



# PROSPECTS

FEBRUARY 2008

**BROWN SHIPLEY**  
Private Banking

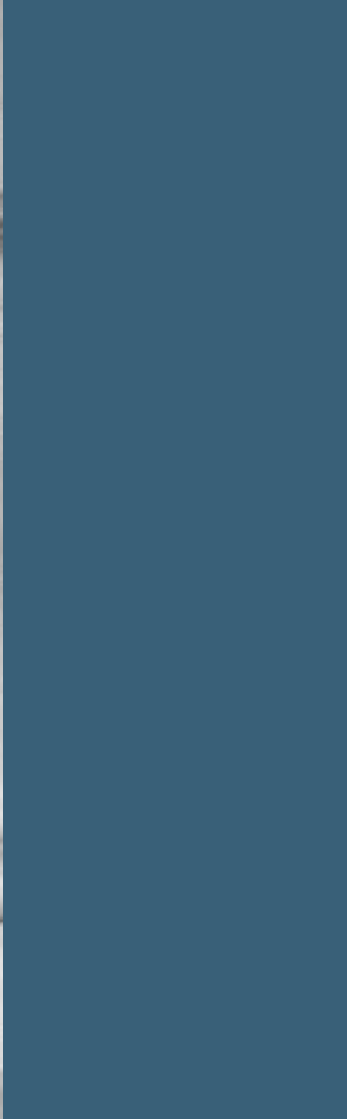
## A wealth of knowledge

**Brown Shipley stands for trust.** Our clients have confidence in us because we are committed to looking after their wealth, whatever the ups and downs of the economy and the turbulence of the markets.

In this first edition of *Prospects* we asked five of our own experts to give you a taste of their views on 2008 and beyond.

We hope you find what they have to say interesting.

If you have any questions about what you read, please don't hesitate to contact us. We're always ready to talk.



# Ian Sackfield

Head of Private Banking



“A risk-averse philosophy underpins the relationship of trust we have with every one of our clients.”

- Brown Shipley – part of KBL European Private Bankers
- Parent KBC – Belgium’s fifth largest company. Operates throughout Europe
  - Market capitalisation: €36 billion
  - Staff: 51,000
  - Customers: 11 million
  - Assets under management: €209 billion

(As at 31/12/06)

# Blue chip banking

**Banks provide gearing to the economy just as they do to the individual. But their ability to do so depends entirely on the strength of their balance sheet.**

Ever since the first signs of mould began to appear within the US sub-prime mortgage markets, a liquidity crisis within the banking sector was on its way.

Given that the strong economic growth of the past 5 years has been fuelled by significant increases in borrowing, it is clear that, in the short term at least, if banks can't or won't be lending so freely, economic growth is bound to suffer.

The banking sector is integral to the fabric that binds the whole economy together.

It is an old adage that "bad loans are written in good times". Having witnessed a period of protracted growth and strong increases in asset prices, there's no doubt there'll be more write-offs to come, though more likely via less exotic channels such as increased defaults from companies and customers with home loans and credit cards.

The willingness of sovereign wealth funds to keep fixing the gears, and so postpone the inevitable hang-over, remains to be seen. Indeed their willingness may serve only to make the problem worse next time it rears its head.

Brown Shipley is fortunate to have zero exposure to the problems that have beset many other banks, large and small, national and international. Our balance sheet is as strong as ever, and our connection with KBC, one of Europe's biggest banking groups, means we have a parent whose own balance sheet will provide significant comfort to many clients.

Our risk-averse philosophy underpins all our private banking and investment management services.

# Kevin Doran

Chief Investment Officer



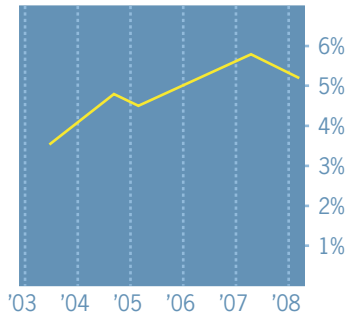
“Central Banks will keep jabbing the accelerator until the gear box engages and the economy roars back into life.”

- Interest rates on their way down
- Limited ability of Central Banks to affect the ‘real’ economy
- Full scale of banking ‘write-offs’ and ‘bad debts’ still not known
- Sovereign Wealth Funds provide welcome first aid and help banks replenish capital

# Economy falters

Interest rates are on their way down. But will this be enough to revive economic growth?

Movements in the UK Base Rate



Source: Bank of England from 10/7/2003 to 7/2/2008

In a healthy banking market, declines in the Central Bank Rate quickly translate into increased demand for loans, which in turn acts as a boost to consumption and economic growth.

But here's the rub. For this system to work the reductions in the Central Bank Rate (which can be thought of as the engine of the economy) must be transmitted to the "real" economy via a healthy banking system (which can be thought of as the gearbox). And at the moment, the gearbox is in tatters.

Normally a bank will run a loan book 20-25 times its equity capital base. When times are good, this gearing effect has a large impact on the economy since £1bn of retained profits can be used to fund £20bn-£25bn of new loans. But the reverse also holds true; £1bn of losses destroys the capacity to make £20bn-£25bn of

new loans to customers – and this is what is happening at the moment.

For their part, the Central Banks are "rewinding" the engine by cutting interest rates. But until the gearbox is fixed, their ability to affect the real economy is limited.

Many US and European banks have been able to raise significant new capital via sovereign wealth funds and thereby re-established much of the lending capacity they had written off. But whether they will be willing to lend against their replenished balance sheets remains to be seen.

In the meantime Central Banks around the world will have to keep jabbing the accelerator until the gearbox engages and the economy roars back into life.

# John Smith

Senior Fund Manager



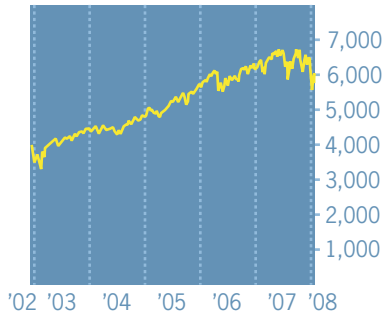
“Major equity markets took fright in 2007 at almost the same levels as the last bull market peak in 1999-2000.”

- Four years of strong rises in equities ended in 2007
- 2008 started with continuing deterioration in sentiment
- Full extent of banking write-downs still not known
- Conditions not the same as last bear market

# Best buys after a fall?

**Equity markets took a big hit in January 2008. Are conditions the same as the last bear market eight years ago? If so, will it be as bad as last time?**

Movements in the FTSE 100 Index



Source: Bloomberg. Capital return from 31/12/2002 to 11/02/2008

It took four years for equities to completely recover from the 2000-2003 decline. By 2007 they were back to the levels last seen at the peak of the 1999-2000 bull market. All the talk is now of a US recession with worldwide consequences and continuing worries about the health of the banking sector. Yes, it's a bear market. But no, we don't expect it to be as bad as last time.

In 2000-2002 the bear market was caused primarily by excessively high valuations, particularly in the Technology, Media and Telecommunications (TMT) sectors. By contrast, at the present time valuations appear reasonable. Eight years ago, so called 'growth' stocks also traded on unrealistic valuations. GlaxoSmithKline, for instance, was on a price earnings ratio of around 35x; today its rating is a third of that.

2008 is likely to be a year where concerns about growth cause some setbacks. The Resources sectors (oils and mining) for example have been a sizeable beneficiary of China and India's economic boom, but whatever happens in the short term, long term growth prospects remain. The Banking sector will also have an important influence and the reporting season due soon will enable us to judge the full extent of the write-offs and write-downs.

When sentiment is bad and markets have been falling it is often difficult to think about the next upturn. Markets anticipate events up to a year ahead so later this year we should witness many opportunities to buy equities in key sectors where the fundamentals are good. Investors should remember the best buying opportunities can come after significant falls.

# Clive Garnett

Private Client Director



“Getting the best tax result means choosing the right wrapper in which your investments are held.”

- Higher rate tax threshold has not kept pace with earnings growth
- New rate for CGT from April 2008
- Multiple strategy now required to minimise tax liabilities

# Capital Gains and Inheritance Tax

**Significant changes to tax rules mean you can never afford to be complacent. The certainty of taxes makes regular reviews essential.**

## Capital Taxes

It has always been important to structure your investments to get the best tax result. But this doesn't simply mean where you make your investments. It also means choosing the right 'wrapper' in which the investments are held. For example, are you investing for capital growth or a combination of income and growth? What are the tax consequences? And how do you want to be treated? Are you resident or non-resident for tax purposes? All of these factors influence what you'll end up with as the net return from your investment strategy. These issues are especially important for investors who want real control of their investments and not off-the-shelf plans.

## Inheritance Tax

Similar considerations apply to Inheritance Tax, where the changes to Trusts introduced from 6 April 2008 appear to

have restricted choice. However, once again ideas are appearing on the market that can be structured to meet a family's needs. One example might be the holding of assets for young children, which are transferred as a Potentially Exempt Transfer (PET) and therefore have no upper limit, but which are not available to them as a matter of course at age 18.

Many other structures are equally interesting in the new environment, where the amounts that can and cannot be transferred free of IHT other than to individuals appear limited. Now that the nil rate band is transferable between spouses and civil partners, the effective nil rate band has doubled to £600,000; this calls into question the value of nil rate band trusts. But there are many circumstances in which these can be extremely valuable in sheltering assets. Get professional advice before you change anything.

# Julie Sebastianelli

Private Client Director



“Avoid knee-jerk responses to short term volatility.”

- Contributions limit up to £235,000 from April 2008
- Basic rate tax down to 20%
- Annuity rates falling
- Lower bonus rates on with-profit policies
- Longer notice periods for encashment of property funds

# In for the long term

**Pensions are as tax efficient as ever. So what's changed?**

In times of uncertainty it makes sense to look at your investments. But avoid knee jerk responses to short term volatility. If your objectives haven't changed and your time horizon is long, there should be no need to change course.

The tax breaks are still a big plus. This means anyone in the 'growth' phase of pension funding shouldn't be tempted to delay contributions, or to avoid investment decisions. Market timing is impossible to call, and just as sharp falls happen over short periods, so too do sharp rises – it is too easy to miss out on gains by trying to avoid losses! Phase your investments.

With falling interest rates and inflationary pressures, there is no completely safe haven with good returns. So it makes sense to review your overall strategy.

Taking high income withdrawals may deplete the fund, so reducing or deferring

income could be sensible. If you are nearing age 75 though, or have other wealth you may be less concerned.

With gilt yields falling, the February GAD rate for calculating withdrawals has reduced by 0.5% to 4.25%, the lowest since December 2006. Annuity rates too are lower, so deferring annuity purchase may be wise.

Cooling markets bring other changes. Property fund managers in particular are introducing longer notice periods or penalties on encashment, to protect existing investors. Providers of with-profit funds will also review bonus policy. Expect lower final bonuses and higher Market Value Adjustments. So a review of all holdings at this time could be worthwhile.



# Private Client Services

**Brown Shipley** combines almost 200 years of pedigree with a contemporary vision.

As part of one of Europe's most regarded Private Banking networks, our wealth of knowledge can provide you with a uniquely personal banking relationship.

The opportunities together could be considerable.

## **Investment Management**

- Discretionary & Advisory services
- Global Equities
- ISAs
- Nominee service
- Probate
- Structured products
- Alternative Assets
- Fund management through Solus
- Collective Investment Schemes

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- SIPP's
- Trustee services

## **Banking**

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- Specialist lending
- VISA card

## **Estate & Financial Planning**

- Inheritance Tax and Estate Planning
- Wills and Trust
- Tax efficient investment structures
- Onshore/offshore solutions
- AIM Portfolio
- Life assurance and protection

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