



Interest piqued?

Change is definitely around the corner, says **Jon Moulton**. Plan for the worst and take the upside

So another month, another new prime minister. Like Gordon Brown, the chancellor Rishi Sunak has become PM. Liz Truss must be the only prime minister to have spent the largest proportion of her premiership visiting Buckingham Palace. In her short spell in charge, we had a chancellor with an even shorter shelf life. We're on our fourth chancellor as I write and it might be the fifth by the time you read this. I suspect Sunak might stick with Jeremy Hunt.

The Right Honourable Jacob Rees-Mogg's 'robust statements' on growth and regulation seem irrelevant now that he, too, has had a short-lived cabinet career. The Right Honourable Member for the 18th century and North-East Somerset said he wanted to get rid of all regulation for companies below 500 employees. It is hard to imagine the end of employment laws, health and safety regulation or auditing accounts for these smaller companies, but that appears to be his wish. That is very unlikely to come true, but one thing is certain - more regulation is the last thing the economy needs.

The struggle between the government and the Bank of England is going to be interesting to watch. The government plans to spend a great deal more than its income, having just over a month ago advocated spending and tax cuts to stimulate growth, with some money printing thrown in - exactly what gives there we will see. Our independent central bank seems intent on crushing inflation, which is running way ahead of its targets and forecasts, by reducing consumer demand using increasing interest rates.

The government tried and failed to adopt policies that no other country, save Turkey, had adopted. While UK inflation of 10.1% hit a 40-year high, inflation in Turkey reached a 24-year high last month - 83% per annum. Its interest rates are 12% and its currency has fallen 70% in value over the past year. But it does have 7.6% growth. Crucially, UK business confidence has slumped.

For those in corporate finance and private equity in the UK, the environment is now more unforecastable than it has been for a long time. Portfolio valuations, and reported returns, are under huge pressure as industry indices have dropped to

levels of five years ago. The appetite of buyers for businesses has diminished. Debt is more expensive and less available for companies and transactions.

It is also more limited for the perhaps less well-known subscription lines. These are basically loans secured on investors' commitments to funds. As long as they cost less in interest than the return on fund investments, there was universal rejoicing. More than half of the larger funds used them. Sadly, times have changed. The economics have evaporated and risk levels of investor default have risen in the last weeks. Banks and other lenders are getting out of this market.

End of innocence

It is interesting to see what has happened in the pensions world. Traditionally, pension funds have attacked what they see as short termism and excess leverage in private equity - while enjoying the returns, of course. Now comes a newcomer to most financial souls: the innocent-sounding 'liability-driven investment' approach adopted by many pension funds. The original idea was to match assets maturation with payments to pensioners; no one could object to that, could they?

However, the term got hijacked and became a route to getting better returns by essentially borrowing against gilt holdings to buy equities, with this being effected through more or less complex derivative contracts. When the value of the gilts fell, the derivative writers demanded security and the Bank of England had to intervene to avoid a death spiral in the gilts market. An intervention of (potentially up to) £65bn, considerably more than the UK defence budget, was needed. It seems no one at the pension funds thought it likely that interest rates would ever rise so quickly. A brief gloat seems fine.

Advice for this world? Plan for pretty bad and you will survive what might be coming. And don't spend time being surprised by what does.

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