomers outspending younger generations by a ratio of 2:1. In short, from 1980 to 2007, boomers were the money behind almost every economic development in the country.

But they’re also the ones picking up the bill for the household wealth implosion. In just one year, they lost nearly 20% of the money they had planned to retire on, and the pain keeps coming as the US housing market meltdown continues. Now “boomers are in trouble”, says Graham Summers on Seeking Alpha. “We’ve now entered what may be the greatest period of wealth destruction in American history. The effects on boomer spending and investing will completely change the investing and economic landscape for the US regardless of what the Fed, Obama, or any other economic/political authority attempts.”

In other words, America’s boomers will be cutting back and saving what they can. And Britain’s boomers will have to do the same.

“I think we’re at a behaviour inflection point,” says Professor Edward Kerschner.

Continued overleaf
cover story

Continued from previous page

of Global Wealth Management on CNNMoney. “Consumers aren’t just being frugal – they’re being thrifty.” And this “isn’t just a cyclical retrenchment. We’re seeing a shift from ‘conspicuous consumption’ to ‘conscious consumption’.” Pimco’s Mohammed El Erian calls it the “new normal.”

So how will this savings drive play out? The charts on the right show what’s been happening to the savings ratio (the percentage of household disposable income stashed away) and consumption over the last 50 years. The dark line in each case shows the savings ratio, which in both Britain and America was on a progressive decline from the low to mid teens 30 years ago to zero by 2007. In other words, consumers weren’t saving any net money out of their incomes. That hadn’t been seen in Britain since 1959, and was a new experience for the US.

Meanwhile, consumer spending just kept on going. The dotted line shows the real (inflation adjusted) year-on-year change in private consumption. We’ve inverted it to show how consumers tended to spend more even as they saved less. Until the latest recession, that is. The savings ratio in both countries has rebounded off zero, and consumption fell off a cliff. But the reason it’s different this time is that, on previous occasions when consumers retrenched, they at least had some cash in the kitty eventually to kick start another spending spree. But now the cupboard is bare and it looks like a long-lasting shift has begun. “It would not be at all unusual for savings to go to 9% or more in a few years,” says Mauldin. “That means consumer spending will drop by 9%.”

A long-term rise in the savings ratio will mean homeowners staying put for longer; cars being driven for another year or two; shoppers hunting for value; and more holidays at home, or “staycations”, as Ravi Dhar of Yale’s Centre for Consumer Insights tells SmartMoney. Less cash being splashed in shopping malls, high streets or online will be bad news for a wide range of retailers and their suppliers. But it won’t be bad news for every company.

“The idea again is a focus on thriftiness, on long-term value and savings,” says Professor Kerschner. “People aren’t going to be talking about 20% returns from the hottest initial public offering or hedge fund. They’re going to be considering the value of their investments.” In a nutshell, this requires a new approach to selecting and buying shares.

“Cyclical” stocks, such as commodity producers and industrials, which have driven the global stockmarket rally since 9 March, depend on improving economies for their profits. With “the global crisis morphing again”, says El Erian, “threatening the potency and credibility of the economic policy-making apparatus, the economy will continue to struggle”. That’s bad news for cyclical stocks’ earnings – and their share prices, too.

So what should you buy? We’ve been banging the ‘defensive’ drum for a while now. These are firms that don’t need economic growth to make their money, like pharmaceuticals, utilities and telecoms. Now could also be the right time to invest in businesses that will prosper from the ‘new normal’ – stocks that will benefit from newly ‘thrifty’ consumers. We look at seven options in the box below.

Continued from previous page

The collapse in mortgage and other lending has hit-boking revenues, while growing competition in the motor insurance market has squeezed margins. But while the latter remains very competitive, the mortgage market has stabilised. And on its current market cap of £250m, Moneysupermarket now looks cheap, on a current p/e of 13 and yielding 6.2%. For 2010, City analysts expect these numbers to look even better as cost cutting kicks in, with the p/e ratio set to drop to 11.3 and the forward yield set to rise to 6.4%.

With £73.5m of cash and positive operating cash flows, Moneysupermarket can afford to win market share at the expense of more weakly capitalised peers,” says Jamie Briggs at Noble Research. “Our model suggests a valuation 37% above the current price”.

Businesses need to cut back too. Symantec Corporation (NYSE: SYMC, $15.52) sells security software and data storage systems. Thrifty firms “are turning to new options like cloud computing (computer services over the web) to reduce software expenses”, says Kapadia. “Companies like Symantec should benefit.” The stock has been out of favour with investors, but that could be about to change. On a 2009/2010 p/e of just 10.2, falling to 9.7 next year, Symantec looks cheap. “We believe Symantec offers one of the most compelling values on software,” says Gregg Moskowitz of Auriga, who has a price target of $21.

Finally, there’s Mitie (LSE: MTO, 220p). This £700m British ‘facilities’ company helps both private- and public-sector firms cut costs by outsourcing management of everything from property to catering, cleaning, security and pest control – you get the picture. “It has defensive yet growing earnings, an attractive combination,” says Fiona Orford-Williams of Edison Investment Research. A “strong order book, good cash flow and robust financial position” mean the board is confident on the company’s future, according to last week’s statement. The stock is on a p/e of 12 for this year, dropping to 11 for next, while the yield is 3.5%.

“Tesco takes one in every three pounds spent in British supermarkets”
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Save when paying abroad

by Ruth Jackson

Need to organise your holiday cash? A foreign currency pre-pay card could save you more than you think. A pre-pay card works much like a standard cash card, except that it needs loading up before you use it and it isn’t linked to a bank account. Like a traveller’s cheque, if you lose the card you can get it replaced without the fear of losing any money. These cards also offer the convenience of a debit card as you can use them to withdraw money from cash machines or pay for goods in shops.

The main saving when using a pre-pay card abroad, rather than a credit or debit card, is there’s no foreign-exchange usage fee. Most credit cards, for example, charge you between 2.5%-3% on overseas transactions. In the past you could dodge these charges on a debit card by using a Nationwide Flexaccount card, but the introduction of a 0.84% charge leaves pre-paid cards as your only fee-free option.

Another big perk with certain pre-paid cards is that some of them – such as the Travelex Cash Passport – are Visa Electron cards. This breed of debit card is fairly rare, but has one major advantage over other types of debit cards – Ryanair, Easyjet and other budget airlines don’t levy a booking or processing fee if you use one. So you can sidestep those cheeky airline ‘payment handling fees’. That feature alone could save you as much as £5 per person per flight with Ryanair – that’s £40 for a family of four.

To get a Travelex Cash Passport, visit www.travelex.co.uk. The cards are intended for foreign, not British, spending. However, you can load up a card with sterling intended for overseas use by picking certain destinations. Choose Barbados, for example, from the drop-down currency menu and you will be able to load up your card with sterling. The minimum amount you can put onto the card is £100 – free if you do it online, or subject to a fee at a Travelex counter. Then once you’ve loaded up your card use it to book your holiday flights and save yourself a bit of cash.

One downside to the Travelex Cash Passport is that you will be charged £2.50 each time you withdraw money from a cash machine. But you can use the card for purchases free from any fees.

Also be aware that if you don’t use the card for 12 months you will trigger a £2 monthly inactivity fee. So either use it from time to time or cancel it after you’ve purchased your flights if you think you won’t need it again.

Overall, for a little bit of extra effort, a Travelex Cash Passport is well worth nabbing for the flight and holiday-money savings alone. As a bonus Travelex also offers very competitive exchange rates. Enjoy your trip.
How I got my muesli into the supermarkets

by Jody Clarke

Want to improve your time-management skills? Try having three children under the age of five, says Carolyn Cresswell, the 35-year-old founder of A$15m-a-year muesli maker Carmen’s Fine Foods. “It makes you more efficient. I need to walk out the door at 5.30pm every day and know everything is done.”

Cresswell comes from a long line of entrepreneurs, including caravan makers, dye wholesalers and the owner of a school canteen. She started out selling lemonade in her Melbourne neighbourhood. But it was a Saturday night babysitting job that led to her big break. The family she was childminding for ran a small business making muesli and Cresswell helped them out part-time. But in 1991, after less than a year, they decided to sell up. Not wishing to lose her main source of income before she went off to university, the 18-year-old and a friend put in an offer. “It was only A$2,000. It wasn’t like I was a year-old and a friend put in an offer. “It was a Saturday night babysitting job that led to her big break. The family she was childminding for ran a small business making muesli and Cresswell helped them out part-time. But in 1991, after less than a year, they decided to sell up. Not wishing to lose her main source of income before she went off to university, the 18-year-old and a friend put in an offer. “It was only A$2,000. It wasn’t like I was buying a sheep station.”

That bought them a list of 80 customers – mostly small cafes around Melbourne – and a recipe for muesli. Cresswell hired out a small bakery in a supermarket at $8 an hour. She’d take cargo of boxes in a small van, alongside trucks unloading 20 pallets at a time, she knew she’d made it. Turnover hit $250,000, rising to $1m after a year. Woolworths (the equivalent of Tesco in the UK) took her muesli two years later.

But then disaster struck. One of the supermarket chains (she won’t say which) stopped stocking her products. “We had trucks all over the country delivering stuff that was then returned. It was horrendous.” Two to three hundred pallets of goods, about half the business, was destroyed overnight, “and the supermarket sold the rest at bargain basement prices”.

Angry customers rang Carmen’s, asking why they couldn’t buy the product anymore. “So we asked them to harass the supermarket.” They did. Her customers called and wrote to the offending supermarket’s shareholders, driving them “absolutely crazy. It made them realise how strong our customer base was.” Within a year, Carmen’s was reinstated and back on the shelves.

Cresswell has now branched out into the UK, after Carmen’s was chosen by the Australian government as one of five Australian products (selected from 300) to be stocked in Sainsbury’s stores across Britain. “The fact that Australia is a place people come to on holidays, and has an image for being clean and green, helps. But I’ve always tried to make the product stand on its own two legs. At the end of the day, it’s got to be better than everything else on the shelves.”

MY FIRST MILLION

Carolyn Cresswell, Carmen’s Fine Foods

in. This was put in an oven and roasted, packed up, then delivered on a Wednesday in her Daewoo hatchback. The business was profitable, but “local shops would only get you so far. I needed to get into the supermarkets.”

After finishing her politics degree, Cresswell bought her partner out. In 1997 she persuaded Australian supermarket Coles to trial the muesli in 20 of its Melbourne stores. Delivering her cargo of boxes in a small van, alongside trailers unloading 20 pallets at a time, she knew she’d made it. Turnover hit $250,000, rising to $1m after a year. Woolworths (the equivalent of Tesco in the UK) took her muesli two years later.

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The MoneyWeek audit: Paul Collingwood

■ How did he start out? England cricket player Paul Collingwood, 33, got his first job when he was 14. He worked as a cleaner in a local factory every Saturday morning, earning a pound £10 a shift for a few hours’ work. Five years later, in 1995, he began playing cricket professionally for Durham. By 1999, aged 23, he was earning around £8,500 a year at cricket, and still playing for Durham.

■ How much does he earn now? In 2001, Collingwood made his debut for the England cricket team and now earns a six-figure salary from the English Cricket Board (ECB) for his regular appearances on the England team. On top of this he gets bonuses when the team wins. For example, he reckons he will get between £20,000-£30,000 if England win this summer’s Ashes tournament. His earnings for this year also received a significant boost from the Indian Premier League. He earned just over £200,000 for playing in four games as part of the Delhi Daredevils.

■ What does he spend his money on? In 2007, Collingwood was fined £1,000 by the England team’s management for visiting a lap-dancing club in Cape Town during the World Twenty20 championship. His other outgoings are less controversial. As well as owning two homes in the Durham area worth around £1.1m together, he has a love of cars, which, he tells The Sunday Times, is his greatest financial weakness. His largest recent expense was £50,000 for membership of the Loch Lomond golf club, which he tells the newspaper is “one of the most beautiful places I’ve been”.

www.moneyweek.com
You’ve heard all the hype about the Bric (Brazil, Russia, India and China) economies. But now everyone has a new favourite emerging market: Indonesia. Buoyed by a healthy banking system, the re-election of a reformist president, and a young, bright population, Indonesia’s Jakarta Index has soared 52% this year. That makes it the fourth best-performing stockmarket in the world for 2009, says Bloomberg. Can it last?

On the face of it, yes. Firstly, despite the bounce, the market’s still cheap, on 14 times earnings against 23 for the MSCI Asia-Pacific Index. Secondly, demographics are on Indonesia’s side – 44% of its 240-million-strong population is under 24, meaning a growing workforce for years to come, while the basic literacy rate is 90%, far higher than India’s 61%. Thirdly, the economy is driven by domestic demand; consumption accounts for 60% of GDP, says Cris Sholto Heaton in the MoneyWeek Asia email. GDP should grow by 4% this year, even as demand for coffee, palm oil and coal (of which it is a major exporter) falls.

It’s not all good news. The banks look healthy and household debt is low (only 1% of households has a mortgage, says CLSA Asia-Pacific Markets), but loan portfolios are untested, says The Wall Street Journal. Indonesian banks made more than a third of their loans in just the past two years, more than any Asian economy save India, says Morgan Stanley. And the country is the world’s 126th most corrupt state, reports Transparency International, behind India, China and even the infamously corrupt Nigeria.

But you face these concerns in any emerging market – the key is whether the country is progressing or backsliding. The good news is that Indonesia seems to have learned the lessons of the 1997-1998 Asian crisis, when companies overextended themselves with foreign currency loans. Total public- and private-sector debt as a percentage of GDP has fallen from more than 100% in 2000 to 60% last year. So how do you play the market? The easiest way is via the US-listed Van Eck Market Vectors Indonesia ETF (US: IDX), says Heaton. It holds 25 large Indonesian stocks and has a gross expense ratio of 1.08%. Or there’s the Indonesia Fund (US: IF). It’s up 40% in dollar terms this year, but trades on a discount to net asset value of 7.5% or so. The management fee is 1.62%. These funds are denominated in dollars, so sterling investors face currency risk.

To receive our free weekly Asia-focused email, MoneyWeek Asia, go to moneyweek.com and click on ‘Free emails’.
What is the point of economic sanctions? asks Jason McLure. When applied to an already isolated regime they can be disastrous. Take Eritrea. The UN Security Council is thinking of imposing them on the country for channeling arms to Somalia’s Islamist militants. But this won’t solve anything. Eritrea “already trades less with the outside world than any other country in Africa”. And the country’s president, Isaias Afewerki, just isn’t interested in being a “globe-trotting statesman”. So sanctions will only strengthen his relations with “less savoury allies”, such as Libya and Sudan, who already provide Eritrea with aid.

Nor will sanctioning Eritrea choke off the flow of arms and money to Somalia. There has been an arms embargo on Somalia for more than a decade and “it has been about as effective as a chastity belt on Silvio Berlusconi”. The 3,000km coastline is a nightmare to police and a crack down on the “dizzying array of money-transfer services” in Mogadishu would push the economy further towards total collapse. There’s a wider lesson here too. Why punish, say, North Korea with sanctions when it trades with a handful of countries who will ignore them? Sanctions only give rogue leaders an excuse for more bad behaviour.

We should allow over-65s to carry on

Government plans to allow workers to work past the age of 65 have disappointed the Confederation of British Industry. But I can’t see why, says Chris Dillow. Studies have found that average productivity declines only slightly with age. Take academic economists, for example – measured by publications in top journals, their productivity rises to the age of 50 and even then only levels off. Physical productivity doesn’t fall off either. The time taken to run half-marathons dips by only 1.1% on average between 55 and 65. The productivity of manufacturing workers does fall off after 50, but it’s more than offset by lower wages. So people should be allowed to work past 65. “I just hope they don’t make it compulsory.”

French must cheer up

Faced with a 17% year-on-year fall in tourists this January due to the financial crisis and a reputation for being rude, the Paris tourist board has made a simple request to the city’s residents: smile. It seems the French are worried by a TripAdvisor survey conducted in May. This found Paris “the most over-rated city in Europe” – with high prices and unpleasant residents. In response, teams of “smile ambassadors” have been despatched to welcome holiday makers at the city’s most popular spots. Meanwhile, hundreds of roller-skaters have popped up at popular tourist sites, such as the Place Vendome, to form giant smiles. And according to Daniel Fasquelle of the tourist association, the French will no longer taunt “an English person lost in northern France by honking our car horns”.

Obama can’t ignore bankrupt states

Barack Obama thinks he can get away with not bailing out bankrupt California, says Gregor McDonald. He’d rather wait while “the states rebuild their balance sheets and clean up their payrolls”. However, the situation is already too dire for that. “This isn’t a recession. This is collapse.” Normally, increased savings could be used to support government debt issuance. But all the money Americans are saving is being used up to service debt. And the internal composition of the US economy is much weaker than in previous recessions – manufactured goods have been replaced by manufactured debt and dollars.

So it’s time for a second big stimulus. Washington must bail out all the states suffering from collapsed revenues and massive job losses. It can’t “take a pass on this one”. Indeed, if it does, it will render all the intended effects of the first stimulus useless. It will also loosen Washington’s grip on power and could kickstart the devolution of authority to the states. Let’s face it, a Californian who has watched houses decline by 40%, household income fall by 30%, and seen school programmes and town services being shut, while banks are bailed out, is really going to lose it this time. If Washington doesn’t print more dollars and bail out states when they need it most, then “what use is it”?

What the bloggers are saying
This week: James Palumbo

Ministry of Sound founder turned satirical novelist who made £130m from dance clubs

In the glory days of the Ministry of Sound, the club's mercurial founder was usually to be found in a glass cube office peering down at his youthful workforce. James Palumbo was always a remote figure, says The Independent on Sunday. It would be hard to find a more unlikely dance club boss. He combined an aesthetic's love of fine wine and classical music with a reputation for ruthless business dealings, inspiring either devotion or loathing. “He'd make a good Bond villain,” noted an associate at the time. “The chilly, clever loner who wants to take over the world.”

On most measures, Palumbo has succeeded. Having transformed a derelict former bus garage in Elephant and Castle into “an urban dance cathedral”, he has built the Ministry (renamed MSHK last year) into what he claims is the world's largest independent record firm, turning over £80m last year. But the business (now 18 years old) has had its ups and downs. Most notably a planned £150m stockmarket flotation a few years back was hastily scrapped. But it has since rebounded, despite rivals claiming dance was ousted his father, cementing “an extraordinary estrangement... that has lasted 25 years”, says The Times. Despite an upbringing “of textbook privilege”, Palumbo has always had a “visceral” fear of poverty. He grew up at Buckhurst Park, Windsor (now the home of the King of Jordan), and was educated at Eton and Oxford. “But when I left home at 18, I felt that it was me against the world.” At school, he became a hated figure as house captain after getting some cannabis smokers expelled. He was rumoured to keep “a little black book of secrets”. Some claim he thrived on the hostility. He was certainly driven enough to take in his first big wedge of cash during his gap year when he headed to Los Angeles with a friend and set up the Etonian Butler Service.

After Oxford, he emerged as a high-flyer at Merrill Lynch and Morgan Stanley. When a friend approached him in 1991, with the idea of bringing the US dance-club craze to Britain, he put up £250,000. But the edge he brought was “discipline”. “His grotesque but gripping lampoon of celebrity culture... that has lasted 25 years”, says The Times. He has never married, although he has an 18-year-old son, and he lives in the same elegant Kensington flat he bought 25 years ago with his old friend Pim (a Thai Princess), surrounded by pre-revolutionary French artefacts. A friend of Peter Mandelson, he is mulling over starting a career in politics. Some consider that a waste of his ability. “He could be the new Richard Branson if he wanted,” the music impresario, Simon Napier-Bell, once remarked. “The difference is he's a much better businessman than Branson.”

His grotesque but gripping lampoon of celebrity culture

For a man who got rich by capturing the zeitgeist, Palumbo is curiously old-fashioned, says The Times. “I never borrow money. I think the opposite of someone who'd drive down the Croisette in Cannes in a convertible Ferrari with loud music and a blonde.” Palumbo captures some of that mood in his first book Tomos (an acronym for There is Only Money And Sex) – a surrealist take on the future, “which lampoons the vulgarity of a craven celebrity culture fed by reality TV, and businessmen genuflecting before Russian oligarchs.” It is Rabelais meets Tom Wolfe. “I have always been fascinated by how people behave round money... the excesses, the obscenity of it all,” he says. The book has already won plaudits from the likes of Stephen Fry and Niall Ferguson, who described it as “grotesque”, but also “gripping”.

Palumbo's main business inspiration was his grandfather, Rudolf, the son of an immigrant Italian who built a property empire in the City. “I probably sensed... that the business side of the family might not endure following my grandfather's success.” Yet given his father Lord Palumbo's record in property (he made a fortune developing 1, Poultry, a retail building in London), this seems odd. Perhaps his father lacks a sufficiently puritanical streak. “To me extravagance is exceeding the limits of reason or necessity.” You've got to have money. “But once you've got it, so what?”
Spending it

Travel

Serenity in the south of France

By Ruth Jackson

Finding the perfect holiday combination of peace, luxury and fine dining can be tricky. But head to the south coast of France and you can get all three.

The medieval village of Eza winds around the top of a hill overlooking the Mediterranean. It is situated between Monte Carlo and Nice, but feels as though it’s a million miles from the flash, brash crowds of the rest of the south of France. The narrow streets mean that most of the village is inaccessible to cars, so you can wander the slopes in peace. Yet it still manages to cram in two luxury hotels, a Michelin-starred restaurant and fantastic views of the Mediterranean.

Sitting right at the top of the village is the luxury boutique hotel Chateau Eza. It has just ten guest rooms, in buildings dotted around the village. Each is individually decorated in a style sympathetic to the medieval buildings and most offer unrivalled views out across miles of coastline. Opt for the suite and you can even enjoy the view from your own private hot tub on the balcony.

But the pièce de résistance is the hotel’s Michelin-starred restaurant. Situated in a room that practically hangs over the edge of a cliff looking out over the Med, it offers stunning views and delicious French cuisine without the pomp and ceremony of many other French restaurants.

If you tire of the peace and quiet on offer in Eza, Monaco – where another great Michelin-starred restaurant awaits – is just a ten-minute drive away. Monte Carlo is mainly a tax haven for the hugely wealthy, so there are relatively few things for tourists to do – in fact, you can cover everything in a day. The main sights to take in are the palace, the main casino and, of course, the various high-end forms of transport docked in the marina or parked by the side of the road.

After a day’s yacht-spotting, settle down on the terrace at the Restaurant Mandarin at the Port Palace hotel and prepare for another great meal. This restaurant earned its Michelin-star for its fabulous fresh fish. The Mediterranean sea bass is particularly tasty and worth the €45 price tag. As you eat, you can enjoy the view of the port and the roads that become the Formula One race track once a year – the Port Palace is Monte Carlo’s only hotel to look directly onto the course.

Rooms at Chateau Eza cost from €280. For more information, visit www.chateauzea.com, or call 00 33 4 9341 1224.

Wine of the week: a cheeky little sparkler for summer parties

by Matthew Jukes

2008 Crémant du Jura Sparkling Chardonnay, France (£5.99, Aldi).

I have not lost my marbles, nor mislaid my taste buds. In my quest to track down the finest wines I often have to taste disparate and random bottles. I taste a lot of ‘supermarket wines’, but have yet to taste an Aldi range until now. The other day I sipped through 30 or so clean, accurate, cheap wines, and felt pleased that the hard-working team at Aldi does such a solid job for their keen customers.

But I didn’t get too carried away – there was but a smattering of favourable notes until this cheeky little sparkler pole-vaulted its way into my glass. If you’re going to host a party this summer, you’ll need to see some cocktail action. I have, in the past, sought decent mixing bases for cocktails in safe havens like Waitrose. But this year, you must buy this wine. It’ll set you back three quid a bottle less than anywhere else – a decent saving if you’re wading through a few cases.

But it’s also an accomplished creation without the addition of cassis or orange juice, and a smart, dry, invigorating ingredient for your parties and mine.

Matthew Jukes is a winner of the International Wine & Spirit Competition’s Communicator of the Year.
This week: properties with swimming pools – from a luxury villa in the British Virgin Islands to a charming oast house in Sussex.

Loudoun Road, St John’s Wood, London NW8.
This London property has established landscaped gardens and a swimming pool, but is in need of some refurbishing. 7 beds, 4 baths, dressing room, 3 receps, study, off-street parking. £5.75m Beauchamp Estates 020-7499 7722.

Rycliffe House, Ripponden, Sowerby Bridge, West Yorkshire.
A Georgian house surrounded by landscaped gardens with a heated pool. The house has wood panelling and a dining kitchen with a glass-roofed section and doors leading onto the garden. 5 beds, 2 baths, dressing room, 3 receps, pool house with kichenette, garaging/office. £675,000 Carter Jonas 01484-842105.

Musings Oast, Darwell Hole, Netherfield, East Sussex. A twin-roundel oast house in an Area of Outstanding Natural Beauty. It has beamed ceilings, open fireplaces and a swimming pool with summer house and covered verandah. 3 beds, 2 baths, 2 receps, pool, garage/workshop, gardens, 0.7 acres. £660,000 Batcheller Thacker 01892-512020.

Stomacher Farm, Downside, Shepton Mallet, Somerset. A restored farmhouse with a range of outbuildings and a swimming pool. The house has open fireplaces and Victorian floor tiles. 4 beds, 3 baths, loft/studio, 5 receps, kitchen/orangery, office, workshop, gym, stables, barns, 7 acres. £1.45m Carter Jonas 01749-677667.

The Old Rectory, Carleton Rode, Norfolk.
A renovated, Grade II-listed, Georgian-fronted former rectory. The landscaped gardens include a courtyard area and a swimming pool. 7 beds, 5 baths, 4 receps, study, workroom, garaging, stables, stores, woodland, paddocks, 6 acres. £1.75m Jackson-Stops & Staff 01603-612333.
Properties on the market

Turpentine, Tortola Island, British Virgin Islands. A luxury villa with ocean views on a private hillside. It is arranged as two separate pavilions connected by the pool deck. 3 beds, 4 baths, open-plan living area, breakfast/barbecue courtyard, office, separate workshop, verandas, terraces, gardens, 1.46 acres. £1.93m Knight Frank 020-7629 8171.

Church House, Grittleton, Wiltshire. The landscaped gardens of this Grade II-listed Georgian rectory lie behind Grade II-listed stone pillars with wrought iron gates and include a swimming pool and walled kitchen garden. 6 beds, 3 baths, 2 receps, library, study, cellars, east wing, west wing with bed/bath/recep, pool house, 9.3 acres. £2.25m Savills 01225-474544.

Vero Beach, Florida, USA. A waterfront house with French doors opening onto a loggia and summer kitchen. The pool is surrounded by landscaped gardens with panoramic waterfront views and there is a boat dock. 6 beds, 7 baths, 3 receps, gardens, balconies, terraces. £4.8m Mayfair International Realty 020-7467 5330.
Porsche’s roomy family saloon

The Panamera is Porsche’s first luxury saloon, says Ben Barry in Car, and it is a “highly appealing car – fast, comfortable, practical, frugal and very well built”. The basic idea was a very good one: wrap a Porsche 911 in a gran turismo body. You’ll get what Porsche was trying to do the moment you climb into the very-911-like interior. And from the outside it looks much like a 911 too, albeit with its 4.8-litre, V8 engine in the front. It doesn’t, however, drive like a 911, and that’s not necessarily a bad thing. It’s smoother at low speeds, the ride is more reminiscent of a Mercedes, and it’s not as sporting as its stablemates – making the car a more relaxing place to be for driver and passengers. It will still, however, do 0-60mph in 5.5 seconds and go on to a top speed of 176mph (for the £72,266 ‘S’ model).

And it really is a proper, big saloon, says Stuart Birch in The Daily Telegraph. It’s roomy inside, and each of the four occupants “can feel part of the whole driving experience in an ambience of leathery luxury, comprehensive infotainment systems and detailing that Porsche immodestly calls ‘opulent’.” The car’s ability to “mix whopping performance and confidence-inspiring dynamics” makes it a “very satisfactory solution to the enduring Porsche clan’s problem of creating a family sports saloon. After 50 years: sorted.”

The best cameras

If you need a camera that can take the rough with the smooth, then the Canon Powershot D10 is the one for you, says Stuff. It’s waterproof to 10 metres and is as “tough as a prize conker” – you can drop it from a height of 1.2 metres safely. It also features a 2.5-inch LCD screen, optical image stabiliser, plus face and blink detection. The zoom is “weedy”, but the pics “superb.” Price: £380. Contact: www.canon.co.uk.

The “ultimate dinky snapper”, with all the “fancy image tech you could want”, is the Fujifilm F200EXR, says Stuff. It has a 12-megapixel sensor that’s larger than average to reduce picture noise, and will automatically alter picture size in low light, so you get “the best possible pic regardless of size”. Screens “don’t get much sharper” than its 3 inch LCD, and it has a 5x zoom. Price: £300. Contact: www.fujifilm.co.uk.

Can one camera really offer all things to all people? Sony certainly seems to think so with its DSC-HX1, says Stuff. It’s a “super-zoomer that’s also trying to be a high-definition video camera”, and all for the price of an entry level SLR (single-lens reflex) camera. Its camera and video talents may be pretty average, but that you can get them together in one package is what makes it “great”. Price: £500. Contact: www.sony.co.uk.

www.moneyweek.com
What on earth’s wrong with a bit of shopping?

I’m not a great shopper. A year or two ago I took my family on a sailing holiday in Croatia. When we went ashore in the ancient town of Split, it took me a moment or two to tie up the dinghy. Fatal. By the time I had climbed up to the quayside there was no sign either of my daughters or my wife. They had vanished.

Then I saw a row of fashionable stores set back from the waterfront and the mystery was solved. They were in Topshop – trying on hats.

The experience was not an unusual one. Show my teenage daughters a clothes shop and they’re in it. I, on the other hand, will just pace about impatiently waiting until they’re finished.

Neal Lawson, the author of All Consuming, would approve of my behaviour. He says that buying stuff is the “heroin of human happiness”. In our frenetic consumer society, he argues, we have to go on and on shopping because otherwise the whole system would grind to a halt. Instead we have to be sold “just enough to keep us going, but never enough that our wants are satisfied”.

Geoffrey Miller, a professor at the University of New Mexico, comes to much the same conclusion in another study. Runaway consumerism, he thinks, “offers little more than narcissism, exhaustion and alienation”.

How did we get here, wonders The Times’s Carol Midgley. “How did we get to a point where shopping became the premier leisure activity, where we gladly boarded the work-to-spend treadmill, the insatiable pursuit of ‘more’, which resulted in there being, for example, 121 mobile phones for every 100 people in the UK by 2008?”

Midgley went off to a busy shopping mall to find out. The young designer-bag-laden consumers she talked to weren’t very enlightening. They said they loved shopping, that it got them out of the house, that while the recession might have made them hunt more for bargains it hadn’t killed their enthusiasm.

Good. Capitalism would be in dire straights if everyone behaved like me (although, come to think of it, I do my bit for the consumer society by owning a ridiculously un-cost-effective boat that requires constant expensive repairs and new parts.)

Of course, the shopping habit can be taken too far. Television advertising undoubtedly encourages foolish shopaholics to spend too much. And perhaps Professor Miller is right that some of this spending has to do with people endlessly repackaging themselves with fancy new dresses and Rolex watches in a desperate and usually pointless effort to attract the opposite sex.

But there’s nothing really wrong with shopping and, unlike heroin, it doesn’t kill anyone. I may not enjoy it, but lots of people do – it’s not called retail therapy for nothing – and I’m sure my daughters don’t find it exhausting, alienating or even narcissistic to buy a new dress or two from time to time.

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HarperCollins and runs crossword workshops (see www.timmoorey.info).

Tim Moorey is author of www.moneyweek.com

How to Master the Times Crossword

Sudoku 444

To complete MoneyWeek's Sudoku, fill in the squares in the grid so that every row and column of the nine 3x3 squares contain all the digits from one to nine.

Solutions to 442

ACROSS 1 Eater 5 Crave 8 Eases 9 Barre 10 Range 11 Scars 12 Faces 14 Adder 16 Rates 18 Right 20 Surer 21 Prate 22 Early 23 Ailed

DOWN 1 Eyedrop 2 Tyson 3 Sharers 4 Nelson's column 5 Cubes 6 Air raid 7 Evens 13 Caterer 14 Agrippa 15 Retreat 16 Russe 17 Sorry 19 Grail.

The winner of MoneyWeek Quick Crossword No. 442 is: Jill Phillips of Kent.

The bidding

South

4 2 1 3

West

Pass pass pass

North

Pass

East

3 1

Pass

Bridge by Andrew Robson

Spotting the singleton

The opponents bid and support a suit – then lead another suit. Why?

Because they are leading a singleton.

Dealer South

North-South vulnerable

Spade

2 9

Heart

A Q 8

Diamond

K J 10

Club

A 7

The bidding

South

4 2 1 3

West

Pass pass pass

North

Pass

East

3 1

Pass

West led the two of spades, but declarer did not heed the likely warning that this was a singleton. He won dummy's king to lead a trump. West won his ten with the queen, shifted to the knave of clubs, whereupon East won his ace and led a second spade. West ruffed with the two of trumps and had the ace of trumps still to come. Down one.

Declarer must try to discard his singleton club so that West cannot reach his partner's hand to score his spade ruff. His best shot is to win the queen of spades and lead a diamond to dummy's queen at trick two. When the finesse succeeds he cashes the ace, discarding the third of clubs, then leads a third diamond. If East (carelessly) discards then declarer throws his queen of clubs. He has swapped a club loser for a diamond loser, but now West cannot reach his partner's hand and can only score the queen and ace of trumps.

However, in case you were thinking that declarer could make his contract, consider what happens if East alertly ruffs the third diamond. Now declarer cannot prevent East from winning the lead and must fail.

Andrew Robson runs the Andrew Robson Bridge Club in southwest London (www.arobson.co.uk).
the share tipsters at a glance

MoneyWeek’s comprehensive guide to the week’s share tips

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<th>Company</th>
<th>Publication</th>
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<tbody>
<tr>
<td>Bglobal (BGBL)</td>
<td>Shares</td>
<td>This smart meter specialist’s money problems have been solved, allowing the firm to increase installations. The shares should rally now.</td>
<td>16p</td>
</tr>
<tr>
<td>BP (BP)</td>
<td>Shares</td>
<td>With a yield of 7.8%, this oil major should be a good defensive play even if the crude market rolls over. A restructuring programme provides potential upside.</td>
<td>480p</td>
</tr>
<tr>
<td>Cape (CIU)</td>
<td>Aim</td>
<td>Despite huge gains these shares are still a buy after good news about the energy and mining services group’s net debt, which has fallen in the first half.</td>
<td>189p</td>
</tr>
<tr>
<td>Cranswick (CWK)</td>
<td>The Daily Telegraph</td>
<td>This pork firm has released an excellent first-quarter update. Net debt has fallen from £66.6m to £64m and sales are up. The yield of 3.7% looks secure.</td>
<td>610p</td>
</tr>
<tr>
<td>Croda (CRDA)</td>
<td>The Daily Telegraph</td>
<td>Despite closing a factory this chemicals firm is still a buy. Pre-tax profits for this year are estimated to be £99.6m compared to £98.4m last year.</td>
<td>562p</td>
</tr>
<tr>
<td>Diploma (DPLM)</td>
<td>The Sunday Telegraph</td>
<td>This support services company is proving particularly resilient to the recession and has a good 5.8% dividend yield that looks fairly secure.</td>
<td>130p</td>
</tr>
<tr>
<td>First Quantum Minerals (FQM)</td>
<td>Shares</td>
<td>This copper miner produces around 250,000 tonnes of copper a year. The shares industrial metals &amp; mining have further to go as the firm moves “to the premier league of miners.”</td>
<td>2,881p</td>
</tr>
<tr>
<td>Informa (INF)</td>
<td>Investors Chronicle</td>
<td>A resilient publishing division, plus minimal exposure to advertising, mean this media firm’s shares have been oversold as the market avoids media plays. It’s a buy.</td>
<td>229p</td>
</tr>
<tr>
<td>Ithaca (IAE)</td>
<td>Investors Chronicle</td>
<td>An asset deal with Dutch firm Dyas has put this oil firm on a much sounder financial footing, with a relatively large cash pile, and it is entirely free of debt.</td>
<td>36p</td>
</tr>
<tr>
<td>JP Morgan Indian InvestTrust (JII)</td>
<td>The Daily Telegraph</td>
<td>A dip in the Indian stockmarket provides an opportunity for investors who wish to invest in the development of one of the world’s largest emerging economies.</td>
<td>306p</td>
</tr>
<tr>
<td>LMS Capital (LMS)</td>
<td>The Times</td>
<td>This investment firm may not offer a dividend, but it has no direct debt and is trading at a 50% discount to net asset value. The scope for capital growth makes it a buy.</td>
<td>44p</td>
</tr>
<tr>
<td>Low &amp; Bonar (LWB)</td>
<td>The Times</td>
<td>This toughened textiles firm has maintained flat operating margins, despite a 25% fall in underlying sales in the past six months. On a p/e of six, it’s one to “tuck away.”</td>
<td>25p</td>
</tr>
<tr>
<td>Morgan Sindall (MGNS)</td>
<td>Investors Chronicle</td>
<td>This construction firm has a strong order book and a diverse revenue stream. Yet the shares aren’t highly rated on a 2009 p/e of just eight.</td>
<td>626p</td>
</tr>
<tr>
<td>National Grid (NG)</td>
<td>The Mail on Sunday</td>
<td>“The backbone of the British energy system” offers a “handsome” 7% yield. The share price fall from 700p last year seems overdone given its income potential.</td>
<td>543p</td>
</tr>
</tbody>
</table>

I wish I knew what the quick ratio was, but I’m too embarrassed to ask

This measures a firm’s ability to pay short-term creditors. Divide the balance sheet total for current assets, minus stock, into the figure under ‘creditors: amounts falling due in less than one year’. Stock is omitted, as it’s often hard to sell quickly. Say current assets total £100m, made up of £30m stock, £40m debtors and £30m cash. Short-term creditors total £40m. The quick ratio is (£100m-£30m)/£40m = 1.75 times. In theory, the higher the better, as it shows a firm is unlikely to go bust. But a very high quick ratio may reveal a firm holding too much cash or taking too long to collect it from customers. Also some analysts prefer to take balance sheet cash as a multiple of short-term creditors (the ‘cash ratio’) as the ultimate test of liquidity.
the share tipsters at a glance

MoneyWeek’s comprehensive guide to the week’s share tips

BUY

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<tr>
<td>Premier Oil (PMO)</td>
<td>The Times</td>
<td>This “unlucky” oil explorer’s luck could be about to change. The firm has the scope to make “opportunistic deals”; steady cash flow and a strong balance sheet.</td>
<td>1,050p 1,880p/560p</td>
</tr>
<tr>
<td>Resaca Exploitation (RSDX)</td>
<td>Investors Chronicle</td>
<td>This firm, which uses injection technology to maximise oil and gas recovery, is “on the way to achieving substantial growth”. The group should soon be profitable.</td>
<td>28p 145p/10p</td>
</tr>
<tr>
<td>Rurelec (RUR)</td>
<td>Shares</td>
<td>Rurelec operates power plants in Bolivia and Argentina, where demand vastly outstrips supply. It’s a good entry point into a growing market.</td>
<td>12p 72p/11p</td>
</tr>
<tr>
<td>Tullow Oil (TLW)</td>
<td>The Times</td>
<td>This oil firm is “a success story”. The firm has 825 million barrels of proven oil reserves, or the equivalent in gas. If you want a bet on a rising oil price, this is it.</td>
<td>848p 1,049p/406p</td>
</tr>
<tr>
<td>Velti (VEL)</td>
<td>The Mail on Sunday</td>
<td>As more companies move into targeted mobile advertising, this mobile marketing firm should grow exponentially over the next five years. So “watch this space”.</td>
<td>158p 178p/105p</td>
</tr>
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</table>

SELL

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<tr>
<td>Computacenter (CCC)</td>
<td>The Times</td>
<td>This IT reseller has issued its third profit upgrade in six months. The shares have responded with a 131% gain since January, so now seems a good time to sell.</td>
<td>207p 214p/87p</td>
</tr>
<tr>
<td>Game Group (GMG)</td>
<td>Investors Chronicle</td>
<td>Like-for-like sales at this games retailer are deteriorating in the face of the recession and a lack of new releases. They fell 15.4% in the 21 weeks to June.</td>
<td>150p 260p/101p</td>
</tr>
<tr>
<td>Hallin Marine Subsea Int (HMS)</td>
<td>Investors Chronicle</td>
<td>The deflated oil price is hitting oil equipment firms as the oil majors spend less on exploration. Earnings are expected to fall sharply.</td>
<td>105p 192p/83p</td>
</tr>
<tr>
<td>Marston (MARS)</td>
<td>Investors Chronicle</td>
<td>This pub operator’s £1.3bn net debt pile “continues to be a millstone around its neck”. The dividend has been cut, but the turnaround strategy is unconvincing.</td>
<td>91p 238p/81p</td>
</tr>
<tr>
<td>Telecom Plus (TEP)</td>
<td>The Times</td>
<td>This firm provides discount utilities to customers, so it is benefiting from the recession. But with the shares on a peak of 16, there will be better times to buy.</td>
<td>285p 395p/53p</td>
</tr>
<tr>
<td>WPP (WPP)</td>
<td>Shares</td>
<td>Earnings forecasts for this marketing agency look too optimistic given the deterioration in the advertising market. Forecasts are likely to be cut next month.</td>
<td>391p 565p/299p</td>
</tr>
<tr>
<td>Yelti Group (YELL)</td>
<td>Investors Chronicle</td>
<td>A grim advertising market is causing problems for this advertising directory specialist. Sales and earnings are sliding. The shares could come under pressure.</td>
<td>22p 116p/12p</td>
</tr>
</tbody>
</table>

Portfolio round-up

“There is a time to be a bull, a time to be a bear, and a time to go fishing”, says Norm Caris, managing director of institutional sales for Caris and Co in the Honolulu Star. “This is a time to go fishing.” His hypothetical $20,000 portfolio soared by 66.5% in the first half of this year, putting him in second place in the newspaper’s eighth annual stock-picking contest. He took a gamble on the struggling car industry by buying shares in Ford. Up 165%, it’s paid off. His other picks include the Pimco High Income Fund, up 78.5%, and BlackBerry maker Research in Motion. It rose an impressive 75.2%. Shoe company Collective Brands is up 24.3%, while Hawaiian Holdings, which runs Hawaiian airlines, was the only loser. It’s down 5.6%. 

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US economy was unsustainable in the excessive, credit-driven expansion of the 1990s. But did the planners learn anything? They never said they were sorry... and now they’re creating a new bubble.

Across the world, the feds deal with the problems they caused by causing more of them. If you ask a serious economist, “What was the lesson of the Soviet economic experience?” He’d have a ready answer: “It was that distributed information is more reliable than the centralised variety.” In the non-communist world, if a man had money and no bread, he exchanged the former for the latter, and sat down to dinner. As if guided by an ‘invisible hand’, millions did the same. Everyone tried to get a bit more grease on his plate, by making his own decisions based on the facts before him. The result: standards of living rose for practically everyone.

In centrally planned economies, on the other hand, neither householder nor baker had a choice. Their tasks were set by apparatchiks who presumed to know exactly how much of society’s resources should be devoted to making bread – and exactly how much each person should eat. By the 1980s, it was obvious that central planning had failed. By 1990, both the Soviets and the Chinese had abandoned the experiment. Mankind sighed with relief. It seemed to have made a genuine great leap forward. Finally, it was generally accepted that people should be able to offer up their money as they did their prayers – to whatever god they chose.

The planners had made millions of people miserable over seven decades, but none were hung from lampposts. Rather, they retreated to the universities, central banks and finance ministries, and kept meddling. Soon, they were in the drivers’ seats – and headed for another wall.

China is a special case. “To get rich is glorious,” announced Deng Xiaoping after coming to power in 1978. The state pulled back its long arm. People were free to run businesses, pay wages, keep bank accounts. Today, in many ways, the average Chinese entrepreneur is freer than, say, his counterpart in Britain or the US. He faces fewer obstacles. Factories go up overnight and he’s in business.

China’s central planners are blowing up a big bubble

So dynamic was the Chinese economy that it responded to America’s centralised monetary policies in record time. Spooked by the recession of 2001-2002, the Americans cut rates and boosted public spending. This brought a bubble in the housing sector, which gave English speaking consumers an appetite. Soon they were gobbling up boat loads of Chinese-made goods.

For their part, the Chinese enjoy the liberty of the damned. With no creditor looking over their shoulder, they are free to fight the downturn even more recklessly. In the first six months of this year, Chinese banks lent more than $1tn – or about four times the rate of 2007. Most of that lending is designed to increase capacity. But why should they want to increase output? They already have too much.

Chinese planners thought they were pretty smart. They fixed the yuan to the dollar and refused to let it rise. This spurred rapid growth in China’s export sector. But like all central economic planning, it backfired. China’s entrepreneurs were misled. They didn’t know their biggest customers were going broke. Now, the Chinese have too many factories producing too much stuff for too many people who can’t afford it.

But that is the beauty of being a central planner; you never have to say you’re sorry. Instead, you double up. The economy is expanding at 8% this year, according to official estimates. It is expected to generate 74% of the worldwide GDP growth in the 2007-2010 period. As for commodities, were it not for Chinese buying, prices would collapse. Of course, that could be said for a lot of things. Were it not for Chinese buying, prices would collapse. Of course, that could be said for a lot of things. Were it not for Chinese buying, prices would collapse. Of course, that could be said for a lot of things...

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