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London property: enjoy the view

Key issue: having de-coupled from the rest of the UK, central-London prime property has proved an exciting investment opportunity.

Key recommendation: locals have long been priced out of the market, leaving only international high rollers. Eye watering valuations make only genuine sense to long term players who can appreciate the joys of living in the city.

'When a man is tired of London, he is tired of life', Samuel Johnson

The United Kingdom has bequeathed the world many things, the rules of most international sports, the **English language**, an **honest legal system** and even the time that we use to run our busy lives. But in the metropolis of London the gift is complete. Sitting bestride a **central time zone**, with a **clement climate and police force**, speaking the world's 'lingua franca' and **welcoming internationals**, this conurbation has a major claim to be the **'city of the world'.** Property investors and developers have flocked to supply the demand to live, or crucially maintain a residence here, in doing so pushing prices to stratospheric levels. As any concept of value has receded, fresh investors may yet be more squeamish as the politics of envy have started to intrude.

ALVINE CAPITAL MANAGEMENT LTD. 4 HILL STREET, LONDON, W1J 5NE, TEL: +44 (0)20 7529 7690 FAX +44 (0)20 7409 1688
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London rules the waves

Two cheerleaders for London

A combination of factors cemented London as a destination for investment. While banker bonuses may have faded, foreigners have increasingly flocked to the UK's safe haven status. Concerns voiced by these new arrivals cover:

Middle Eastern turmoil and the Arab spring/ Russian political uncertainty/ euro-zone existential issues/'real asset' value in a world of monetary debasement/Far eastern burgeoning wealth and a desire for diversification.

'London continues to benefit from overseas buyers looking for a safe haven for their capital', Cheryl Lim (Straits Times 16/09/12.)

Looking forward into 2013 and beyond it is difficult to see many of these concerns abating in any great measure. As the world gets richer and more connected, London's role may move beyond a simple safety play. A second home in the city has become a badge of honour, or a plaything for the next generation, almost however the parents made their money. This forecast alone may safeguard continued investment flows.

Her majesty the Queen: a symbol of stability

Kenneth Rogoff has tried, as only an American would do, to try and sully the UK's enviable record of never defaulting on its debts. His claim in his book titled 'This time it's different' (source: The Telegraph 21/2/12) that the coupon of the First World War 'consol' loan was cut from 5% to 3.5%, and hence this must rank as an effective debt restructuring. But present day holders of gilts should rest easy, as the prospectus of these instruments allowed the government to call the bond if they so wished and then refinance. This is in fact what the treasury did in 1932, as market interest rates had fallen so far, a simple re-financing took place much as many US fixed rate mortgage holders have. The UK has always honoured contracts, and its debts.

With the ever **primacy of the English legal system** demonstrated by various disputes between Oligarchs, or high profile divorces, investors have drawn great comfort from the certainty derived. Unlike many places around the world where it might be easier to generate wealth, **the UK is a place to retain it**.

There is something enduring and comforting with pound sterling, and the queen's head on every coin and banknote. After the financial crisis, sterling depreciated by 25-30% providing a good entry level for foreign investors.

The next wave of investors: Asia

Battersea Power station: development potential now in Asian hands

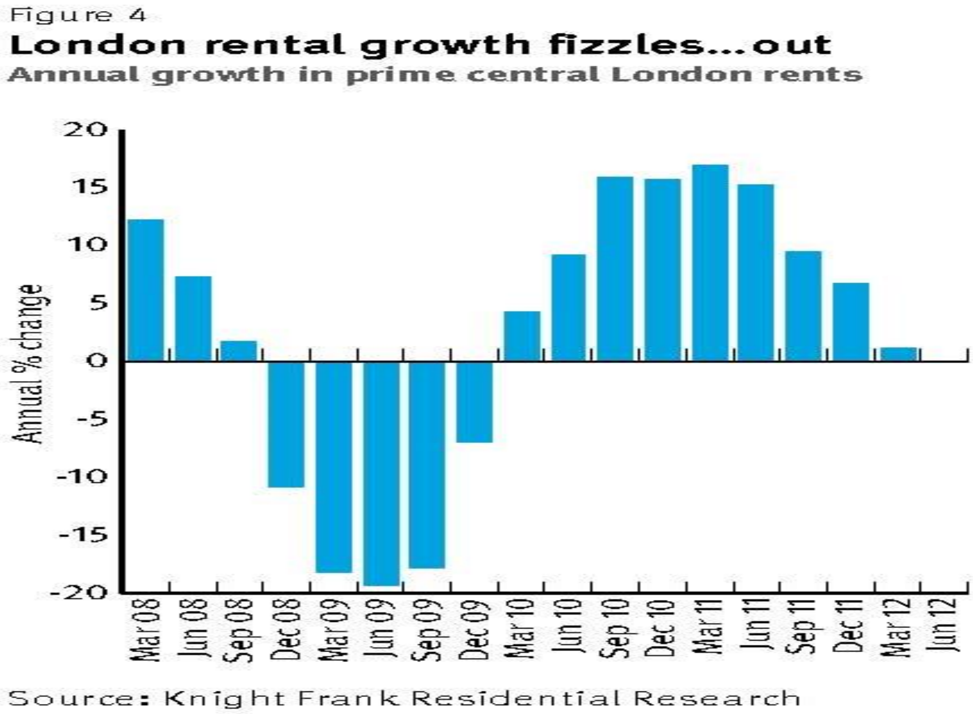
Trophy houses in Kensington are not the only investment horizon for cash rich overseas investors. As the world has got richer, London's place as a commercial centre has drawn opportunities.

The fallout from the financial crisis also threw up the chance to buy up distressed assets, like Battersea Power station, that had become available. This prime site has been acquired by a Malaysian consortium. Not only do they expect to develop the site, but then to sell on apartments to Asian investors.

Other London landmarks falling into foreign hands include HSBC's Canary wharf tower going to South Korea's National Pension Service. In a recent ruling, China's Insurance Regulatory Commission has relaxed prohibitions on investment. 'The **deregulation of the Chinese life companies** will be the next wave of Asian capital to hit the London market', James Beckham director of Lang LaSalle (source: The Times 27/11/12.)

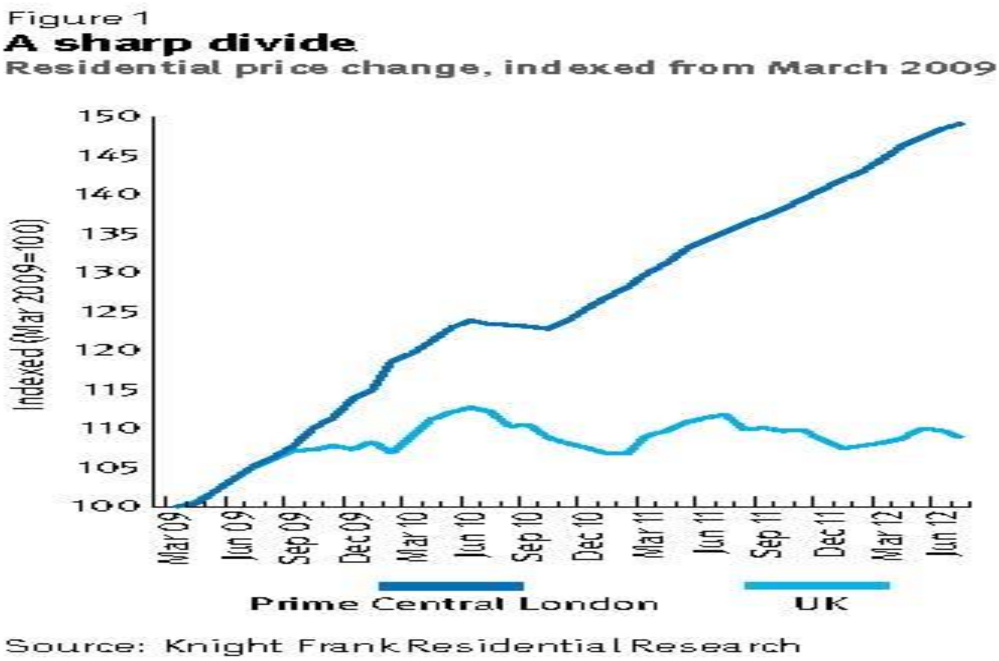
'If you were selling a £100mio building a decade ago you could identify exactly who would be on the list of potential bidders. Today, there could be three on the list that you have never heard of', Alistair Elliott Knight Frank (source: FT.com 22/11/12). This new breed of investors is as much driven by a chase for yield.

Will it last: supply emerges



London is a surprisingly big, spread out city less densely populated than New York, or even Paris. While it is certainly true that no more Georgian mansions can be built, as land prices have soared, new supply has emerged. Whether it is **brown-field pub conversions**, or the new series of **skyscrapers**, fresh volumes are hitting the market.

As the gap between London and the rest of the country widens, an increasing number of locals have chosen to sell up and move out of the city. This also bolsters supply. With the national economy mired in recession, the ability of landlords to hang on to high rents must be questioned.



Poor policy intrudes

With a stubborn budget deficit, and political pressures on an unpopular government, the booming London real estate scene must have been seen as too good to be true. Revenue from stamp duty has been one of the few areas to hold up. It was also an anomaly that buyers who used a corporate scheme had a lower duty to pay.

However George Osborne's decision to increase this tax to 7% on homes over £2mio, and company purchases to 15%, may have backfired. The Audit Office had assumed that this 'milk cow' could be squeezed to enhance the tax take by £1bn per annum. In fact, after the first six months the tax take is faltering. It is clear at a time when prices had already reached unprecedented levels, that this extra cost was unwelcome.

'Clearly, the tax changes have slammed the brakes on both the domestic and investment market', Naomi Heaton, Chief Executive of London Central Portfolio (source: FT.com 20/11/12.)

While to full UK taxpayers the concept of **non-domicile** tax exemption may have seemed unreasonable, its existence has helped explain why London has been so sought after for a home. Even though the first move to **tax an initial £30,000** that came in Alistair Darling's 2008 budget, may not bother the likes of Roman Abramovich, it could be seen as the thin edge of the wedge. The Liberal Democrat part of the UK's governing coalition has been vocal in **demanding a mansion tax.**

‘I was talking to a client earlier this month and he said the message from the UK government to overseas buyers is not a welcoming one’, **Charles McDowell**, a leading London estate agent (source: FT.com 20/11/12.)

Conclusion: living yes, investment more questionable

One of the reasons for the success of the Olympics was just how beautiful London looked as a backdrop for the games. The organisers should be commended for weaving so many landmarks into the games.

For those lucky enough to still be able to afford to reside here, the mixture of old and new architecture, an international vibrant population, culture and the best of life is hard to beat. London really is an amazing place to live.

However, blindly chasing ever higher valuations for pure investment may now have passed. **A great deal of money has been made in central London property, but it is no longer assured that much is left on the table.**

Model Portfolio

November has been characterised by corrections from the sharp summer rally, and particular concerns centring on negotiations to avert the US fiscal cliff. We are confident that President Obama's comfortable re-election will give the necessary impetus to resolve this problem.

The collapse of the Social democratic government in Japan and the impending elections in December, have provided the latest example of impending monetising of debts.

http://www.ft.com/cms/s/0/e2a389e2-394f-11e2-afa8-00144feabdc0.html#axzz2DcAPLE6H

Shinzo Abe: Japan's next likely prime minister

Calls for the inflation target to be tripled to 3%, and the mass creation of money has so far largely been restricted to Yen weakness. We see this as yet more signs of easier monetary conditions in 2013. Where Japan has lead, others have not been far behind.

For this reason we remain overweight risk assets.

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