



# BREWIN DOLPHIN

# PERSPECTIVE

**stocktrade**

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Winter 2010



**Charlotte Black**  
Editor and Director  
Corporate Affairs

# Season's Greetings

\* The Brewin Dolphin Holdings PLC Preliminary Results for 2010 were announced on 1st December and can be found in full on our website at [www.brewin.co.uk](http://www.brewin.co.uk). Jamie Matheson, Executive Chairman said "By comparison with recent years financial markets proved relatively stable over the year and in this environment Brewin Dolphin continued to make steady progress. While it would be foolhardy to rule out further unforeseen market events, it does appear there is a growing realisation that prudent financial management and the merits of equity over debt finance are key to economic growth. In particular we believe that this view is strongly held in the UK and this leads us to look to the future with considered optimism."

\* Jamie Matheson has also written an article on page 5 setting out his concerns about the imminent regulatory reform and warning of the dangers of over protecting investors.

\* There were good and bad developments for ISAs last month; the good news is that their future seems assured following the announcement that contributions levels will be index linked in future and that a junior version will be introduced as the savings vehicle for children, following the withdrawal of the Child Trust Fund. Kathryn Cooper – Money Editor of The Sunday Times assesses the significance of ISAs for us on page 7. The bad news is that the new Financial Secretary has just announced that AIM stocks will not be eligible for ISAs – they are deemed too risky – which does tinkle the nanny state alarm bells somewhat.

\* We are very pleased to report following the set up of our specialist charity team and now that our charity funds under management have reached £1.7 billion; we have moved into the list of top ten Charity Investment Managers, following Charity Finances Annual survey.

\* Last month we launched our new online valuation and reporting system which if you do not yet use – you will find very simple and informative with daily pricing and analysis of your portfolios. The service can be found in the Client Area at [www.brewin.co.uk](http://www.brewin.co.uk) along with the facility to vote your shares at their AGMs.

\* We have produced a Miscellany of Money in association with Debrett's. It is an informative and amusing history of money and how wealth can be created and protected. The Miscellany is free and could be a good stocking filler and so please do call 0845 213 2000 or email [info@brewin.co.uk](mailto:info@brewin.co.uk) for your copy.

\* This autumn we have sponsored the Spectator Debates series on topics including the Arts; Defence; America; Education and the Church. The debates are chaired by Andrew Neil and usually have included Ministers on their panels. A great many clients have been able to join us for these debates which take place in Central London and this success has prompted us to agree to sponsor the next series starting in the spring. Details of the 2011 debates will shortly be on our website and free tickets will be available for clients on request.

***Happy Christmas and very best wishes for 2011 to all our clients.***

# MINING SUPER CYCLE



**Nik Stanojevic**  
Assistant Director,  
Equity Analyst

Much is written about China and how long its high growth can sustain booming commodity markets – in an up-cycle all commentators are positive and in a downcycle all agree that the world is coming to an end – so what is the reasonable view? There are a number of compelling reasons which make us confident that the industry will continue to make large returns for the next five to ten years.

## Supply really is constrained

First, we believe the supply side will continue to be constrained. In the early 2000s as Chinese demand growth ramped up, the mining industry had just come to the end of over two decades of poor prices, low returns and underinvestment.

To be clear, the earth is not running out of minerals by a long way (unlike perhaps the oil industry which may be close to peak production levels). 5% of the earth's crust is iron, 8% aluminium, 0.01% copper (this seems low but still corresponds to millions of years of supply at current consumption levels). However, over time these minerals are becoming more expensive to mine and higher prices are needed for new projects to be

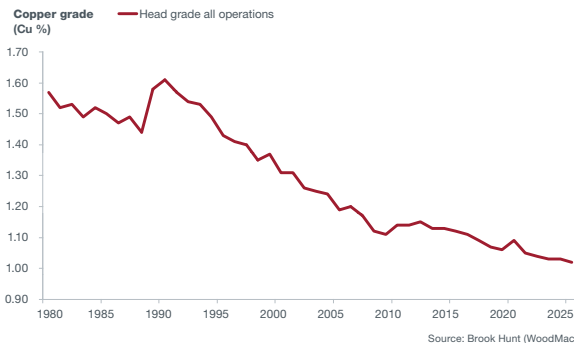


worthwhile. This is because many of the largest, highest grade deposits have been found with new projects being generally lower grade and thus potentially higher cost than existing mines. Take as an example the copper industry, where the average copper mine grade has been declining for the last 20 years (see the chart opposite).

The problem is essentially long project lead times and capital constraints. Most large mining projects require many years, sometimes decades, to go from discovery to production.

In addition, despite the large cash flows from the mining industry, capital has been constrained. This is partly due to the large upfront capital required – a typical new copper or iron ore mine could cost several billions of dollars to develop. Another problem is the availability of deposits, which are often lower quality than those in production today. Mining companies have been understandably reluctant to bring

## Declining head grades



these into production even if they are the best of the possible new mines available. Although many projects are economic at today's prices, they have been reticent to raise their long term price assumptions when evaluating them.

Finally, the capital resources required to bring on these projects is in short supply. This includes not only equipment but also human capital – the 20+ year slump means a shortage of experienced geologists and mining engineers. The economic downturn has exacerbated these issues as many companies cut capex and postponed or cancelled projects.

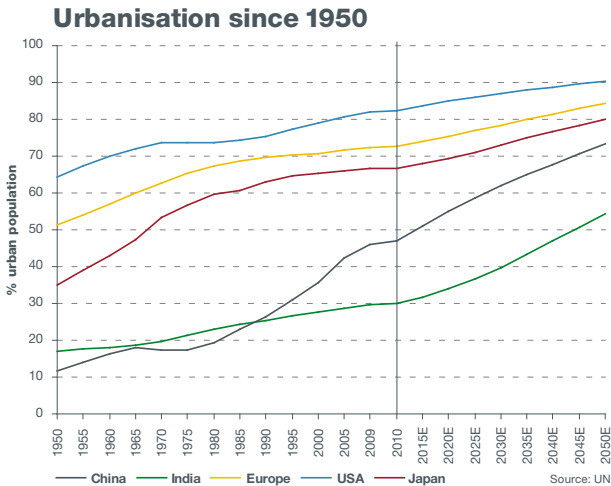
### The demand outlook is good, but could be lumpy

The second essential component is continued strong demand growth. This is more contentious with bears pointing out that as the Chinese economy moves away from relying on fixed asset investment to consumer driven growth, metals use will be far slower. In addition, Chinese GDP growth cannot continue to grow at the heady double digit rates of recent years and will inevitably fall (analysts expect at around 8% for the next few years).

We point to a number of measures which indicate that metals consumption in China has substantial room to rise from here, all be it with periods of slower and faster growth as it evolves. Infrastructure investment has been driven by urbanisation with wages in cities more than double the countryside. Over the last 10 years the urban population has grown by 170 million people or 25 cities the size of London, or around 3 United

Kingdoms. However, urbanisation rates are still only around 47% in China, well below developed economies most of which have rates of over 70% - excluding the impact of population growth this represents over 300 million more Chinese citizens who could move into cities. By 2025 some forecast that China will have built 10 cities larger than New York and that there will be more than 200 cities with more than one million inhabitants. That compares with only 35 in Europe.

Looking at the amount of metal consumed per person, China also has significant room for expansion. Taking copper as an example, China consumes just under four kilos per person per year. Most developed economies reached well over eight kilos in the metals intensive phase of development (e.g. the United States and the UK reached over ten kilos). On the same basis consumption in China could comfortably double for most of the major metals.



Anecdotal data also supports these views. The Chinese Central Government is planning to build 15.4 million social housing units by 2012 of which 5.2 million are already under construction - this corresponds to a total of almost a trillion square feet of living space. Based on its most recent five year plan (the 12th five year

plan, 2011 - 2015) China intends to build 85,000 km of motorways and a 40,000 km high speed railway network. It plans to double its installed generation capacity from 874GW in 2009 to 1,600GW by 2020 with huge expansions in wind, hydro, coal and nuclear. In nuclear alone 23 reactors are under construction with a further 39 at the planning stage and 120 more proposed. It has set aside \$600bn just



*Shenzhen in the 1980s and today.*

to upgrade its transmission grid to cope with this expanded generation fleet. The list could go on.

While growth in China may well slow from the heady double digit levels of the past, with corresponding lower growth rates in commodity consumption, this growth is now from a much larger base which therefore has a larger impact on global commodity markets. For example 1% of Chinese steel consumption in 2000 was around 1.3 million tonnes, but with China expected to consume over 600 million tonnes this year, every percentage point growth now corresponds to over six million tonnes.

Finally, if India begins its process of industrialisation at a rate anything close to China's unprecedented development, then there will be another billion plus people who will want and may be able to afford somewhere better to live, new places of work,

power to heat, cool and light these, transport between them and consumer goods to fill them.

### **What could spoil the party?**

We are to some extent relying on the Chinese state maintaining its growth as planned and this does not seem unlikely. The recent track record is good and there is evidence that China is getting better at pulling the levers required to control its economy. In the last 10 years or so China has managed to grow its economy remarkably quickly, whilst keeping inflation under control and managing the transition from full central planning to a free market, but a still centrally controlled economy.

The next challenge for China will be migration from an economy driven by exports and fixed asset investment, to one which is more consumer driven. This is especially important now as many of the end markets for Chinese goods will have sluggish growth over the next few years and these depressed economies need Chinese consumers.

Global macro factors are a concern. China will need to keep inflation under control (especially food inflation) to avoid social unrest and keep real income growth positive. Letting the renminbi rise would help inflation and give Chinese consumers more pricing power, but this will be balanced against keeping its export industry competitive. China will not take much of the medicine necessary to cure the debts of the West.

By 2025 some forecast that China will have built 10 cities larger than New York and that there will be more than 200 cities with more than one million inhabitants. That compares with only 35 in Europe.

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## PROTECTING THE GOLDEN GOOSE



**Jamie Matheson**  
Executive Chairman

After the debt-fuelled binge that led to the financial crisis, we all know how important it is to shift the balance back towards equity finance to encourage sustainable growth and job-creation. One part of the Government professes to understand this. But another part seems determined to impose more and more regulation which makes it increasingly difficult for investors to put up the risk capital needed to restore the equity base of British industry.

George Osborne, the Chancellor, has stressed the importance of encouraging a savings culture, shareholder democracy and an economy built on equity over debt. He understands the threat that excessive regulation poses to this goal. Indeed in the recent past he has spoken of the need for a new model of economic growth which will “raise from the ruins of an economy built on debt a new, balanced economy where we save, invest and export.” He has also called for the “recapitalisation” of the whole of British business, not just the leading banks. And he has pointed out that the tax system, which treats corporate debt ‘more generously’ than any other major global economy, needs to be reformed to encourage less risky forms of finance.

*It is all good stuff and I agree with the Chancellor. The truth is that building an economy on the never-never does not make for a happy ending as we all found to our cost. Savings and investment lie at the heart of long-term prosperity, not debt, and that requires making it possible for people to take on equity risk.*

The liquidity and long term nature of investments are an important feature of the equity market and this kind of risk-taking by investors is essential for the economy to flourish. If savers just put their money into government bonds and deposit accounts, where will the money come from that enables growing companies to expand and flourish?

The problem is that despite the Chancellor’s clear-sightedness, parts of the Government and the Regulator seem intent on making it all very difficult for investors to provide this much-needed equity. To be fair to the Coalition, this is not a new phenomenon. The burden of bureaucratic regulation heaped on to private investors has been growing for some time. But there are worrying signs it may continue to get worse as the present Government reforms the regulatory system.

Here are some examples of what I mean and why this has become such an issue for private client investment managers such as ourselves. Despite the fact that the clients who come to us want to invest in securities, regulation forces us to go through more and more bureaucratic hoops before we are allowed to help them invest their money the way they want. Over the past decade, for instance, there have been a string of new investor protection measures – each with their own impenetrable acronym (N2; MiFID; TCF; CRD and now the RDR). Three times we have had to agree new contracts with our clients, a major exercise costing us £1 million each time. Our current Terms & Conditions now have

more than 225 clauses. During the last five years we have also seen our regulatory staff costs increase from around 2 per cent of our total wage bill, to 3.5 per cent today.

If things carry on this way it will become prohibitively expensive to give private clients the personal advice service that is so important in ensuring they can make sensible, well informed decisions about their personal savings and investments. In fact, we already find we are sometimes prevented by regulation from giving clients the advice they want. For instance, if a client wants to take on more risk than we believe we can justify in accordance with the regulations, we struggle to give them that advice and often have to say we will only act for them on an execution-only basis.

Sadly these kind of unintended consequences will increasingly undermine the Government's objectives of encouraging savings, share

ownership and equity investment in both large and small quoted companies and we intend to continue pointing this out.

Of course we understand the importance of protecting consumers from financial rogues and helping guide them towards appropriate forms of savings. The problem is the regulatory regime adopts a one-size-fits-all approach which does not discriminate adequately between different types of investors and different types of organisation. Some of our clients are well-informed private investors who have decided they want to take some equity risk and they are investing through firms like ours, that are not a systemic risk and had nothing whatever to do with the financial crisis.

We alone have 130,000 clients with over £23 billion of savings and the assets under management in our sector as a whole total £400 billion. Surely it makes sense for much of these savings to be invested in UK plc rather than be stifled by regulation that prevents our clients investing their money where they want.

The liquidity and long term nature of investments are an important feature of the equity market and this kind of risk-taking by investors is essential for the economy to flourish. If savers just put their money into government bonds and deposit accounts, where will the money come from that enables growing companies to expand and flourish?



## ISAs FOREVER



**Kathryn Cooper**  
Money Editor,  
The Sunday Times

Investors may be feeling the squeeze from rising taxes, but there is one bright spot amid the gloom: individual savings accounts (ISAs), the tax-sheltered savings schemes, are going from strength to strength.

The coalition government announced last month that it intends to launch a junior ISA for under-18s by autumn next year, helping parents who want to start saving for their children.

Moreover, the grown ups' ISA allowance – currently £10,200 – will be linked to inflation from April 2011, meaning the amount you can save tax free will rise every year rather than stay flat as it does now.

assuming the current allowance rises in line with inflation at 3.5% and the underlying investments grow by 5%.

The junior ISA will enable parents to give their children a head start in building up an ISA portfolio, which could be used to fund their university education or the deposit on their first home. Alternatively, their ISA portfolio could be rolled into a pension at a later date – subject to the annual contribution cap of £50,000 – and get an uplift from tax relief in the process.

The junior ISA will replace the child-trust fund (CTF), which will be scrapped from December 31 and in which parents and relatives could invest up to £1,200 a year.

The junior ISA may keep the same maximum contribution as the CTF, although it will not benefit from government contributions. These were £250 at the child's birth and on their seventh birthday (or £500 for children from low-income families). This contribution has already been cut to £50 for children born between August and December 31, when the trust fund will be abolished altogether.

The Treasury intends to backdate the new junior ISA to the beginning of 2011 to ensure any children not eligible for CTFs will benefit. About 5m children in Britain have had CTFs taken out in their names since they were launched in 2002.

Parents will be able to invest the junior ISA in either cash or shares, and any income and growth will be tax free. If parents saved outside an ISA for their children, any income above £100 would be taxed as their own, although capital



The benefits of starting to save early should not be underestimated – if you save regularly over your working life, you could be an ISA millionaire by the time you retire. An investor who saves the maximum into an ISA over the next 30 years could have an ISA portfolio worth £1,081,816 by the end of the period,

gains would be likely to fall within the child's own CGT allowance.

Children will not be able to access the account until the age of 18, and the industry would like to see the government offer a bonus to those who use funds built up in their junior ISA to cover tuition fees – although the Treasury may be reluctant to do so while the public finances remain under pressure.

Parents saving for their children, or anyone investing their own long-term savings, are encouraged to consider higher-risk sectors, such as UK smaller companies and emerging markets. While such sectors can be volatile over shorter periods, investing over a lifetime is likely to give superior returns.

If you had invested the maximum in ISAs and their predecessors, personal equity plans (Peps), since 1987, your total contributions would be £173,400. If your funds had performed in line with the market (as measured by the APCIMS growth index), your portfolio would be worth £421,774 today. However, if you had invested in a more racy portfolio, say returning 9.5% PA, it would now be worth nearly £550,000.

The decision to link the ISA allowance to inflation could also have a big impact on your returns. The limit will go up to £10,680 in April, the coalition has adopted a proposal that the limit should rise in line with inflation each year. The amount will be increased every April in line with the retail prices index (RPI) the previous September. Next April's rise is based on a figure of 4.6%.

If the allowance had stayed flat and you invested the maximum each year, you would have contributed £306,000



after 30 years. With an indexed allowance, the total amount saved would be £526,551, assuming an average inflation rate of 3.5%.

Another big benefit with ISAs is that you can draw a tax-sheltered income from your portfolio, whereas income from investments outside ISAs, and from pensions, is taxed.

Taking our fund of £1.082m after 30 years, a higher-rate taxpayer could draw an income of £43,273 from inside the ISA wrapper compared with only £37,263 outside, assuming they are invested in shares with a dividend yield of 4%.

Pensions are likely to remain the key vehicle for funding retirement because the tax relief on the way in will ultimately give you a bigger fund, but the flexibility of ISAs will only increase their attractions in these uncertain times.

## PUT YOUR TRUST IN DURABILITY



**John Newlands**  
Head of Investment  
Companies Research

As the global credit crunch was being played out a year or two ago I happened to be reading the Chairman's remarks of a certain Scottish investment trust. "Trust companies must expect a fall in revenue", Chairman David Murray argued, "but there is no reason for alarm about permanent capital values. These will come right again some day, and investment companies will be little the worse for an experience against which no provision could have insured them". That's about right, I thought to myself as I glanced at the latest grim headlines reporting a bout of market strife in Wall Street, Tokyo and London's Square Mile.

In fact I knew that Mr Murray was right, because he had made his comments not in the twenty-first century but at the 1915 Annual General Meeting of The Scottish Western Investment Company,

held in Glasgow during the darkest days of World War 1. Uncertainty and gloom abounded and the Chairman used his own experience to put market events into a longer-term context. That has to be a difficult thing to do while a crisis is actually happening but his call proved correct. I believe that his basic message remains as valid now as it was then. The use of quality investment trusts continues to offer a means of creating a store of long-term value, whatever disaster or headline of the moment might suggest otherwise.

Take 'Scottish Western' itself. The trust went on not just to survive both world wars but every crash and crisis along the way, from the 1930s Great Depression to the 1956 Suez crisis to the 'oil shocks' of 1973 and 1974. Moreover it is still going strong, under its present name of Murray International Trust, with total assets of approximately one billion pounds.

Contrast the sheer durability of investment trusts such as Murray International with the mixed fortunes of individual companies over the years. Who remembers those once-fashionable investments, Liebig's Extract of Meat, United Horse Shoe & Nail or the wonderfully evocative Incandescent Light Company, all listed on the London Stock Exchange in the closing years of the nineteenth century? Each had its glory days, however briefly, before the world and technology moved on.

The disappearance of well-known names is not confined to the distant past. In the modern era, we have witnessed the rise and fall of Marconi



*A 1920s railway poster showing the return of happier times after the Great War. Quality investment trusts have also proved capable of withstanding the worst crises in history and thriving again.*



*The Suez crisis of 1956.*

and British Energy as well, for example, as Freeserve, the share price of which climbed so stratospherically during the internet boom that the company roared from nowhere into the FTSE-100 Index in early 2000. Freeserve was struck from the Index the same October when its share price fell by more than 90% from its peak, admittedly after its founders had sold out to Wanadoo at vast personal gain.

This pattern of booms and bubbles is repeated over stockmarket history time and again. In 1999 the boom happened to be in technology and the internet. Yet noticeably similar patterns were followed in the nineteenth century 'railway mania', the 1909 rubber boom, the Wall Street surge and then crash of 1929 and on other occasions before and since.

The managers of diversified funds such as investment trusts, on the other hand, can maintain broad portfolios of holdings and constantly adjust them to meet not just the market conditions of the moment but the onset of new opportunities. These might include investments in mortgages to farmers along the Oregon Trail well over a century ago; or in new technologies, a current example being renewable energy sources such as wind turbines or high-efficiency solar panels.

In a classic personification of the tortoise and the hare, large 'generalist' investment trusts tend to chug along behind the scenes, taking up diversified exposure to a range of investments seen as offering value over the medium or longer term. In so doing they will typically only capture some of the upside of whatever happens to be the present vogue – but also avoid the eye-watering negative returns when sentiment reverses or a new trend emerges.

Trusts have another advantage – the ability to build up revenue reserves for a rainy day. This squirreling away of a few pence per share allows the smoothing out and indeed the progression of dividend payments even during the dark times. That is how cautiously-managed trusts such as City of London and the Alliance of Dundee have managed to increase their dividends for more than 40 years in a row. That really does count for something against an overall market backdrop of hail and bullets.

For all of the above reasons, I believe that 'pedigree' investment trusts have a durability that is rarely acknowledged yet which really counts for something when the chips are down.

# OUTLOOK FOR 2011 AND ASSET ALLOCATION



**Mike Lenhoff**  
Chief Strategist

With the year drawing to a close, investors are turning their attention on the prospects for 2011. The Federal Reserve has delivered on QE (quantitative easing), which it encouraged the markets to expect. Also, the outcome of last month's G20 meeting in Korea, almost a distant memory, is likely to be viewed more as 'work in progress' than anything else. What matters now is where the global economy is heading. The following sets out the general features we think will form part of the relevant investment backdrop for next year.

## Global economic recovery to continue

The major developed economies should maintain growth at this year's steady pace. But in contrast growth has been so impressively strong in the developing economies, that inflation is now rising. Central banks are therefore raising interest rates and exchange rates in some of the developing economies are coming under upwards pressure, as a result of the weakening dollar, and this combination is likely to produce a loss of momentum in economic growth for next year.

All this should help to reduce some commodities' price momentum. But bearing in mind the contribution made by the developing economies to global growth over the past year – it is estimated that some two-thirds of it has come from the developing world – this also means that the overall pace of growth for the world economy in 2011 will be a touch slower than in 2010.

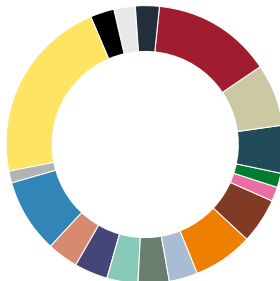
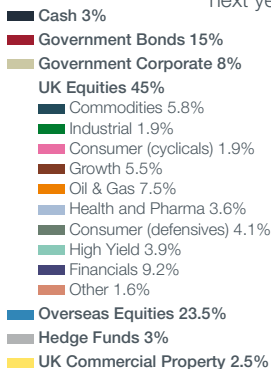
Although inflation should remain subdued in the major economies, the UK is the odd one out and inflation here will remain above the Bank of England's 2 percent target for most, if not all, of next year. Core inflation for the US economy is on a downward trend and heading for zero, so part of the intention behind the Fed's QE program is to raise inflation expectations.

## Outlook for bond yields.

Reflation throughout the global economy is underway, though this is less apparent in the developed economies. The ultimate aim of QE is to create jobs, to bring down the unemployment rate and to stabilize inflation. We expect that the US Treasury market will soon believe that the Fed will succeed in this and that yields will rise over the course of the year. Indeed, they are rising already on longer maturity bonds. Ordinarily, rising yields in the bond markets would not be taken lightly by equity markets but global reflation is good for corporate profitability.

## Corporate earnings recovery

Corporate earnings recovery has also been unusually strong, so some slowdown in the pace is expected, but importantly, reflation also means that



sales should contribute a little more to the bottom line next year than this year.

### Equity market values

Momentum has swung decisively in favour of equity markets – owing, among other things, to extraordinarily low bond yields. Thus, provided the adjustment in bond markets, and particularly the US Treasury market, is relatively modest – a view consistent with the expectation of modest inflation – then equity markets should retain their recent gains.

Given this relatively positive outlook, it is just as well to remember that recoveries from financial crises are seldom easy or without their difficulties. One such bogey is the eurozone's sovereign debt crisis and another, last summer, was the sudden loss of momentum in the major economies recovery. It was this that led to the expectation of further monetary stimulus in the US and to the markets' preoccupation with QE.

Financial difficulties associated with the eurozone's sovereign debt crisis are re-surfacing and bond yields have shot upwards for peripheral eurozone economies, notably Greece, Ireland and Portugal. While there has been little contagion so far – equity markets have been unfazed – the risk of upheaval remains.

Other risks abound, such as protectionism. Capital controls have been introduced in Brazil and throughout emerging Asia in response to hot money

flows and while a few of America's trading partners point the finger at US monetary policy, the imposition of such controls is protectionist with potentially undesirable consequences if extended further.

So what does the outlook, with its attendant risks, mean for asset allocation?

When the Committee met at the start of November, just ahead of the Federal Reserve's announcement on QE, much time was devoted to where this stimulus program might lead and how markets might react.

Our market prediction for the end of this year was 5500 for the FTSE 100 and I am hopeful that the index will move above 6000 in 2011 to reach somewhere between 6200 to 6400 by the end of the year.

With so much uncertainty the Committee felt it best to sit tight with the recommendations adopted in October when it was judged that the fundamentals, looking ahead over next 12-months, were supportive enough to

warrant raising the weighting for equity markets. The Committee also took the view that policymakers are determined to ensure that the recovery is sustained and that, until the central banks are convinced this is underpinned, it is most unlikely that interest rates would be raised in the US, Europe, the UK or Japan.

Our view on the outlook not only suggests that a sustainable recovery lies ahead and but also that equities are favoured to bonds.

Our market prediction for the end of this year was 5500 for the FTSE 100 and I am hopeful that the index will move above 6000 in 2011 to reach somewhere between 6200 to 6400 by the end of the year.



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## FEES FOR FUNDS IN THE SPOTLIGHT



**Matthew Butcher**  
Head of Research

There has been much debate recently over both the nature and the extent of fees charged by fund managers for access to their funds. Not only can they be significant in absolute terms, but they can also be applied at every stage of a client's investment experience; an initial charge, an annual management, plus sometimes a performance fee and then an exit charge to crown it all.

All this adds up to a sense of distrust in the industry and, quite rightly, the topic now commands many more column inches than prior to the global financial crisis. It is also likely as a result of this increased attention, that third party costs will merit greater consideration in investors decision making as it certainly does in ours.

Whilst welcome comments from Terry Smith, chief executive of Tullet Prebon and now Fundsmith, can only help in driving overall fee levels down; I will now, gently propose an argument that some of these fees are justifiable if applied appropriately.

Regarding initial charges, Brewin Dolphin have long been able to avoid paying any such entry cost. Depending on the size of the underlying investment, however, annual management charges are likely to be applied at either an institutional or retail rate. We are naturally keen for both of these figures to come down as much as possible but, in broad terms, prices seem pretty stable at 1% and 1.5% respectively, for a typical equity fund.

Total Expense Ratios (TERs) are a measure of the total cost of investing in a fund (including management fees, dealing costs and other disbursements) and are a valid point of reference within a fund selection process. However, we

must not conclude too much from this lone figure. A high TER may be a result of excessive and unnecessary trading within a fund, earning commissions for undeserving brokers; it could however, be a result of dynamic portfolio hedging and risk management. TER is also a backward-looking measure and, given the level of volatility the market has experienced, should drop in a more benign environment. All else being equal, however, lower TERs do indicate a prudent management style.

What is of genuine concern to the Brewin Dolphin research team though, is the application of 'inappropriate' performance fees. So when are performance fees appropriate and when are they not?

Since the global credit crisis began, many hedge funds have struggled both in terms of performance and at retaining assets. This has two distinct negatives; first there are fewer assets upon which to charge a fee, and second the fund's performance is likely to be a long way below the level required before it can resume charging the performance fee.

With increased interest from the retail world for lower volatility products, hedge funds (as well as long only asset managers) spotted a commercial opportunity to launch products which are designed for private investors.

Whilst some of these fund launches have been welcome, some have come with performance fees attached, that do not align management and investors interests.



*Take risks for performance.*

Giving us particular unease are those funds that charge a performance fee for returns above the cash rate (or, even worse, on any absolute gain) when the fund has an ashamedly 'long' bias. Such funds are able to command a performance fee (sometimes as much as 20%) in addition to an annual management fee, if the market simply goes up and, therefore, are likely to be biased towards being invested rather than not. These funds carry real risk of experiencing a significant capital loss, yet they command a fee worthy only of an 'absolute return' manager. In technical terms this is known as charging a fee on beta i.e. where the market is doing the work and manager is reaping the reward.

We have also experienced fund managers who reset their performance fee benchmarks annually. A high water mark is a level which a fund must return above before it can again command a performance fee. With this annual hurdle removed, management is incentivised to assume risk in all market conditions.

The performance fee we may be more comfortable paying, however, is when a manager truly delivers some degree of out-performance through skill rather than through a structural long bias. Long-only managers who charge for performance above an appropriate benchmark align investor and manager interests. For example, when we allocate capital to Asian equities, our chosen manager will only charge a fee if they do the job that we have asked of them i.e. they outperform the Asian equity benchmark. In this circumstance, while a client may pay more in fees, the net returns are beyond that of a passive investor (who is charged a lower fee). In this situation a manager is charging a fee on alpha (skill) not beta and what we always look for.

## THINGS TO CONSIDER BEFORE APRIL 2011



**Richard Harwood**  
Director, Financial  
Planning and  
Pensions

The Office of Tax Simplification (OTS) was established by Chancellor George Osborne earlier this year to review the myriad of tax reliefs available. Over 1,000 reliefs have been identified and we do not yet know where the axe will fall, but there must be a virtue in making best use of the various investment related tax concessions, while they are certainly still available.

Tax relief is used by the Government to encourage investment into areas which might not otherwise be so attractive. The tax advantages should be considered, but do remember that tax should not be the sole determining

factor for any investment. The overall net benefit to any investor will derive from the combination of investment performance and the tax treatment. It is the net return which is important after all the risks are evaluated.

Pension saving is the principal and most obvious area of investment attracting tax relief and there have already been proposals announced modifying the level of relief available which are set to come into force from April 2011. Some of the other investments which are high risk are outlined below:

### Venture Capital Trusts (VCT)

VCTs were established to attract investment into certain small businesses and start-ups. There are some limitations to the nature of the underlying assets but they can still range from SMEs (small and medium size enterprises) and AIM listed companies to property based investments and investments in renewable energy businesses, which benefit from Government feeder tariffs.

#### VCT parameters are:

- Maximum annual contribution £200,000.
- 30% Income Tax relief on investment (assuming it is held for over 5 years).
- Dividends free of Income Tax
- No Capital Gains Tax on growth on the investment.

Higher rate tax payers looking for an investment for a period of over 5 years could benefit significantly from the initial tax relief, and longer term investors requiring income will find the tax free dividends prove very attractive, though dividends do not always flow freely from SMEs, particularly in the early years.



## Enterprise Investment Schemes (EIS)

EIS companies target slightly different investment objectives to VCTs but are still designed to encourage investment into small and young businesses. Again, many derivations of EISs have sprung up over recent years allowing schemes which invest into property, media and, in one case, even the trading of fine wines.

### EIS characteristics are:

- Maximum contribution £500,000.
- 20% Income Tax relief on investment (must be held for over 3 years).
- Ability to roll over capital gains arising in the previous 3 years.
- The investment usually qualifies for Business Property Relief which provides protection from Inheritance Tax after 2 years.

A higher rate tax payer willing to invest over 3 years may benefit significantly from the initial tax relief. Those holding such EIS investments until death may avoid both Capital Gains Tax and Inheritance Tax.

## Enterprise Zone Syndicates (EZS)

Enterprise Zones were first designated by the Government in the early 1980s to encourage regeneration in specific areas of the country. An EZS is a structure which purchases property through a syndicate. Such investments allow gearing and as such are not suitable for all investors. When an investment is made in an EZS syndicate tax relief is available at the member's highest rate of tax. The syndicates then borrow sufficiently to reduce the actual cost to the investor to the equivalent of their tax relief. To retain the benefit of the tax relief the investments must be held for 7 years. After which the underlying property can be sold, giving a return to the investor providing the sale price exceeds the value of the original loan (plus any costs and interest). Income Tax and Capital Gains Tax do apply to any income or capital returns from the investment.

Tax relief on an investment into an Enterprise Zone will cease at the end of the 2010/2011 tax year. Consequently the capacity within any remaining schemes is limited, but we feel they do illustrate the various opportunities to gain tax relief.

Given the range of underlying assets available via the various schemes, it is often possible to find investments which fit with an investor's requirements and also provide tax efficient benefits. However, it is vital to bear in mind all of the factors concerned and unwise for such investments to form more than a minority of an individual's overall investment portfolio. We are aware of the demise of Enterprise Zones and the future regulations concerning pensions which have been announced, however, we expect the Treasury to continue to restrict tax relief over the forthcoming few years. In such a climate it is important that any investor considers the options available and seeks to make best use of any tax reliefs, if these can be obtained without adding unpalatable risk to their overall portfolio.



## VIEWS ON ASIA



**Harry Burnham**  
Director, Investment  
Management

I attended an industry conference in Hong Kong during September and from the moment I arrived was hit by the sheer scale of industry. The port of Hong Kong has to be seen to be believed with queues of ships waiting to unload and stacks of containers as far as the eye could see.

Overall, the fund managers we saw were very positive for the region and whilst you might expect this, the scale and extent of the numbers is compelling. One of the reasons is that Asia has so little debt stems from the Asian crisis of 1998. Asian banks took at least six years to restore balance sheets with the banks reluctant to lend money, which

might give us some indication of what is happening in the West. Meanwhile infrastructure spend over the next 10 years is expected to be \$8tn with upward revisions.

### CHINA

My colleague Nik Stanojevic has written extensively about China on page 2 so just a few observations may be worth adding. Whilst the one child policy actually only applies to less than 50% of China, this does affect the way the Chinese think and has been a hindrance on retail consumer spending. People save aggressively for their retirement as they cannot rely on their children to look after them - by 2030 50% of the Chinese population will be elderly or children. Also worth noting is that China now produces more cars than the United States and crude oil consumption this year will be 2.25bn tonnes, compared to the USA's 2.1bn. Surprisingly China is also taking notice of the environment and substantial sums being invested in renewables and alternative sources of power.

### TAIWAN

In the rest of the region Taiwan is expected to bounce back rapidly. Between 2000 and 2008 the government pursued an independence policy and with a change of government to the KMT there have been improved relations with mainland China, with direct flights and shipping between the two. Many believe that Taiwan will ultimately fall into China.

The leisure sector in Macau now dwarfs Las Vegas and Singapore and is going through a similar growth model while in the luxury retail sector, brands such as Louis Vuitton see about 25% of their sales in Asian markets. There is also



growth in the private healthcare and life assurance market as disposal income increases. Asian industrial production is still 20% above pre-crisis levels with the nearest comparable of Latin America, which is flat.

## INDIA

The area which attracted the most interest and confidence was India, with growth of around 8.5% and similar numbers forecast. Inflation is expected to fall to around 6% and this net growth should underpin the stock market. However, there have been a number of false dawns in India and it was, perhaps unkindly, described by one fund manager as 'rather like the drunk who eventually gets home'.

India is developing service industries and pharmaceuticals rather than concentrating on manufacturing and the Indian stock market now has a value of \$1.4tn with a population of around

1.2bn. Domestic consumption is high with exports less than 20% of GDP. **It was commented that in some ways democracy has held back India, in that if China wanted to build a new city, it just moved people out the way; but never forget that capitalism thrives on freedom.** Corruption is of course a continuing problem along with national security and far more infrastructure spend is needed. 60% of the Indian population is less than 30 years old and the job creation market has to keep pace. The brain drain which affected India is reversing as graduates return and we have seen large international assets such as Corus and Land Rover acquired by Indian companies.

Overall whilst we believe that China's property market is dangerously high, the rest of the region gives very positive signals. A combination of above average growth coupled with low debt, mean that Asia will continue to outpace the West.

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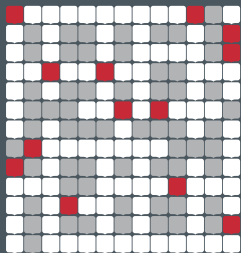
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### COMPETITION



Rearrange the red letters to spell the missing words.

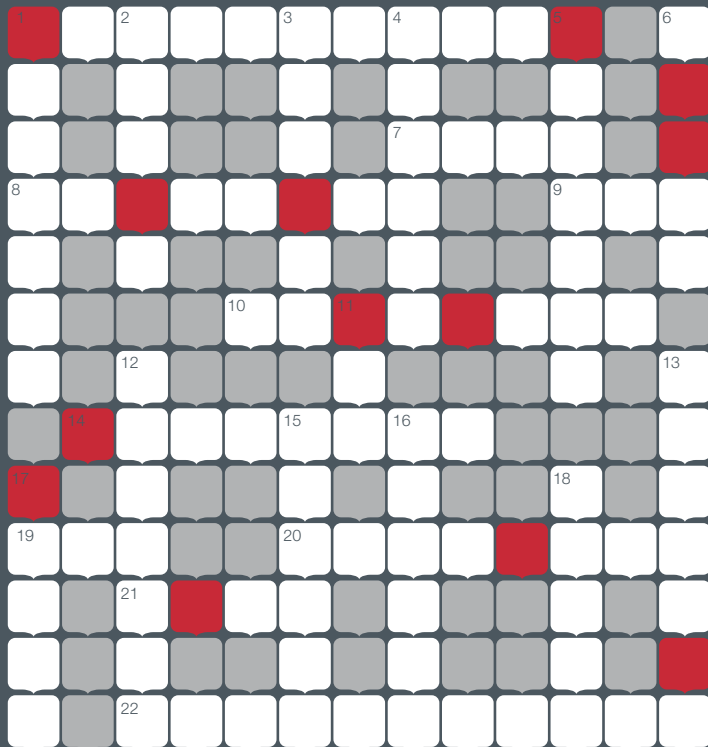


The first five correct entries sent to: [crossword@brewin.co.uk](mailto:crossword@brewin.co.uk) or posted to **Crossword, Brewin Dolphin, 12 Smithfield Street, London, EC1A 9BD** before Monday 13th December will receive a Fortnum & Mason hamper.



The answer to the missing word in the Autumn Edition of Perspective was **ENGINEERS**

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### CLUES ACROSS

- 1 Money holdings (11)
- 7 Metric unit (4)
- 8 Stock \_\_\_\_: place where securities are bought & sold (8)
- 9 Business flat rate tax (abbrev.) (1,1,1)
- 10 Person who sells goods (8)
- 14 Acquiring control of a corporation (8)
- 19 Law enforcement agency (1,1,1)
- 20 Eg Speed and Mercator were this (8)
- 21 Yugoslavian dictator (4)
- 22 Selling all a firm's assets (11)

### CLUES DOWN

- 1 Eg FTSE and DOW (7)
- 2 \_\_\_\_ Da Gama: explorer (5)
- 3 Top French tennis player (6)
- 4 \_\_\_\_ Onegin: novel by Alexander Pushkin (6)
- 5 Japanese warriors (7)
- 6 Canary \_\_\_\_: financial area (5)
- 11 Basic monetary unit in Bulgaria (3)
- 12 Money one has invested (7)
- 13 Company's net debt against its equity capital (7)
- 15 Article made of gilded bronze (6)
- 16 Become larger (6)
- 17 \_\_\_\_ price: price at which a broker is willing to sell (5)
- 18 African mammal related to the giraffe (5)