for financial advisers only

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a guiding star

With some proclaiming the cult of the 'star fund manager' to be in decline, one manager with a record worthy of the title has recently returned to retail fund management.

William Littlewood returns to the Skandia platforms this month with the Artemis Strategic Assets Fund. Here, he offers his own stark view of the current economic situation and how investors should react.

Based on the belief that the end of the recession, rather than the end of the world, is now in sight, shares have had a good rally in the last couple of months. Meanwhile, most investors still agree that this recession is an unusually deep one. Even so, if this were a conventional recession then there would be a powerful case to suggest that shares will rally further, and that the bear market is over. Is that right?

I believe this recession is not ordinary; rather it's one caused by an enormous credit bubble followed by a bank bust. This type is rare – and much more damaging. In a 'normal' recession, economic growth declines, the central banks cut interest rates – and after a while, growth returns. Bank bust recessions are characterised by monetary policy that is ineffective and by consumers, companies and banks all trying to reduce their levels of debt. This is what we have observed so far.

comparisons with the 1930s

The magnitude and geographic breadth of the credit bubble that preceded this downturn was colossal. So it is no surprise that gloomy commentators compare what we are going through now to the 1930s. Some of the recent economic data suggests that we are on a similar trajectory to the 1930s. For example, commodity prices fell faster in 2008 then they did in the 1930s, the de-stocking we saw at the end of 2008 was probably more vicious then the 1930s, and the trade figures coming out of Asia showing year-on-year falls of nearly 50% are extraordinary. Furthermore, the banking system has so far performed every bit as badly as it did in the 1930s.

In stark contrast to the 1930s, government intervention has been extensive, global and co-ordinated. Governments have employed Keynesian remedies: deficit financing and slashing interest rates. That wasn't enough, and so more recently governments have resorted to printing money via 'quantitative easing'. Western policy-makers, led by the chairman of the US Federal Reserve, have taken the view that the heavily indebted western economies cannot stomach deflation of any form. So it looks like both politicians and central bankers will do everything in their power to avoid debt deflation.

state intervention

These policies should be enough to prevent a 1930s depression. But they come at a cost. Politically the world is sliding leftwards, responding to the fact that laissez-faire economics has failed, and we can expect more state intervention and further regulation. The result? Lower price/earnings (p/e) ratios for companies.

> "In these volatile times, investors have to be nimble and move quickly between different asset classes. That is precisely what this Fund will do: seek out profits, wherever they're to be found."

William Littlewood worked at Jupiter Asset Management from 1989 to 2000, where he managed £1.6 billion in top-performing assets.* In December 2005 he joined Artemis to run the Artemis Absolute Return Hedge Fund. In managing this new Fund, William will add the resources and expertise of Artemis' and 16 other fund managers to his own extensive experience of multi-asset investing.

Artemis Strategic Assets

Making the most of the legislation on collective investment funds, the Artemis Strategic Assets Fund exploits the best characteristics of both unit trusts and hedge funds. As and when they are appropriate, William uses Exchange Traded Funds, derivatives, short-selling and other financial instruments in search of superior returns.

*Source: Lipper, 3,288 days from 30 November 1990- 1 December 1999.

I don't believe that states allocate resources efficiently, and as they get more involved, private capital will be less inclined to invest. Government deficits are rising and these will have to be paid for, the usual payment being both higher inflation and higher taxes. Inflation seems the inevitable conclusion to governments throwing enormous amounts of money at the recession. And given the long lags of monetary policy and the uncertainty caused by printing money, it would seem unlikely that central bankers will be able to create a world where inflation is just right. More likely is a return one day to worryingly high levels of inflation.

The UK has been leading the world in deficit financing and is in an unenviably poor situation. From 2003 to 2007, certain politicians thought this was a new era of stability which they had created. The enormous tax revenues enabled them to plan for massive increases in public expenditure so that now we have a situation where for every £3 the government receives in taxes, it spends over £4.

Since 1997 nearly a million extra people have been added to the state workforce with salaries which now average more than the private sector. Furthermore many of these jobs come with enormous pension pots which are contractual and unfunded. Indeed the total unfunded liability of public sector workers is estimated to be around one trillion pounds, a figure which realistically can never be paid.

defensive outlook

So how should investors react? If I am right in saying this is not an ordinary recession, then investors in the short run need to be careful about equities, particularly cyclical ones. Defensive shares on low p/e ratios with earnings which have held up well in this recession look much more attractive.

Unfortunately, and as with all investments, timing is difficult. While we stay in deflationary times shares are likely to disappoint. But if you assume that policy-makers will do everything in their power to eradicate deflation, then eventually rising inflation will force investors away from gilts and cash and into real assets. Then you will want to be in good equities.

As a defence against debased currency, protectionism and money printing, investors would be wise to consider gold. And lastly, given the appalling state of the UK finances, investors should not have all of their assets in tarnished sterling.

The Artemis Strategic Assets Fund is available through Skandia's Life and Pensions fund ranges and Selestia Investment Solutions platform.

The Skandia fund will not mirror the performance of the underlying fund because of Skandia fund charges, taxation adjustments (if appropriate) and the Skandia investment process.