►On Target

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Investing in Equities for Income

The fear pervading investment markets has heightened interest in high-yield stocks. There is much historical evidence that the shares of companies that pay good, stable dividends carry less risk and even deliver better long-term total returns than those focused on capital growth.

However, the most obvious attraction of "equity income" is to those investors who need secure income flows to support their lifestyle, and find the alternatives unattractive.

Bank deposits offer derisory rates of interest. Bonds offer such low yields that in some cases, after adjusting for inflation, they are negative in real terms. Structured products based on derivatives often carry levels of risk beyond the comfort zone of conservative investors.

A well-chosen portfolio of dividend-paying shares, or a fund owning such a portfolio, however, offers:

► Initial rates of income return averaging about 3½ per cent;

► Income that is likely to grow, and do so faster than inflation;

► With low levels of risk.

There are dozens of companies that are categorized as "dividend aristocrats" because they have a history of more than 25 years of consecutive dividend increases.

Dividend yields on many equities beat those of the corporate bonds issued by the same companies, offering both high return and the possibility of future capital growth.

Investors would be wise to plan on the assumption that the world's economic growth is going to remain subdued for a long, long time, as the dynamic impact of continuing expansion in Asian and other growth economies is offset by sluggishness in the still-much-larger group of debt-burdened mature economies.

That sluggishness will keep central banks under pressure to persist with money-printing policies that keep official interest rates down to derisory levels.

If you are an investor with a need for a secure income flow, don't assume that yields are going to improve for a long, long time.

Japan offers a paradigm that the world's other mature economies seem to be following… with chilling implications. A "double bust" of collapsing bubbles in property and banking. Hugely-expensive stimulus programmes paid for by

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exploding government debt. Money-printing on an unbelievable scale.

Although it isn't true to say that these policies were a failure in Japan – they did prevent a depression – they were ineffective in producing sustainable economic growth greater than a bare-bones minimum averaging around 1 per cent.

The yield on ten-year Japanese government bonds fell from 5.4 per cent at the end of 199l to 1.35 per cent at the end of 2001 and have declined even more, to about 1 per cent now.

If the other mature economies pursue the same policies as those already tried in Japan, as is happening, it seems just about certain that their investors face the same prospect of very low interest rates for a long, long time.

One of the interesting developments in investment markets is that corporate bonds and credit-risk instruments now often trade at lower rates than those of even the lowest-risk government bonds. In other words, investors rate credit risk in the private sector as less than sovereign risk in the public sector.

If this is true of corporate bonds, it suggests that the risk in the soundest dividend-paying stocks is also lower. Buying McDonald's shares is lower-risk than US Treasuries – as well as paying higher income.

But what about the risk that such companies will be unable to keep paying dividends at current levels because of a collapse in their earnings, and/or boards decide that they have to hoard cash by suspending/reducing dividends to pay down their debt?

In the Great Depression US dividends did fall by 47 per cent from peak to trough in real terms. However, they did better than corporate earnings, which fell by 67 per cent, and share values, as measured by the S&P Composite Index, which fell by 81 per cent (both in real terms).

Moreover, that was the shorter-term risk, over the period from peak to trough. Over longer periods, dividends have done much better.

In the UK in the worst year of the past half-century, 1998, the Barclays Capital equity income index fell 14 per cent, but it took less than seven years to regain its previous peak. In the US the equivalent index plummeted 47 per cent at the start of the new millennium, yet it took only three years for dividend flows to recover to their previous peak and go higher.

Economies with built-in stabilizers

It can also be argued that the period we are now experiencing – what has been dubbed the Great Recession – has been and will continue to be very different. Compared to the Thirties, governments now command much greater shares of their economies and they pursue policies which, notwithstanding their defects, are much more aggressive and effective in preventing catastrophe.

Over the past five years, encompassing the equity-market collapse of 2008 triggered by the bursting of the credit bubble, since the peak in October 2007 and using the S&P 500 index at a measure, US shares have lost 26 per cent of their value – but their historic dividend flow has been trimmed back just 1 per cent.

Because of a combination of factors such as aggressive restructuring to cut costs, greater outsourcing from abroad, and availability of very cheap credit because of

money-creation policies, companies have been able to strengthen their balance sheets considerably, so they face the prospect of tougher economic conditions in much better shape.

The better ones have even been able to improve their dividend yields. When I analyzed a range of most of the Dividend Aristocrats I found they were able to raise their dividends by an average of almost 14 per cent a year over the past five... without any general deterioration in their cover because of better earnings.

Such strong dividend-payers are able, not only to sustain their payments, but also to deliver growth in the fundamentals behind them. Companies such as Royal Dutch Shell, which borrowed money at one stage to sustain its dividends, have been exceptions.

All this supports the idea that good dividend-payers are going to contain the downside, and even continue growing their payments, if as I suspect we are going to experience an extended period of difficulty in the world economy.

In any case, conditions aren't going to be the same everywhere. The near-certainty is that it will be a two-speed world, with the growth economies continuing to move ahead much faster than the sclerotic mature ones, offering investment opportunities in both the companies of the growth economies and in multinationals geared to those markets.

Dividends grow faster than inflation

High-yield is a measure, not only of good sustainable income flow, but also of capacity to protect the purchasing power of that income against inflation, and to deliver long-term capital growth in your investment.

Over the years 1970 to 2008 – a period that included the savage equity market of the 1970s – dividend growth beat inflation by an average of 1.2 percentage points across the five biggest stock markets (the US, Japan, Britain, Germany and France).

As long ago as the 1930s the "father" of modern securities analysis, Benjamin Graham, claimed that dividends are "responsible for nearly all the gains ultimately realized by investors," and said that "for the vast majority of stocks, the dividend record and prospects have always been the most important factor controlling investment quality and value."

That has continued to be true over the 80-odd years since.

According to figures in Barclays Capital's latest Equity Gilt Study, reinvested dividends accounted for three-quarters of the real growth in UK equity over the period 1945 to 2010.

Of course, the contribution of dividends to total return is only true if the earnings payouts are reinvested, which doesn't happen where the investor seeks income. But if total return depends so largely on dividends, it's clear how companies paying no or below-average dividends have to deliver very strong capital growth to offset that disadvantage to deliver good long-term total return.

Even if their profits fall, companies are reluctant to cut dividends, as doing so puts their share prices under pressure and reduces management power and prestige.

Investors give great weight to dividends as a measure of the soundness and strength of a company, as they constitute a "real" figure – cash being paid out – and therefore cannot be manipulated by management to give a falsely favourable picture.

For reasons already explained, equity income is becoming a fashion du jour and new funds are being launched to supply investors' growing interest. One, for example, is focusing on the shares of growth economies, favouring sectors such as Brazilian utilities, Malaysian banks, Russian telecoms operators and Taiwanese electronics manufacturers.

However, a problem for income-seeking investors is that such funds' charges cream off a significant proportion of the dividends. Typically they may run to 1 to 1½ per cent a year, while offering an income yield of 4 per cent. To cover that, if they aren't going to stray into companies that offer very high yields because of the income and/or capital risk, means the managements have to be very smart.

My friend David Fuller, the London analyst, suggests it's often wiser for an individual investor to trawl the Web, note the top ten holdings of high-yield funds, then use technical analysis to judge which ones look like a buy. "I want a promising chart, decent balance sheet, leverage to the global economy, and proven growth potential."

Many investment trusts (closed-end funds) have excellent records of consecutive dividend increases. But movements in their unit prices are magnified by fluctuations in the difference between those prices and NAV (market value of the underlying assets) – discounts, sometimes premiums, relative to NAVs.

Some such trusts now pay quarterly dividends, which is a convenience for investors relying on the income.

Choosing a share primarily for income

When I last wrote about investing for income I recommended shares of companies whose well-covered yields seem sustainable. The focus should be on those of large groups with low levels of debt, strong competitive positions and good international diversification, in sectors where demand is not likely to fall sharply, or indeed may continue to grow, such as energy, pharmaceuticals, tobacco, healthcare and many other services industries.

The *Investors Chronicle* recently advised: "If times get tough… the relative degree of safety in these circumstances is a trade-off between the absolute size of the yield, dividend cover, balance sheet strength, cash flow and the susceptibility of the company to further adversity."

When choosing a share primarily for the income it will provide, the first filter you need to apply is the current rate of dividend.

Choosing stocks with very high yields is not a good idea. They may be signalling that the shares are very cheap because the markets expect the companies, usually operating in tough sectors such as banking, construction or technology, expect them to cut or suspend their dividends and are unlikely to rebound soon.

Research by Andrew Lapthorne of Societé Generale suggests you should look to a dividend yield that is above-average, but not too much so – say 100 to 120 per cent of average, excluding the often-distressed very-high-yielders.

You also need to consider recent-years' history of growth in dividend, but also the degree to which it is covered by earnings, reviewing underlying profits and cashflow growth over time, volatility in the trends, gearing (level of debt) and share-price performance -- what the markets have been saying about their confidence in the company.

Graham reckoned that you should require a cover – earnings relative to dividends – of at least 1½ times.

To reduce risk it's best to avoid companies burdened with debt. One commonly-used rule of thumb is to exclude any with a gearing (debt to equity ratio) greater than 50 per cent.

Lapthorne recommends using techniques such as Altman Z and Piotroski scores to filter out stocks that are financially weak and face significant bankruptcy risk.

You also need to make some assumptions about future currency trends – and they are not as simple as they seem.

Certainly if the base currency of your portfolio is, say, the US dollar, then by investing in a firm that does most of its business in, say, Asia, you take on the additional risk that exchange rates will move against you. Everyone realizes that. Not so readily recognized is that by refraining from buying into such companies you also accept the risk of opportunity cost, of denying yourself the benefit of potential currency profits.

Where you have an advantage over institutional investors

Institutions avoid "small-caps" for good reasons, but those don't apply to individual investors. Your buying or selling a few thousand shares isn't likely to prove difficult nor move prices against you. There are opportunities to buy value in markets that are effectively closed to the big boys.

There are hundreds of equity income securities from which to choose, including not only conventional companies but also master listed partnerships in the US (many with steady cashflows and strong records of payouts), Canadian trusts and their successor income-focused companies, and real estate investment trusts.

However if you are a global investor, you may prefer to keep to large entities listed on major stock exchanges, easy to track and collect your dividends.

I have spent much time recently trawling through the universe, and have reached several conclusions.

One is that most of the stocks generally regarded as good choices for income-seeking investors are unattractive when you consider the risk that they will be able to maintain their dividend and the probability that you won't get much if any longer-term dividend growth.

Pharmaceutical companies often have poor earnings growth records and substantial debt that threaten the sustainability of their dividends; GlaxoSmithKline, for example, didn't even earn enough last year to cover its dividend.

In choosing an equity income stock I believe you should take into account:

► Current dividend yield and track record of dividend growth;

► Cover -- the extent to which dividends are currently covered by earnings;

Low-Risk Income-Yielders to Consider

Stock	Ticker	Price	Div. yield %	PE ratio	Div. cover	Price % 12m	Price % 5y	Div. % growth	Earns. growth	Gear-ing	DA ?	Sector
Asia Pacific Breweries	A46:SES	25.00	2.96	19.2	1.8	40	66	17	18	41	N	Beverages
Astra International	ASII:JKT	63250	2.53	15.5	2.6	8	394	29	21	74	N	Automotive
Bristol Myers Squibb	BMY:NYQ	32.38	4.08	16.9	1.5	19	33	3	4	34	N	Pharmaceuticals
Bunzl	BNZL:LSE	785	3.30	15.1	2.0	3	14	8	7	103	Y	Commercial services
Canadian REIT	REF.UN:TOR	34.42	4.18	7.3	3.3	11	25	2	24	83	Y	Property
Charoen Pokphands	CPF:SET	27	4.26	12.2	1.9	14	458	18	13	80	N	Agriculture
Chevron	CVX:NYQ	94.40	3.31	8.2	3.7	13	48	10	8	10	N	Oil/gas
Coca Cola	KO:NYQ	65.90	2.85	12.3	2.8	11	47	9	20	75	Y	Beverages
Compass Group	CPG:LSE	535	3.55	14.3	2.0	2	99	12	44	39	Y	Food service
General Mills	GIS:NYQ	38.75	3.15	14.8	2.1	4	40	11	13	124	N	Foodstuffs
Heinz	HNZ:NYQ	50.36	3.81	16.7	1.6	5	21	8	19	149	N	Foodstuffs
Johnson & Johnson	JNJ:NYQ	63.13	3.61	15.1	1.8	0	-3	11	7	30	Y	Healthcare
Kaken Pharmaceutical	4521:TYO	1009	3.57	11.7	2.4	14	27	19	21	14	Y	Pharmaceuticals
Link REIT	823:HKG	25.00	4.40	3.6	6.3	4	56	13	36	19	N	Property
McDonald's	MCD:NYQ	87.20	2.80	17.6	2.0	15	117	28	18	82	Y	Food service
Pearson	PSON:LSE	1155	3.44	17.6	1.6	16	49	7	11	38	N	Education, publishing
Procter & Gamble	PG:NYQ	63.91	3.29	16.3	1.9	5	1	11	10	47	Y	Cosmetics, personal care
Syngenta	SYNN:VTX	250.00	2.80	16.1	2.2	2	28	22	20	46	N	Agriculture
Telus Corp.	T:TOR	52.09	4.22	15.0	1.6	12	-18	18	11	89	Y	Telecoms
TSMC	2330:TAI	69.10	4.34	11.2	2.1	13	16	5	12	8	N	Electronics manu.
Vodafone	VOD:LSE	170	5.24	11.3	1.7	5	34	5	26	44	N	Telecoms
Averages			3.60	13.7	2.3	10	74	13	17	59		

Price: at time of writing. Div. cover: latest earnings per share divided by latest dividend yield. Price %: change over past 12 months and the past five years. Div. % growth: Annual average increase over past five years. Earns. % growth: Annual average increase in earnings per share over past five years. Gearing: debt as a percentage of equity capital. DA: a "dividend aristocrat" (25 years of consecutive dividend increases), Yes or No?

► Track record of earnings growth, especially to see that dividend growth has been driven by equivalent profit increases;

► Volatility in earnings growth, especially what happened to earnings through the 2008/9 period of crisis;

► Debt levels (the company may opt to cut its dividends so cash can be diverted to reducing debt);

► Historic performance of the share price (risk of capital loss that could more than offset the income yield);

► Chart analysis suggesting whether or not now is a good time to invest.

The accompanying table shows my short list of equity income stocks that you should seriously consider, especially if stock markets decline even further and they become even cheaper to buy.

Many of the companies are well-known, but there are a few surprises, ones you may not be familiar with. See the box on the next page.

Asia Pacific Breweries has the world-famous Tiger beer, and Heineken as its biggest shareholders. It owns 30 plants in a dozen countries, with strong market positions in Singapore, Vietnam, Cambodia, New Zealand and Indonesia.

Astra International is a conglomerate whose core business is making and distributing motor vehicles in Indonesia, with strong ties to Toyota and other Japanese brands, Peugeot and BMW.

Bunzl is a UK provider of supplies to service companies, especially in the food sectors, in North America and Europe.

Canadian Real Estate Investment Trust owns more than 160 properties with 22 million sq.ft. of leasable space, principally in Alberta and Toronto.

Charoen Pokphand Foods is Thailand's largest agribusiness, its main focus being chicken, pork and egg farming, and aquaculture.

Compass Group, UK-based, is the world's largest contract food service company, serving meals to offices, factories, schools, hospitals, sports venues, even offshore oil platforms.

General Mills markets more than 100 leading US and global brands, mainly foodstuffs, such as Betty Crocker.

Kaken Pharmaceutical in Japan makes drugs, medical devices, agro-chemicals and animal health products. It's tiny relative to these other companies – but it's a Dividend Aristocrat!

Link REIT is one of the world's largest real estate investment trusts, with a portfolio of 180 properties in Hong Kong, mainly shopping malls and car parks.

Pearson, UK-based, is the world's biggest company in education and in book publishing, with imprints that include Penguin, and also owns the *Financial Times*.

Syngenta is a Swiss agri-business giant, a leader in crop protection chemicals and seeds.

Telus is the second largest telecoms company in Canada, and also has international interests, especially in Asia.

TSMC in Taiwan is the world's biggest independent foundry making electronic chips.

Ruling Elites Forfeit Our Trust

Occupy Wall Street, the continuous street demonstration in New York against the power and privileges of the giants of finance, is easy to dismiss as an irrelevancy. It is, after all, inchoate, leaderless, without any clear policy demands, and trifling in scale – a maximum of a mere 20,000 people in a world where street protests of a million or more are not unusual.

It also shows signs of being captured by the usual suspects of the Left – labour unions, enemies of globalization and free enterprise, and the academic commentariat – who seek to advance their own material, political or ideological interests through expanding protectionism, regulation and bureaucracies.

Nevertheless, it would be dangerous for investors to ignore the consequences of what could be an early sign of worse to come.

The populist causes voiced by these angry demonstrators – jobs for those without jobs, hostility to global free trade and a fairer distribution of wealth between capital and labour – are rooted in enough validity to provide a global rebellion against the ruling elites.

When things were going well, ordinary folk tolerated the ugly blemishes of capitalism such as fat bankers and profligate politicians. After all, the alternative economic systems of communism and even its milksop cousin socialism were discredited – most obviously by China, which soared to become an economic giant

by abandoning them in favour of a particularly aggressive form of nationalist/capitalist partnership.

Things are no longer going well. Yet the beneficiaries of the old system continue to benefit from their control of the system.

The US central bank, according to one senator: “Provided more than $16 trillion in low-interest loans to every financial system in this country, huge foreign banks, multinational corporations and some of the wealthiest people in the world.” Politicians added to the pot with a huge “stimulus” programme in the US favouring their own interests. And there were similar profligate plans in other countries.

They were, and continue to be, presented as policies to prevent economic collapse. And they did that. But that was and is only part of the story. They were and are wasteful and largely ineffective in promoting economic growth because they have been directed towards defending and advancing the wealth and other interests of the ruling elites.

If you think I’m a Leftwing nutter, here’s what Bill Gross of Pimco, the giant of bond fund management, says: “Almost all remedies proposed by global authorities to date have approached the problem from the standpoint of favouring capital as opposed to labour.”

Big banks, who were the principal perpetrators of the credit crisis, are bigger than ever and have been allowed to return to their previous disgraceful practices of what amount to gambling – this time with virtually unlimited, almost-free public money.

Big companies are in even stronger positions relative to their smaller competitors because of their easy access to capital and credit, and their greater ease to shift business offshore.

Politicians are spending more than ever before on their favoured interests, with even more borrowings piling up debt for future generations to repay.

Bureaucrats have even more power as greater regulation and paperwork are viewed as a greater priority, even though their effect is to hamper expansion in the most dynamic sectors of any economy.

The privileged are cushioned, the rest are exposed

The victims of the crisis of capitalism are those who gained least from all the efforts to ward off depression:

► Tens of millions have lost their jobs, and many millions more are forced to accept temporary and part-time work because they can’t get permanent employ. 25 million un- and under-employed in total in America alone.

► Those on average and lower incomes continue to suffer disproportionately relative to the rich, highly-educated “aristocrats of labour” at the top of the employment pyramid, and the politically well-connected (including many of those who work in the public sector).

Their real incomes are being squeezed by inflation, especially in the many bits of essential household spending such as food and energy that are deliberately excluded, largely for political face-saving, from official calculation of rates of inflation.

► Retirees suffer disproportionately, not only because of inflation, but also because artificially-low interest rates depress their incomes and often force the

newly-retired into accepting much lower pensions than they planned for and saved during their working lives.

It is symbolic of how the ruling elites continue to ignore the very real concerns of the masses that the British central bank governor, Mervyn King, when announcing another huge bail-out for the banks ($116 billion), brushed aside an expert's criticism that it was "a Titanic disaster" for pensioners, saying it was more important to support the wider economy than to support savers. (A fallacious argument, see the following article).

If the ruling elites were sensitive to the issues of job creation, the squeeze on lower incomes, and safeguarding the living standards of retirees, instead of depending on the ineffective route of relying on banks (yes… banks!) to stimulate economic activity, they would be pursuing aggressively policies of direct stimulation.

For example:

► They could cut taxes and the burden of regulation in ways that target the stimulation of small businesses, which it's well known in all countries are by far the most important generator of job creation. In America all net new private-sector jobs between 1980 and 2005 were created by companies less than five years old.

► If the huge subsidies for so-called "green" jobs – an average of a quarter-million dollars for each one created in the US, and that includes counting positions such as bus drivers as "green" – were instead channeled to where it would be most effective, that money would create perhaps five times as many additional jobs.

► Instead of wasting money on financing mega-banks, a poor vehicle for promoting economic growth, employment and consumer demand, those greedy giants should be left to eat their own poisonous waste and die of it, with public money diverted to fostering much smaller banks and new institutions that commit themselves to productive lending.

Longer-term, there are going to be some serious political consequences of this blind obsession of the ruling elites with pouring public resources into defending their own interests instead of focusing on the public interest.

Already we are seeing populist rebellions such as the Tea Party movement and Occupy Wall Street in America, and the rise of the hard Right in Europe. They are likely to be precursors of much worse to come, with disturbing implications for investors if new ruling elites emerge, some of whose policies may not be to our taste.

Hooked on the Money Bubble Fallacy

Although the US central bank seems to be on the verge of launching yet another round of "money printing" and interest-rate manipulation, and its British cousin has already done so, they are unlikely to be any more successful than earlier rounds, which largely wasted resources on saving dud banks.

There is little evidence that such pumping up of "money bubbles" achieves much in the way of stimulating economic activity. Central bankers in the West continue to ignore the evidence of 20 years of such failed policies in Japan.

Such foolish measures just divert attention from the fundamental problems, which have nothing to do with the supply and cost of credit.

Money printing does ensure a continuing flow of resources to huge but least efficient sectors of any economy – mega-banks, mega-companies and the state – but shields them from having to make the structural reforms required in mature economies facing ageing populations and ballooning healthcare costs, while storing up major public debt problems for the future.

It also does nothing to address the immediate issue of weak consumer demand. Indeed, it worsens the situation as negligible interest rates on savings squeeze the purchasing power of the elderly.

Consumers, even if they do have jobs, are seeing their incomes squeezed. In the US, new data from the Census Bureau reveals that last year real median household income contracted by 2.3 per cent, to a 14-year low of $49,445.

Their personal financial debt is still above $1 trillion, and Americans know they need to save more to pay for their retirement, as they cannot rely on capital gains from home ownership.

It's easy to see why consumer demand is providing no impetus for economic growth.

As for the corporate sector… it's increasingly unwilling to invest in expansion when the current American administration's ideas remain focused on more aggressive regulation, higher charges on businesses for healthcare, and heavier taxes for wealth creators stigmatized as "millionaires and billionaires."

An American friend forwarded to me this interesting perspective on what the politically powerful are actually doing about reducing their profligate over-spending…

The US is adding $1.65 trillion to the national debt this year alone, with cuts in the federal budget forecast to save $2.1 trillion… but over ten years.

It helps to get a grip on such astronomical amounts if we imagine that the US's finances are like those of a fictitious family, we'll call the Smiths – actual figures with eight zeros removed…

Total annual income for the Smith family: $21,700.

Annual spending: $38,200.

Amount of new debt charged to the credit card: $16,200.

Outstanding balance on the credit card account: $142,701.

Amount cut from the budgeted spending: $210.

"What family would cut $210 of spending in order to solve $16,500 in deficit spending?"

Multinationals Favour a Welcoming China

Muhtar Kent, chief exec of the giant beverages company Coca-Cola, says the US has a less friendly business environment than China.

While America has an antiquated tax structure that discourages firms from repatriating profits earned overseas, and is in political gridlock, China operates "like a well-managed company."

The Chinese foreign investment agency offers “a one-stop shop,” while local governments compete vigorously to attract such investment.

This year Coke plans to invest $1.3 billion in capital assets in North America – but $3 billion in Russia over the next five years and $4 billion in China over the next three.

General Electric plans to move its x-ray division from Wisconsin to Beijing, investing $2 billion in China and creating six research centres there. This is the same company that made $5.1 billion in the US last year, yet paid no tax on that profit, and now employs more people overseas than is does in America.

So President Obama made a strange decision when he appointed GE chairman Jeff Immelt to head his commission on job creation. It seems the president forgot to tell him in which country he was supposed to be creating jobs.

Impossible Promises

We have arrived at the end-game of “an untenable doctrine,” argues British columnist Janet Daley – “to pay for the entitlements, populations have been led to expect by politicians, the wealth-creating sector has to be taxed to a degree that makes it almost impossible for it to create the wealth needed to pay for those entitlements.

“What is to be done about all those assurances governments have provided for generations about state-subsidized security in old age, universal health provision (in Britain, almost uniquely, free), and a guaranteed living standard for the unemployed?

“We have been pretending… that this could go on for ever,” even when it has become clear that:

► European state pensions, and the US social security system, are gigantic Ponzi schemes in which the present beneficiaries are spending the money of the current generation of contributors;

► Healthcare provision is creating impossible demands on tax revenue; and

► Benefit dependency is becoming a substitute for wealth-creating employment.

Tailpieces

Tax reform: President Barack Obama “is being sensible when he suggests (eventually) capping upper earners’ tax deductions for mortgage interest and charitable giving,” says well-known commentator Christopher Caldwell.

“That will end what amounts to a subsidy for luxury homes, and reassure voters that big philanthropists such as (Warren) Buffett are not merely using the tax code to launder economic power into political power.”

However, Obama “has had trouble presenting himself as a credible populist because – outside of income distribution – there is no facet of populism for which he has shown sympathy.”

The domestic policy issues to which he brings the most passion are anti-populist, such as fighting against laws to curtail illegal immigration and challenging state definitions of marriage to extend the status to gay partnerships.

Caldwell says the professorial Obama, "having never shown much interest in the opinions of the working class," now "finds it hard to claim their allegiance."

An ominous forecast: Although analysts are predicting full-year earnings for companies in America's main index, the S&P 500, should reach $111 a share in 2012, the index has fallen to levels that suggest investors are much more pessimistic, expecting an earnings slide of more than 20 per cent next year, taking profits down to about $80 a share.

Looking further into the future, corporate profit margins are likely to shrink, suggests *FT* commentator Tony Jackson.

The rise in margins in the US and Europe over the past 30 years have been helped by a combination of benign forces – low interest rates, low taxes, technological change ("the arrival of mass computing and the internet has made possible a surge in automation and just-in-time manufacturing"), outsourcing to cheap-labour countries. Those advantages seem to be coming to an end.

Jackson also makes an interesting point about the measure that has become fashionable among analysts – "ebitda," or earnings before interest, tax, depreciation and amortization. It only became accepted because the bits it left out – the cost of debt, tax and investment – were all getting less significant.

He describes this financial measure as "bizarre," quoting Warren Buffett's remark that it only made sense as a basis for valuation if capital spending was paid for by the tooth fairy.

Gold's multiple benefits: The yellow metal not only "performs relatively strongly in a high inflation scenario," but also "does comparatively well" in a deflation scenario linked to a "sharp rise in financial stress," such as a wave of defaults in peripheral Eurozone countries, says a new study by the Oxford Economics consultancy.

"We find that because of its lack of correlation with other financial assets, gold has a useful role to play in stabilizing the value of a portfolio."

Gold's optimum share of a portfolio is about 5 per cent, which "is higher than levels found in typical mainstream investment portfolios."

The power of bankers: Politicians have failed to reform the banks because of the massive lobbying, says *Money Management* commentator Russell Taylor. Their future and security now assured because their institutions are regarded as "too big to fail," bankers don't want outsiders meddling in their affairs.

"The result is that legislators have come up with grand-sounding general principles, but have left detailing the laws to the regulators" – with their proven record of failure.

"Regulators are sooner or later captured by the industry that they are set to regulate. This is especially the case where regulators, as in banking and financial services generally, are outmatched both in salaries and intellectual capacity."

Some good news: The American economy is struggling, but its big businesses are in excellent shape. According to the RiverFront Investment Group, corporations

outside the financial sector have cash balances and liquid assets at record highs ($2 trillion in total), with interest payments as a percentage of cash flow the lowest since the 1950s, effective tax rates at near-record lows and profit margins at near-record highs.

Mega-waste: The US federal administration has guaranteed loans of $737 million to a solar energy company, creating about 600 temporary jobs in construction but only 45 permanent jobs. That's a potential cost to taxpayers averaging $16.4 million for each permanent job.

Bureaucratic lunacy in Europe: A reader suggests this list sums up Europe's problem…

Pythagorean theorem: 24 words.

Lord's prayer: 66 words.

Ten Commandments: 179 words.

Gettysburg address: 286 words.

US Declaration of Independence: 1,300 words.

US Constitution, with all 27 Amendments: 7,818 words.

European Union regulations on the sale of cabbage: 26,911 words.

Wisdom of leaders: An Australian airline ticketing agent offers these gems on the stupidity of his country's politicians (he names them, and they include some of the most important:

► The one who asked for an aisle seat on the plane so her hair wouldn't get messed up by being near the window.

► The one who, inquiring about a holiday package to Hawaii, asked if it wouldn't be cheaper "to fly to California and then take the train to Hawaii…"

► The politician's wife who asked: "Is it possible to see England from Canada?" When told No, not possible, she said: "But they look so close on the map."

► The one who wanted to reserve a flight from Chicago to Rhino, in New York state. When the ticketing agent said there was no record of an American airport at a place called Rhino, she told him: "Don't be silly. Everyone knows where it is. Check your map!" When the agent thought about it, and finally offered: "You don't mean Buffalo?" Her reply: "Whatever… I knew it was a big animal."

Martin

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