Investment Markets in January[1]

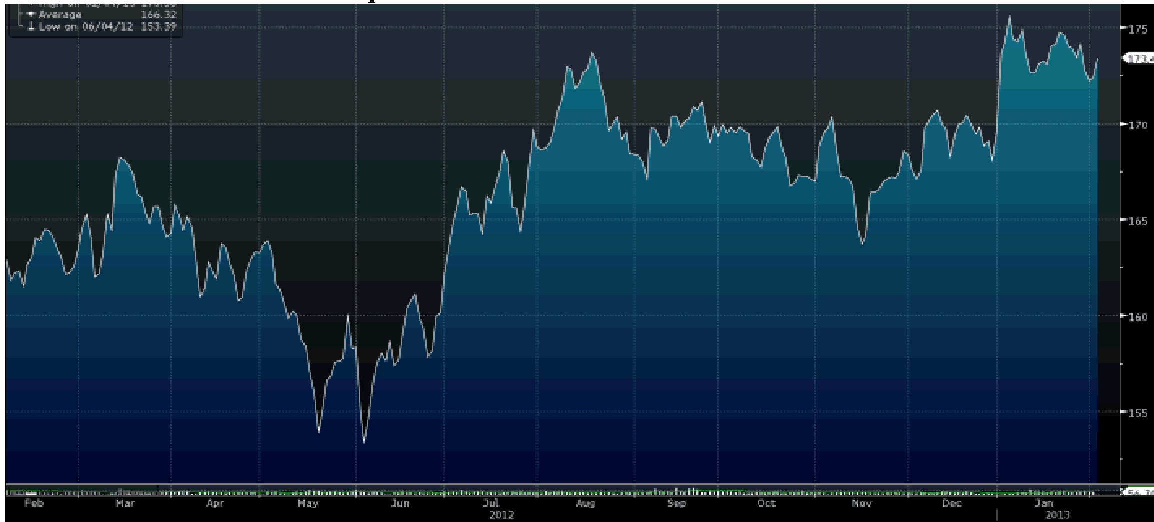
Investment markets started the year on a positive footing with most stockmarkets recording gains; however, sharp falls in Sterling, Yen and the US Dollar against the Euro offset underlying investment gains for Euro based investors. Bonds were weaker in January as a combination of currency movements and shifting investor sentiment towards higher return assets saw a selling of both Government and Corporate paper.

Investment Market Performance				
	Year to Date		January - 2013	
Index	In local Currency (%)	In € %	In local Currency (%)	In € %
ISEQ Index	4.4%	4.4%	4.4%	4.4%
FTSE 100	6.4%	1.1%	6.4%	1.1%
Eurostoxx 50 Index	2.5%	2.5%	2.5%	2.5%
S&P 500	5.0%	2.1%	5.0%	2.1%
Nikkei 225	7.2%	-1.7%	7.2%	-1.7%
FTSE All-World	4.5%	1.5%	4.5%	1.5%
Oil	6.2%	3.2%	6.2%	3.2%
Eurozone Government Bonds		-0.4%		-0.4%
USD / Euro		-2.9%		-2.9%
GBP / Euro		-5.1%		-5.1%

Overall, international equities started the year positively as a last minute deal in the US Congress on averting the so-called "fiscal cliff" provided a good start to 2013. A continuation of the recent positive economic data from the US and China also supported share prices and industrial commodities. Currency markets saw significant volatility in the month as the Japanese Yen fell over 8% as the new government in Tokyo committed to significant monetary easing and a weaker Yen. The US Dollar and Sterling also fell against the Euro as the Federal Reserve and Bank of England also committed to further inflationary measures to support economic growth.

[1] This outlook does not constitute an offer and should not be taken as a recommendation from Wellesley Investments & Pensions Ltd.
Advice should always be sought from an appropriately qualified professional.

FTSE World Index of Global Equities over Past 12 Months



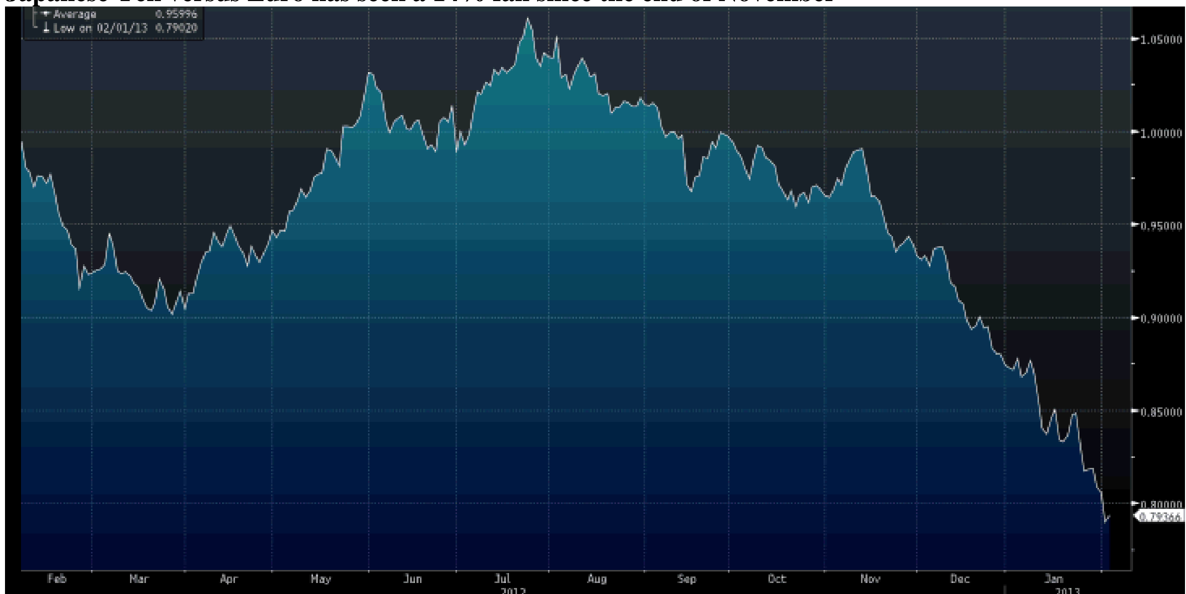
Source: Bloomberg

Currency Wars

With three of the four major global Central Banks pursuing non-standard money-printing measures to generate inflation and in turn economic growth in their respective economies, it was inevitable that the currency volatility generated by these measures would lead to some claims of foul play. The election of a new government in Japan in December on the back of promises to kickstart the moribund Japanese economy using massive monetary stimulus and the subsequent sharp fall in the Yen against most of its major trading partners has seen the first diplomatic skirmishes in what could be a significant theme in 2013.

The 14% and 10% fall in the Yen versus the Euro and the US Dollar respectively since the start of December has raised significant issues for businesses competing on global markets with companies with a Japanese cost base. For Euro based manufacturers the situation is compounded by the recent strength in the Euro against Sterling and the US Dollar and by weakening domestic demand.

Japanese Yen versus Euro has seen a 14% fall since the end of November



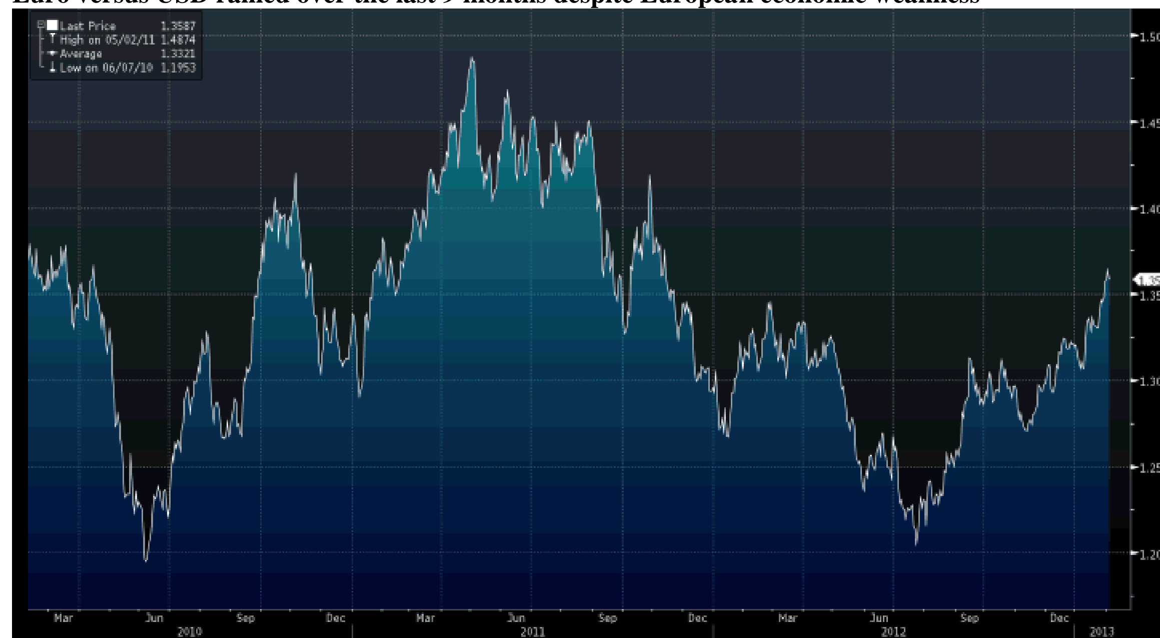
Source: Bloomberg

The impact of quantitative easing on currencies is relatively straightforward. The price of money, like any other good, decreases as more of it is supplied. For any individual currency an increase in the supply (Central Bank Quantitative Easing) is reflected in a fall in its buying power (inflation) and a decline in its value in terms of other currencies (exchange rate). Where multiple Central Banks are actively increasing the supply of currency the impact on exchange rates becomes a relative game with the most aggressively expanding currency falling in terms of the others.

The commitment of the US, Japanese, British and Swiss Central Banks to maintaining or even expanding their quantitative easing programmes leaves the Eurozone exposed as the least enthusiastic money printers. While the US and UK have engaged in successive rounds of quantitative easing over the past four years, the existential crisis facing the Euro staved off any serious concerns of an overvalued currency. As the crisis has eased, or at least the threat of ECB intervention has been enough to obtain some respite for Spanish and Italian bond markets, the impact of monetary policy elsewhere has seen a significant increase in the Euro versus the Dollar, Pound and Yen.

The philosophical and political objections of Germany to any aggressive quantitative easing measures by the European Central Bank has been the main obstacle to the Eurozone pursuing the same blend of monetary stimulus and fiscal austerity as its counterparts in the US, UK and Japan with fiscal austerity forming the only consistent plank of Eurozone policy. As the major manufacturing and exporting base of the Eurozone, Germany is especially exposed to any significant strengthening in the Euro versus competitors such as the US, UK and Japan. As the "Currency War" rhetoric becomes more vocal in the Eurozone's largest economy, it is likely that German attitudes towards quantitative easing will start to soften somewhat.

Euro versus USD rallied over the last 9 months despite European economic weakness



Source: Bloomberg

For Euro based investors, the weakness in foreign currencies versus the Euro has resulted in losses on overseas investments and non- Euro savings in Euro terms during December and January. The strength in the Euro versus the US Dollar is particularly relevant given the exposure of most diversified investment portfolios to the world's largest economy and investment market. We believe that the recent weakness in the Dollar versus the Euro will be reversed, however, as the underlying relative strength of the US economy versus the Eurozone sees normal monetary policy resume sooner in America and so we recommend

holding off any further reductions in exposure to USD. The challenge being posed by a strong Euro to the increasingly fragile German economy also makes the possibility of a further easing of ECB policy more likely, again resulting in a weaker Euro.

Relative Sector Valuations – Equities Remain Cheapest Asset Class in terms of Income

The easing of the funding crisis for Eurozone banks has seen Irish bank deposit rates move closer into line with those of the core Eurozone, with short and medium term deposit rates moving closer to the ECB benchmark rate of 0.75%. With bond yields for most countries also rooted at historically low levels, investors are having to rethink their portfolio allocations to higher risk assets in order to achieve even modest returns. Such an environment is very supportive of asset classes such as equities, commodities and property. With commercial property markets still in turmoil due to oversupply, equities seem likely to benefit from the substantial shift in portfolio allocations resulting from near-zero deposit rates and bond yields. Dividend Yields on major equity indices such as the Dow Jones, the FTSE 100 and the DAX range between 2.5 and 3.5% almost twice the relevant 10 year bond yields. While stock markets have enjoyed a strong performance over the past six months such relative value continues to support shares over other asset classes as long as the economic backdrop remains relatively benign.

Recommended Investment Strategy

Equity markets have recorded a strong six months especially in local currency terms. While the risk of a correction due to profit taking has no doubt increased, the underlying value offered by equities even after the recent gains is hard to ignore. With dividend yields higher than both deposit and bond interest yields, the greater inflationary protection afforded by equities is an added bonus, albeit an important one given the aggressive monetary easing bias of the major Central Banks.

Strength in the Euro has taken the gloss off the most recent gains on international markets for Euro based investors, however, we believe that markets have placed too much confidence in Germany's aversion to monetary easing. A slowing German economy and a strengthening currency depressing domestic exports and threatening manufacturing jobs is the last thing that Angela Merkel needs in an election year so we would expect some movement from the ECB to alleviate the increasing pressure on European exporters providing a boost for equities and a currency gain for non-Euro investment exposures.

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