Investment Markets in December, Review of 2014 and Outlook for 2015

Markets weakened in local currency terms in December but US and Japanese markets gained in Euro terms as the Euro weakened further. Equity market performances diverged in 2014 as European markets underperformed the US as the Eurozone economy lagged the recovery in the American labour and housing markets. US stockmarkets gained over 11% in 2014 with the 13% gain in the US Dollar over the Euro adding to the return in Euro terms.

Investment Market Performance

	Year to Date		December - 2014	
Index	**In local Currency (%)**	**In € %**	**In local Currency (%)**	**In € %**
ISEQ Index	15.1%	15.1%	3.0%	3.0%
FTSE 100	-2.7%	4.3%	-2.3%	0.1%
Eurostoxx 50 Index	1.2%	1.2%	-3.2%	-3.2%
S&P 500	11.4%	26.9%	-0.4%	2.3%
Nikkei 225	7.1%	7.0%	-0.1%	1.6%
FTSE All-World	2.2%	16.4%	-2.0%	0.7%
Oil	-45.9%	-38.3%	-19.5%	-17.2%
Eurozone Government Bonds		13.1%		0.8%
USD / Euro		13.6%		2.9%
GBP / Euro		6.9%		2.5%

Eurozone bonds performed well in 2014 with yields continuing to fall on a weaker outlook for inflation and expectations of ECB intervention to purchase sovereign debt. Oil continued to be weak in December ending the year 45% lower and over 50% down from its peak in June 2014.

A Review of 2014 in Graphs

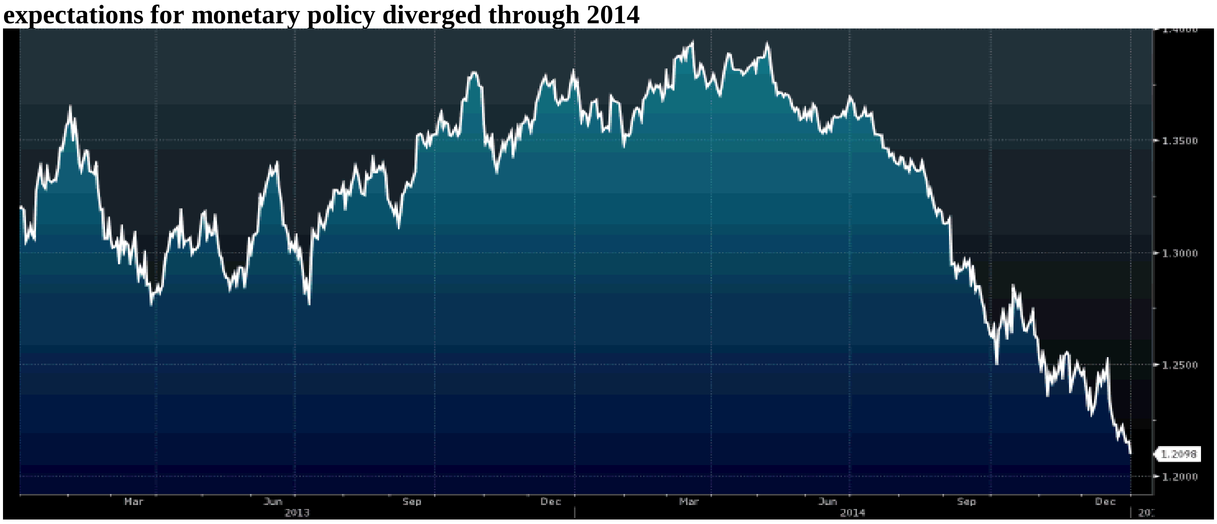
S&P 500 in Euro terms. The S&P 500 continued to reach new highs throughout 2014

Source: Bloomberg

Eurostoxx 50 Index: European markets underperformed the US as growth faltered and geopolitical risks increased in Russia and Greece

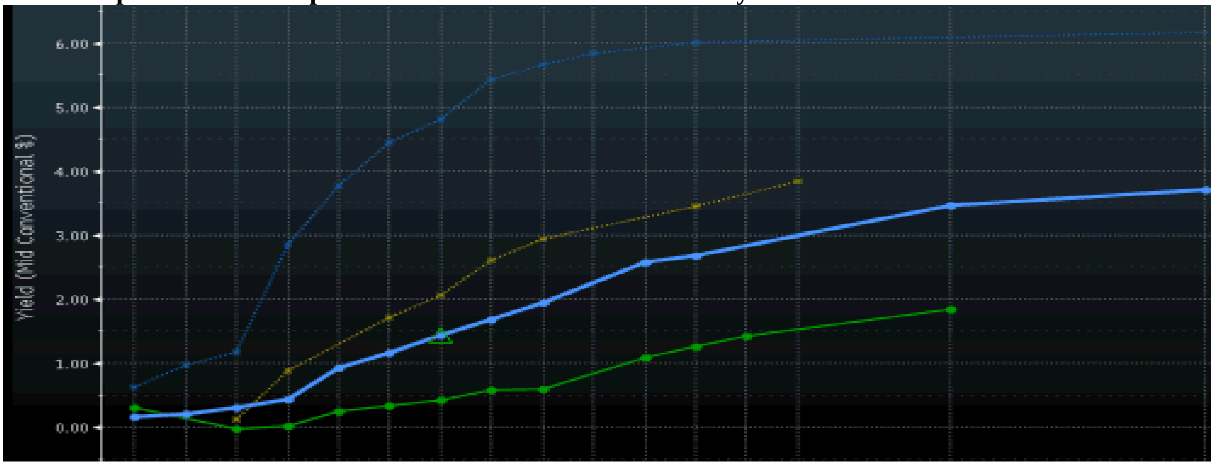
Source: Bloomberg

Euro / US Dollar: The Euro continued to weaken against the Dollar as economic performance and expectations for monetary policy diverged through 2014



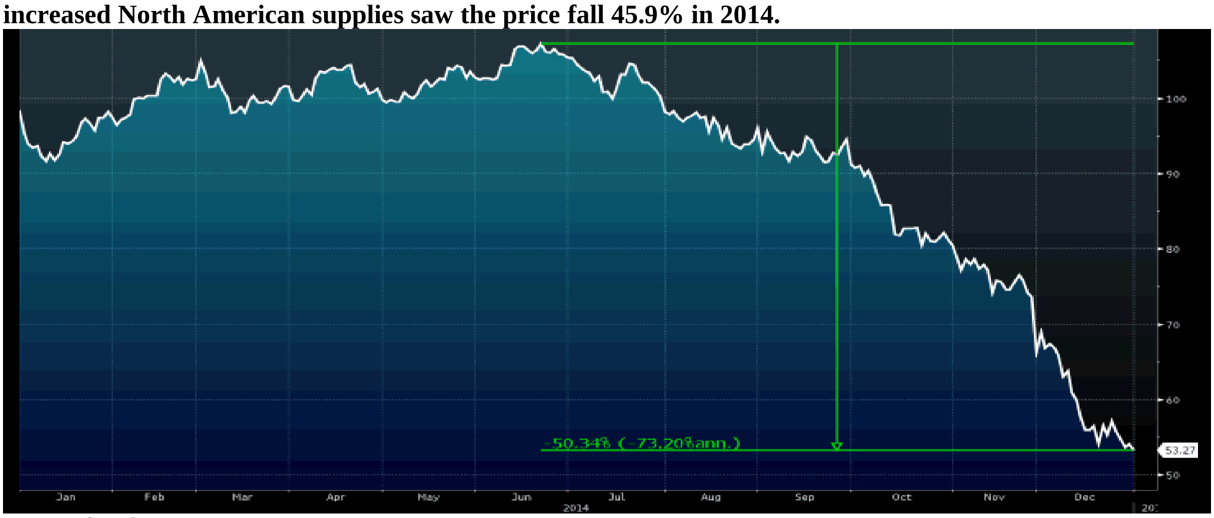
Source: Bloomberg

Irish (Green) and Portuguese (Blue) Bond Yields reduced significantly from 2013 levels (broken lines) as economic performances improved and both countries successfully exited Bailouts



Source: Bloomberg

WTI Crude Oil Price per Barrel: Oil reached lows last seen in 2008 as fears for global demand and increased North American supplies saw the price fall 45.9% in 2014.



Source: Bloomberg

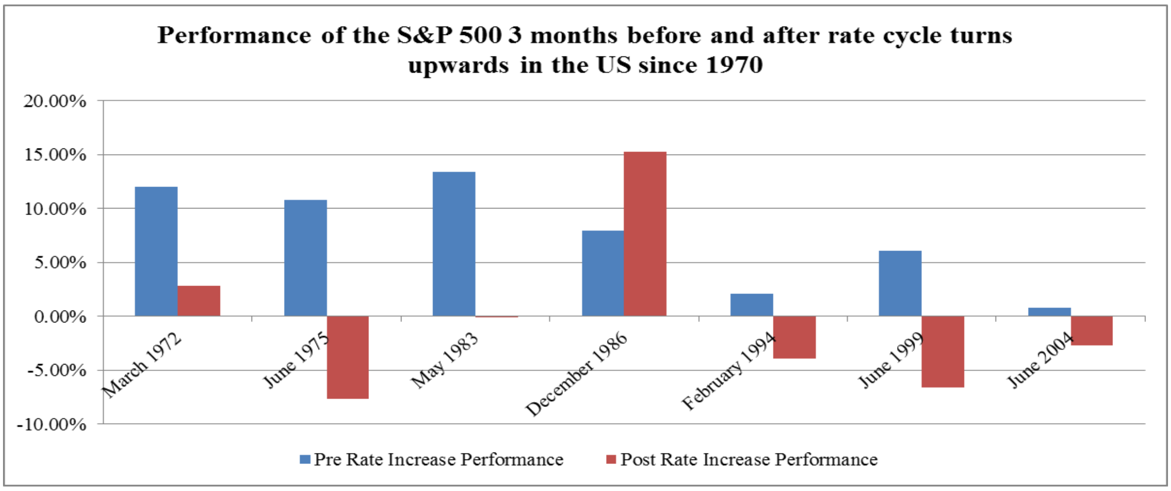
ETFS Agricultural Commodity ETF Price: Food commodities fell sharply on expectations of bumper harvests. Prices have since rallied, however, having reached 10 year lows in September.

Source: Bloomberg

Outlook for 2015

Increased Equity Market Volatility

Equity markets are likely to be more volatile in 2015 as the crutch of quantitative easing has been removed in the US and the FED gradually increases interest rates. Expectations for the first rate increases in the US have moved from June 2015 to April as economic data continues to be positive. The below chart illustrates the US equity market performance three months before and after a turn in the interest rate cycle after the last seven major recessions.

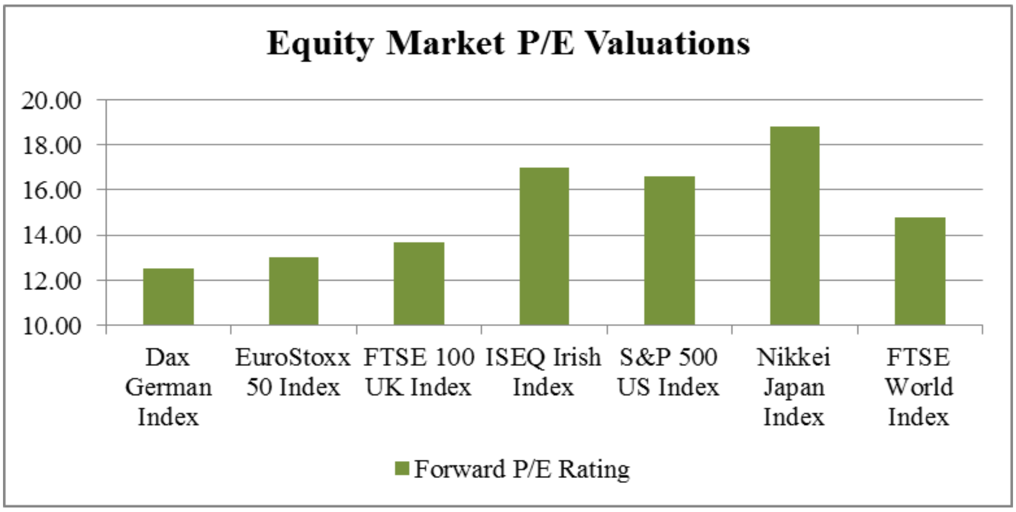


Source: Bloomberg & Wellesley I&P

Recent history suggests a onsistent pattern of strong stockmarket performances into the turn in the interest rate cycle followed by weakness after the first interest rate increase.

European Equity Markets to outperform

European equity markets significantly underperformed US markets in 2014 as stagnation in the European economy and increased geo-political risks relating to Ukraine, Russia and Greece weighed on investor confidence. This underperformance has seen forward P/E valuations in European markets fall significantly below those of US and Japanese markets (Forward P/E is the Price/Earnings Ratio of the index based on year-end earnings estimates at the end of 2015). The German market trades on a multiple of 12.5x forward earnings, the EuroStoxx at 13x and the S&P 500 at 16.6x.



Source: Bloomberg and Wellesley I&P

We see attractive investment value in the German stockmarket as many of the companies are internationally focused (with non-European sales making over 45% of total sales in 2014 for the largest 10 companies). Earnings growth for these companies is not just linked to weak Eurozone economic growth but also to the stronger economic outlook for the global economy. Also, the significant fall in Euro over the last 6 months should boost earnings for exporters such as many of these companies whose costs are largely Euro denominated. Also, growth within the Eurozone should be supported by ECB intervention from a low base of expectation at present.

Oil to rebound albeit from lower levels

Since June of this year the oil price has fallen over 50% as increased supply from US shale production and OPEC swamped the market. US foreign and domestic policy have clearly supported a weaker oil price with US consumers disproportionately benefitting from lower gasoline prices, offsetting the impact of tightening monetary policy. OPEC confirmed their intention to retain supply at current levels keeping downward pressure on oil to protect market share from higher Russian and US Shale production. While political pressure to hold prices at current low levels will likely remain into early 2015, much Shale and deep sea production is economically unsustainable at current price levels and the US may not wish to jeopardise the longer term sustainability of the US oil industry.

West Texas Intermediate Oil Price from 2008

Source: Bloomberg

While US policy may therefore support weaker oil prices in the short term, we envisage a recovery in prices later in 2015 as longer term considerations take precedence. As the above chart shows, after a sharp fall in 2008, the oil price recovered by almost 100% in the 9 months between January and October 2009. The oil price can adjust quickly once political pressures ease and we recommend accumulating a position in oil at or below these levels.

Bank of Ireland – target €0.40c

We remain positive on Bank of Ireland into 2015 as we expect it to continue to benefit from the Irish economic recovery and as the bank leverages record low borrowing rates from a normalised capital base to increase profitability through expanding lending margins and volume as credit demand returns. Technically, the stock reached a 32c ceiling on a number of occasions over the last 6 months as European Bank stress tests and the ownership overhang of the Irish Government stake caused concerns. However, after the Bank passed the stress tests in October, the stock rallied to almost 36c in early December before falling back into year end. We believe the stock will continue to perform into 2015 and see €0.40 as a realistic price target over the coming months. Market volatility may, however, create opportunities to trade in and out of the stock at the margins throughout the year.

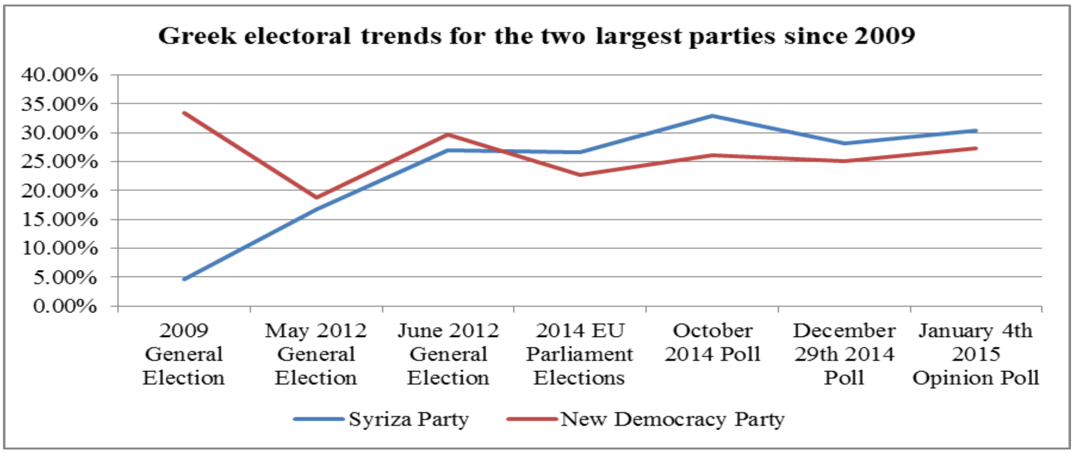
Bank of Ireland Performance (Yellow) relative to the Irish 5 year Sovereign Yield (White) since 2012

Source: Bloomberg

Risks to our outlook in 2015

Greek political instability

Greek prime minister George Samaras' failure to gain sufficient votes to support his nomination for president after three attempts on December 29th, has precipitated an early general election scheduled for January 25th. The Syriza anti austerity party may be set to gain power according to opinion polls, as structural reforms and cutbacks have sapped support for the more traditional pro-European parties.



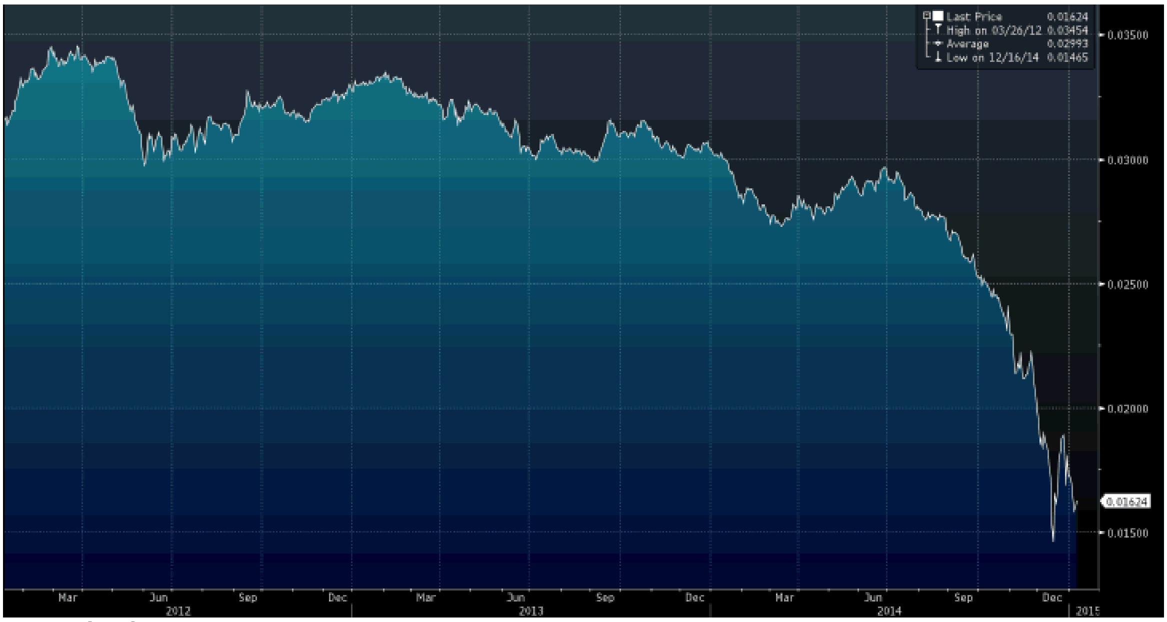
Source: Wellesley I&P, Reuters

The recent developments in Greece have had little effect on other European peripheral sovereign bond yields as investors expect the ECB to protect weaker economies from contagion from an increasingly isolated Greek situation through its quantitative easing programme. However, should the ECB lack conviction in this regard, any political upheaval in Greece could spread to other struggling economies as 2015 progresses and fears of Eurozone stability may return. A successful anti-European vote in Greece will increase nervousness ahead of UK elections in May of this year where European Union membership is likely to be a significant issue in debates.

Russia

In 1998, a collapse of the Russian economy and the Ruble caused a significant correction in capital markets with the S&P 500 Index falling almost 20% in 2 months as some western hedge funds collapsed due to losses in Russia. At present, Russian economic influence does not extend as far and as deeply as it did in 1998 and the recent Ruble weakness has had a much more muted effect on global markets. The Russian administration's increasing isolation internationally and domestic economic woes may result in more unpredictable policy decisions from the Kremlin in 2015 adding to market volatility.

Russian Ruble / US Dollar



Source: Bloomberg

US Economy – Is the recovery reaching maturity?

Sustained US economic growth is the consensus near term outlook among market strategists at the moment with many hoping that this strength will in time aid the global recovery and in particular benefit Europe and emerging markets. However, US growth over recent years has been built on unprecedented stimulus. With QE ended and US interest rates set to increase in early 2015, its effect on US expectations for US economic growth and wage and general inflation levels is uncertain and the offsetting stimulus of low oil prices may only be temporary.

US Unemployment Rate for the last 50 years– economic recoveries (shaded areas) have typically lasted between 4 and 7 years with the current recovery entering its sixth year

Source: Bloomberg and Wellesley I&P

Any disappointment in US economic data in the short term and while European and Asian growth remains weak, leaves risk assets and especially US equities, given their higher valuations, vulnerable to a significant correction.