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## OFFSHORE PILOT QUARTERLY

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#### ***A Toad for Breakfast***

In the aftermath (hopefully) of the Great Recession it is true to say that, in economic terms, most of us will be looking at things differently: for many perhaps this might be considered the time of the Great Reflection but in any event the end of 2010 and the start of the second decade of this century is a good moment to pause and take stock (if not, perhaps, to buy it).

It is sobering to realise that the volume of world trade fell about twice as fast as it did during the last century's Great Depression. In the 15 months after the global economy peaked in June, 1929, commerce fell by some 10 per cent; in the same period after the April, 2008, turning point, global trade was down by 20 per cent, according to Barry Eichengreen at the University of California and Kevin O'Rourke at Trinity College in Dublin. So in today's economic climate in the West, and as we ponder what the second decade will bring, we should note the advice of the 18<sup>th</sup> century French moralist, Nicolas-Sébastien Roch de Chamfort (admired greatly by Nietzsche, Mill and Pushkin): "A man should swallow a toad every morning to be sure of not meeting with anything more revolting in the day ahead".

Hyman Minsky, a mid-20<sup>th</sup> century economist who taught at several US universities, said that stable economies always sow the seeds of their own destruction with investors, banks, consumers and companies assuming the future will be like the recent past and which, as he put it, "breeds a disregard of the possibility of failure". It is little

wonder that his book, "Stabilising an Unstable Economy", is enjoying renewed interest. Several years of steadily growing output and low inflation lead to misguided confidence and what we have experienced bears out Minsky's contention that there are 3 stages before the fatal blow is dealt. In the first stage investors have little debt so can easily meet their capital and interest payments; in the second stage finances are stretched such that only interest, and not capital, can be paid; the third phase sees them taking on debt levels that need rising prices to be securely financed. To see where this leads to, just think of the homebuyers who took out 125% mortgages at the peak of the property boom in the United States of America.

Regular readers of the Offshore Pilot Quarterly might recall a previous issue (March, 2009, Volume 12, Number 1) when I quoted Alan Greenspan under the heading, "The Year of the Oxymoron". He conceded, as the economic dikes failed, that "all the froth bubbles [did] add up to an aggregate bubble". More about this gentleman later. Bubbles, of course, being globes or half globes of liquid, are normally associated with water and it was the sight of it cascading into mountain pools that inspired Irving Fisher on a trip to Switzerland in 1894. Whether or not, of course, economic theories themselves hold water is an entirely different matter – although we know that they can drown you. What Fisher saw in the cascading water was a way to be able to "define precisely the relationships among wealth, capital, interest and income" as Robert Loring Allen, a biographer,

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wrote. This imagery formed the basis of many of the central concepts of financial economies for the next 30 years and as Allen put it, "The flowing water, moving into the pool at a certain volume per unit of time, was income. The pool, a given volume of water at a particular moment, became capital".

Fisher, like Minsky, both belong to the past but their relevance today should not be overlooked. Fisher was probably once America's most famous economist but it is his British contemporary, John Maynard Keynes, who is currently being spoken of constantly, as many of the world's economies continue to struggle and, as in the 1930s, the US is submerged in debt again. It was Fisher who wrote in 1933 about over investment and over speculation, both of which compound existing problems and produce stark outcomes when they are conducted with borrowed money, or as Fisher put it: "The very effort of individuals to lessen their burden of debts increases it, because of the mass effect of the stampede to liquidate ... the more debtors pay, the more they owe. The more the economic boat tips, the more it tends to tip". This month the good ship Ireland began to appreciate this.

Fisher, a humourless individual, had earned a doctorate at Yale University and, like John Kenneth Galbraith, late economist and intellectual, he believed that modesty is a vastly overrated virtue. This very intelligent man, who developed many theories and monetary policies, advocated that the US dollar's value should not be linked to gold but to a basket of commodities – a hot topic at present. There is, nonetheless, no substitute for common sense. During the 1920s he invented a card-index system and became very rich; those, apparently, were the only cards he played well. He bought stocks on margin with the money and by 1929 he was worth US\$10 million. He was considered a financial guru (an abused term these days) and in October of that year he stated that stocks had reached a "permanently high plateau". Two weeks after making those comments the stock market crashed.

Perhaps the humourless, and subsequently, penniless, Mr. Fisher should have considered Adam Smith's opinion: "The chance of gain is by every man more or less overvalued, and the chance of loss is by most men undervalued and by scarce any man who is in tolerable health and spirits valued more than it is worth". Whilst it is always right to heed the words of many, it is still a very wise policy to remember the Roman caution, *festina lente* (hasten slowly), and which is the unofficial motto of my firm. Impetuous behaviour produced some of the ugly financial spectacles we have recently seen and in the case of those that you wear, rather than witness, Senator John McCain once said of Alan Greenspan (he of froth and bubbles fame) that if the Chairman of the US Federal Reserve should die "I would prop him up and put a pair of dark spectacles on him."

### ***Gathering Dangers***

But, of course, often the spectre in the background is greed. It was a craving for gold (one shared by many investors today) which, 500 hundred years ago, lead to Francisco Pizarro's pillage of Perú and which readers can learn more about in this month's Latin Letter, my companion column in Offshore Investment.com. One of the most popular London plays in 1790, in fact, and, apparently, the second most popular play in the 18<sup>th</sup> century, was Richard Brinsley Sheridan's "Pizarro", a portrayal of Peruvian struggles for independence from Spain.

If one considers the fate of those under the flag of Spain at that time in Latin America it is not hard to appreciate why in his 18<sup>th</sup> century poem, "The Vanity of Human Wishes", Doctor Samuel Johnson addresses, in 368 lines, the dangers that greed can bring to people. The poem opens with the lines "Let observation with extensive view,/ Survey mankind, from China to Peru" and certainly today mankind is surveying China more than it is Peru (although both countries are intertwined by substantial investments). Johnson's contention that people ask for the wrong things, that folly is often sister to fortune, is still a philosophy held firmly today by many who believe that, as he writes in his poem, "Wealth heap'd on wealth, no

truth nor safety buys, / The dangers gather as the treasures rise”.

It was said that Johnson was suffering from one of his periodic bouts of depression when he put pen to paper and wrote the poem, but we do know that, unlike Irving Fisher, he had a plentiful supply of humour. Humour, spoken and written, can be an important ingredient in communication. A word to the wise, delivered lightly rather than harshly, is often best. It is why English kings had jesters at court. When perhaps a toad was not available for breakfast, the substitute jester would deliver the uncomfortable news with banter. Shakespeare’s King Lear was told by his Fool, for example, that he was ruling his kingdom badly; unfortunately he failed in the end to heed the advice: “Have more than thou showest / Speak less than though knowest / Lend less than thou owest”. Sage advice, whether from a guru or a fool, in today’s world of risks.

In this month’s Latin Letter, featuring Pizarro, I also wrote about matters which the passage of time seems to have little effect on. Much like the figure-8 cycles I wrote about (Blocks of Ice and Houses of Stone) in the June issue of Offshore Pilot Quarterly, the pattern (and the motives) is continuous. We have all heard, ad nauseam, the familiar expressions of how history repeats itself (if not, I submit, exactly) so let me offer an alternative African quote most (if any) readers will not have heard of before: “kare haagari ari kare”. The language is Shona, from my former home of Rhodesia (now Zimbabwe), and which, like the tribe itself, is direct: translated it means that the past does not remain the past. Sadly for many of the tribes of Africa the past is still the present.

### ***Philosophers and Kings***

In the introduction to my firm’s new brochure I wrote that the late philosopher, Sir Karl Popper, believed that all men and women are philosophers; if this is so, then is there a better guide to one’s thinking than what one either writes or says? I do not believe that there is, and so it is just as important sometimes for professionals to reveal their convictions, and not just their competence. If

such professionals are involved in your international long-term financial strategies they need to have, what perhaps Angela Merkel might describe as, weltanschauung (a world view). I admit in my own case to being, in professional terms, an iceberg in Panama. This is not a reference to cool judgement on my part, but to the fact that only one-third of my 45-year career, so far, has been spent on the isthmus and whilst it is essential that you be familiar with the local environment it is equally important, particularly as a professional adviser, that you also understand other cultures. It is to be hoped that President Obama appreciates other cultures and can take a worldly view because, paradoxically, the world’s superpower has a citizenry that is, in the main, insular and a stranger to international affairs.

Mark Twain, cautious curmudgeon, whose real name was Samuel Clemens, would have got on well with Dr. Johnson because he was also blessed with a sense of humour, choosing a pseudonym which was once the warning cry to river boat pilots when they veered into dangerously shallow water. Twain once warned about being careful when reading health books because you could die of a misprint. I would, however, have suggested to President Obama, ahead of his trip to India last month, that it would have been healthy to have read E.M. Forster’s novel, “A Passage to India”, which is a fine illustration of misunderstanding between foreign peoples (in this instance the British and the Indians) that leads to high expectations which give way, eventually, to disappointment. British diplomats, during some 500 years, have had to learn hard lessons and one classic example from England’s days of empire was Lord McCartney’s fruitless efforts to persuade the Chinese emperor to open his borders to British trade which, in part, came about because he refused to prostrate himself before the Divine ruler. David Cameron, Britain’s prime minister, who went to China last month, was able to remain standing although I am certain that economic imperatives would ensure that the right, polite tone was struck – just as it would have been during President Obama’s stay in India – because both Western leaders represent

crippled economies.

It is no longer true that wealthy nations comprise a “comparatively small corner of the world populated by Europeans”, as John Galbraith observed in 1958. Fifty years later the only thing in a corner are the Americans and the Europeans with China’s population now representing one person for every five on the planet. Today not only the sun, but economies too, rise in the east. In 1968 Japan overtook West Germany to become the second largest capitalist economy and in 2010 China has moved Japan to third position. The West has to come to terms with the new powers and treat them as equals at the bargaining table, which was the case before the emergence of European imperialism, followed by the arrival of what could be termed, the American century. What is for certain, the economic tide is turning for Western countries and just like the real tide that

Canute, the 11<sup>th</sup> century Danish king, ordered, but failed, to turn at his command, they have found themselves powerless. As Canute lamented: “Let all men know how empty and worthless is the power of kings”. And sometimes that is true of nations too, although resignation doesn’t mean retreat, but denial can only lead to greater political and economic woes.

If the Great Recession has made us look at things differently, then having an international perspective helps with any Great Reflection we might experience. The imminent arrival of a new year in Western cultures is certainly a good time to reflect, but on the other hand, whatever the culture and the calendar, remember that professional skill (which most of you reading this are concerned with) is important, although a little weltanschauung and common sense are good things too.

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