Wellesley
Investments & Pensions

Investment Markets in March[1]

Equity markets shrugged off concerns following the inconclusive Italian elections in late February and gained strongly to their close on March 14th. However, the bundled bail out of Cyprus was the catalyst for significant weakness in European markets to month end led by peripheral markets and the banking sector. Elsewhere equity markets continued to gain on the back of firmer economic data and ongoing quantitative easing.

Investment Market Performance

	Year to Date		March - 2013	
Index	**In local Currency (%)**	**In € %**	**In local Currency (%)**	**In € %**
ISEQ Index	16.5%	16.5%	5.4%	5.4%
FTSE 100	8.7%	4.6%	0.8%	2.9%
Eurostoxx 50 Index	-0.5%	-0.5%	-0.4%	-0.4%
S&P 500	10.0%	13.2%	3.6%	5.7%
Nikkei 225	18.7%	12.0%	6.7%	6.9%
FTSE All-World	5.8%	8.9%	1.5%	3.6%
Oil	5.9%	9.0%	5.6%	7.8%
Eurozone Government Bonds		0.4%		0.5%
USD / Euro		3.0%		2.1%
GBP / Euro		-3.7%		2.1%

Higher grade Sovereign Bond markets gained marginally in March as the Cyprus debacle ensured some gains for lower risk assets while peripheral Spanish and Italian Bond yields increased. The main trend in currency markets saw the Euro weaken significantly against all major currencies as Cyprus newsflow raised fears for Euro area stability.

Economic Data

US and EU data showed a marked contrast again as seen from the below table. While some housing and manufacturing data came in weaker than expected, US numbers continued to show expansion with employment data in particular performing well. European data continued to be weak with confidence affected by Cypriot issues raising Euro concerns within the region while German Retail Sales were very weak relative to expectations, down 2.2% year on year.

The US Dept of Agriculture issued US Agricultural commodity inventory numbers that were higher than expected for March end but remain near historic lows post last year's drought. The news saw Agricultural commodities fall in price. All time high US crop acreage sown this spring suggest the expectation of large harvests. As such, much positivity is in prices at present and any negative event will likely push prices higher.

[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.

Global Economic Data Heatmap

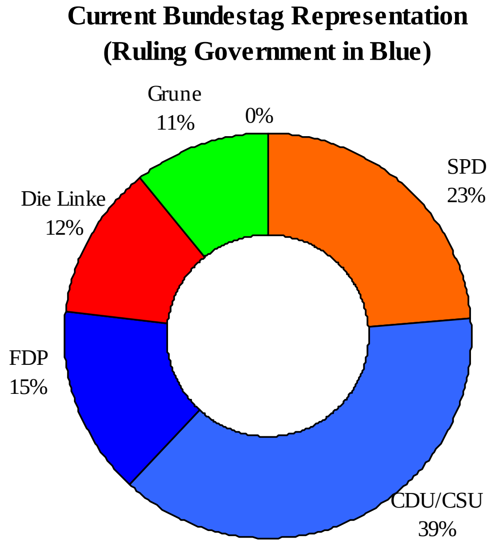
Category	Data	Release Date	latest reading	market forecast	prior reading	better than last reading	better than expected
US Economy	GDP QoQ Annualized	28-Mar	0.4%	0.5%	0.1%	√	X
	ISM (manufacturing)	01-Apr	51.3	54.0	54.2	X	X
US Employment	Initial Jobless Claims	28-Mar	357,000	340,000	336,000	X	X
	Change in Non Farm Payrolls	08-Mar	236,000	165,000	157,000	√	√
US Housing	Pending Home Sales (YoY) %	27-Mar	5.0%	8.7%	10.4%	X	X
	Case Shiller Home Price Index	26-Mar	146.2	146.17	145.95	√	√
	New Home sales	26-Mar	411,000	420,000	437,000	X	X
US Consumer	Advance Retail Sales (YoY)	13-Mar	1.1%	0.5%	0.1%	√	√
	Conference Board Consumer Confidence	26-Mar	59.7	67.5	69.6	X	X
	University of Michigan Consumer Confidence	29-Mar	78.6	72.6	71.8	√	√
Europe	Eurozone Consumer Confidence	27-Mar	-23.5	-23.5	-23.5	X	X
	German IFO (Business Climate)	22-Mar	106.7	107.8	107.4	X	X
	German Retail sales (YOY)	28-Mar	-2.2%	1.2%	2.4%	X	X
	German GDP (QoQ)	14-Feb	-0.6%	-0.5%	0.2%	X	X
UK	Nationwide House Price Index (YoY)	28-Mar	0.8%	0.9%	0.0%	√	X
	GDP (QoQ)	27-Mar	0.2%	0.3%	0.3%	X	X
China	Consumer Price Index (YoY)	08-Feb	3.2%	3.0%	2.0%	√	√
	Chinese Real GDP (YoY)	18-Jan	7.9%	7.8%	7.4%	√	√
	HSBC PMI Manufacturing	01-Mar	51.6	51.6	50.4	√	X

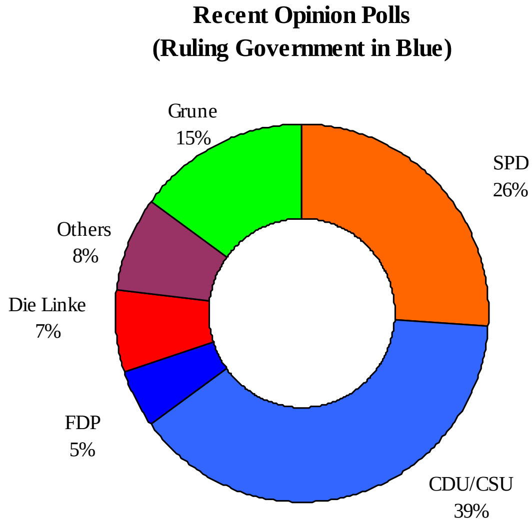
German Political Stability

Elections on September 22nd of this year will be watched closely by markets as German voters have their first opportunity to express their views on the German economy and the country's pivotal role in addressing the Eurozone Sovereign Debt and banking crisis.

Each voter will cast two ballets, one for a local district representative and the second for a political party that measures each party's popular vote. The first ballet results go towards electing half the representatives in the Bundestag while parties are then allocated additional seats pro rata based in results in the popular ballet. The Bundestag then sits to elect a Chancellor by majority. Since the drafting of the 1949 constitution, German politics has been dominated by the Social Democratic Party (SPD) who has put forward, Peer Steinbruck as their challenger for Chancellor and the Christian Democratic Union (CDU) currently led by Angela Merkel. The current coalition is made up of three political parties, the Christian Democratic Union, the Christian Social Union (CSU) and the Free Democratic Party (FDP), while the historical alternative has been the Social Democratic Party & the Greens (Grune).

Regional elections held since 2009 have seen the incumbents receive heavy defeats but recent elections saw an increase in support for the CDU led party block. Opinion polls conducted in mid March 2013 suggest, if elections were now held, neither block would command a majority within the Bundestag.





In such a balanced election the current government may well be strongly incentivised to lessen their insistence on fiscal austerity in order to boost economic growth at the core of Europe in the second half of 2013 to create some political capital. Given the weakness of the core Eurozone economy a greater emphasis on easing of monetary policy by the ECB could receive a more receptive hearing in Berlin than would otherwise be the case. Any loosening of either fiscal or monetary policy to boost growth will likely significantly help European risk assets at the expense of bonds given their discounted valuations and relatively stronger yield.

Mixed messages from the Eurozone in March

Global investors nonchalant reaction to the potential vacuum in Italy post the recent elections, illustrated the positive effect Draghi and other policy leaders in Europe have had in convincing many that the risk to Euro stability had materially lessened. The market's response to the clumsy handling of the Cypriot bail-out and the imposition of losses on bank depositors for the first time revealed how fragile the Eurozone situation remains in the minds of global investors.

However, it is our view that the fall out from the Cyprus bailout and the policy response have been muddied somewhat by the country's status as a haven for off-shore funds and Russian tax evasion. These circumstances are unique and are not necessarily comparable for any future mainstream economy that may face the prospect of requiring a bailout into the future. As such, we see the contagion concerns as somewhat overdone on the Cyprus issue alone and do not see the banking sector treatment as a template to future possible bail outs.

Undoubtedly, the Italian governance issue remains a concern heading into Summer as the Italian president appears to be struggling to pull together either a technocratic or broad coalition government to offer some leadership to the country in the near term, or at least until more decisive elections can be held later in the year. This uncertainty directly contributed to the Italian treasury failing to raise their target level of funds from a debt auction last week as all parties appear to be playing politics at the moment.

Overall Outlook

Our view on European risk assets now is informed by the following:

- **The Cyprus situation is unique and not a template for future Euro bailouts**
- **Germany's pending elections and current balance suggests support for more expansionary policy may be forthcoming**
- **ECB commitment to avoid Euro collapse was reiterated in recent weeks and any policy shift to boost growth will be very positive to European Equities.**
- **Pragmatically, Italians need to cooperate to ensure the country can continue to fund itself into the future.**

As such, we see the recent weakness in European equity markets as an attractive entry point with stocks supported by discounted valuations relative to other geographic markets and alternative asset classes such as cash and bonds. The fact that much of European stock market earnings are driven by global growth, not just European, means that these stocks will also benefit from the US recovery and Chinese led strong Asian activity.

Performance of the S&P500 & Euro Stoxx 50 Index over the last year with Stoxx 50 underperformance clearly evident in 2013.

Source: Bloomberg

<u>Recommended Investment Strategy</u>

Currency volatility continues to play a strong role in portfolio returns with non Euro exposure benefitting significantly from the recent weakness in the single currency. While part of the recent fall in the Euro can be attributed to events in Cyprus which we believe have been overplayed, we believe that the Euro remains vulnerable given the relative weakness of economic data and the risk of a protracted Japan style recession. European shares, however, trade at valuations significantly lower than their international peers despite the major European indices being dominated by globally trading firms. Weakness affords an attractive entry point to European equities in our view.

Euro/Dollar Exchange Rate over the last 12 months – marked volatility evident in recent months

Source: Bloomberg

US & European bond assets have only marginally underperformed recently as equities have rallied, suggesting cash has largely funded equity performance and rotation from bonds to equities has yet to take hold to any great extent. However, should Europe show signs of introducing fiscal or monetary stimulus to boost growth, this could well be the catalyst for such a trade and we will look to a more balanced asset allocation between core European Equities and Bonds to account for the increased prospect of this occurring.