Investment Markets in August 2015

Equity markets saw their biggest falls in over 4 years in August with volatility reaching levels last seen in the financial crisis in 2007-2008. The main catalyst for the volatility was the surprise devaluation of the Chinese yuan and a series of weaker than expected economic data from the world's second largest economy. Commodity markets shared in the general sell-off before recovering most of their declines before the end of the month.

Investment Market Performance

	Year to Date		Aug-15	
Index	In local Currency (%)	In € %	In local Currency (%)	In € %
ISEQ Index	22.6%	22.6%	-1.6%	-1.6%
FTSE 100	-4.8%	1.1%	-6.7%	-10.2%
Eurostoxx 50 Index	3.9%	3.9%	-9.2%	-9.2%
S&P 500	-4.2%	3.4%	-6.3%	-8.2%
Nikkei 225	8.3%	15.4%	-8.2%	-8.1%
FTSE All-World	-4.7%	2.8%	-7.0%	-8.9%
Oil	-7.6%	-0.3%	4.4%	2.3%
Eurozone Government Bonds		0.1%		-1.1%
USD / Euro		7.9%		-2.0%
GBP / Euro		6.3%		-3.8%

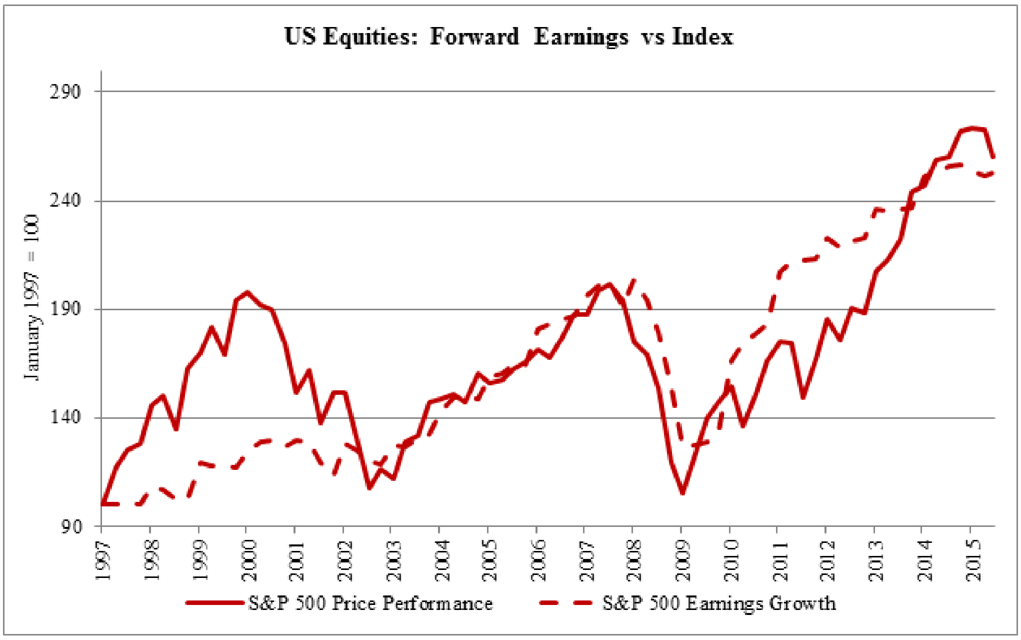
FTSE World Global Equity Index Year to Date

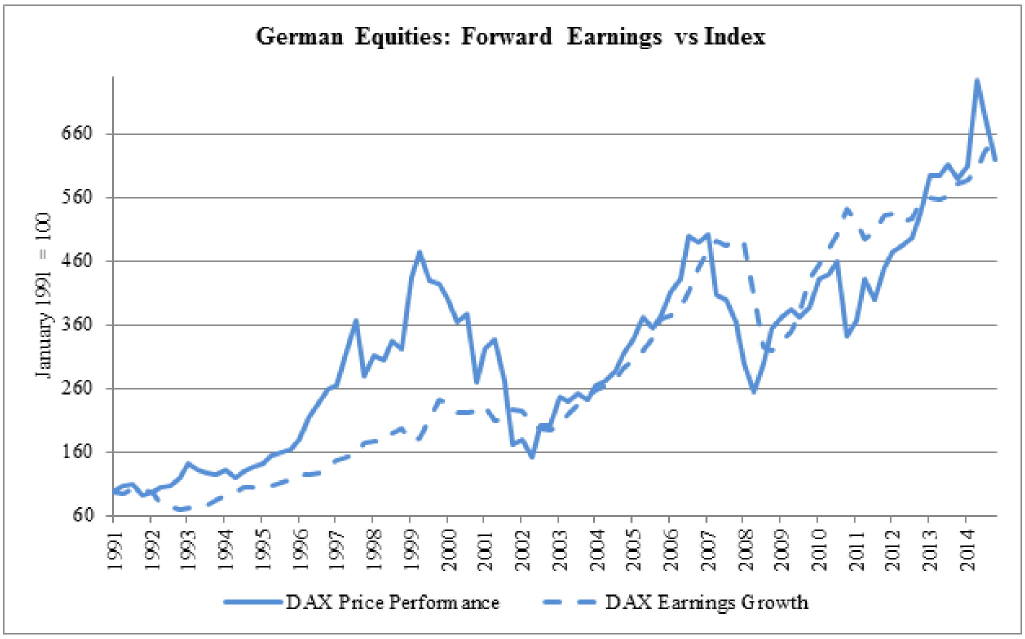
Source: Bloomberg

Do Equities Offer Value after their Recent Correction?

Equity markets fell sharply in August with Asian and European stocks bearing the brunt of the sell-off. Weaker than expected Chinese economic data and concerns over the impact on global trade of the recent devaluations of the Chinese yuan are generally regarded as the catalyst for the sell-off. We have for some time, however, believed that equities have been overpriced relative to underlying corporate earnings and see the recent falls as partly reflecting a correction of this overvaluation.

While corporate profits have grown significantly over the past three years, they have not kept pace with share prices leaving most market indices overextended in terms of valuations and multiples. In our view, equity markets have been trading on a paradox. Lower interest rates are being used to justify higher valuation multiples but the sluggish economic activity driving interest rate policy is not being factored into the outlook for corporate earnings. The sharp falls seen in August have removed a significant amount of this over-valuation especially for European equities.





Source: Bloomberg, Wellesley

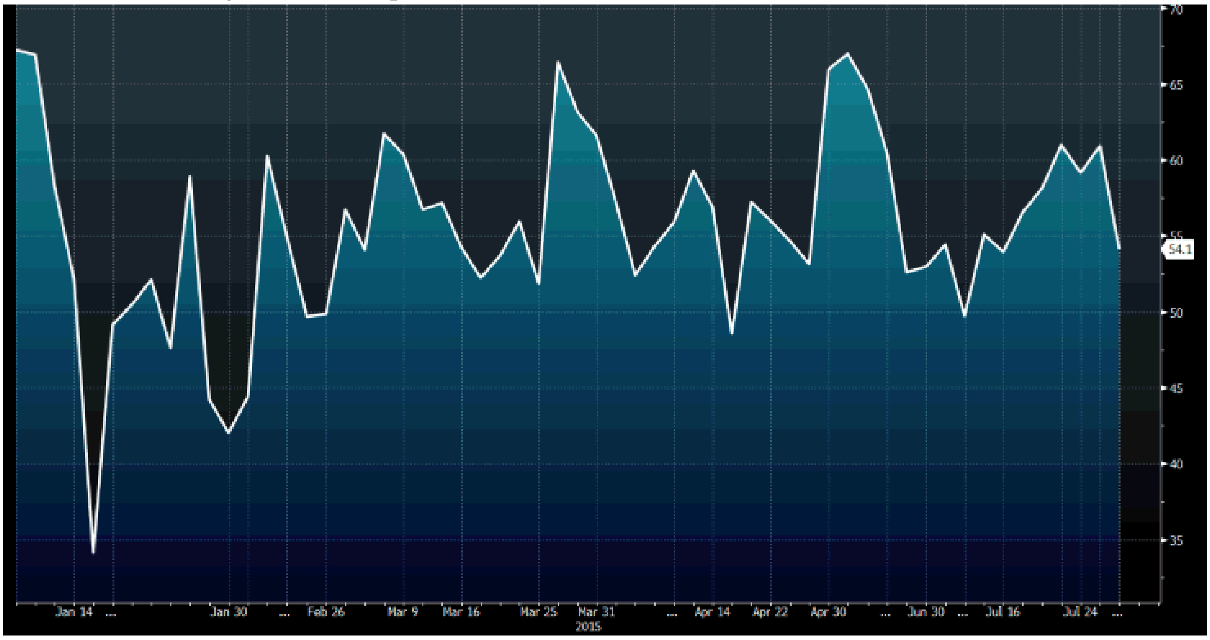
In terms of the outlook for corporate earnings growth, a serious slowdown or even contraction in the Chinese economy would, without doubt, pose a significant challenge for global corporate earnings. This would not only be reflected through reduced Chinese demand for global products and services but also through the impact of Chinese monetary policy and further devaluations of the Chinese yuan.

We believe that despite the recent correction in equity markets, the heightened risks presented by the weaker Chinese economy partly offset the more attractive valuations offered by equities even in the case of European equities which have seen larger falls than other markets.

US Interest Rates

Throughout the summer, markets have anticipated the announcement of US interest rate increases by the Federal Reserve in its September meeting. However, the recent yuan devaluation and lower than expected inflation data in the US have caused economists to now question the likelihood of an announcement in September.

Credit Suisse Survey of market expectations of US rate increases over the next 12 months



Source: Bloomberg

Immediately after the Federal Reserve’s last meeting, the futures market was predicting a 40% probability of a rate increase at the September meeting of between 25 and 50 basis points. This probability has fallen to 34% despite continued improvement in the US labour market. At the annual Central Bankers Jackson Hole Conference, Stanley Fischer, the Federal Reserve Vice Chair, acknowledged the positive data but also pointed to risks to the outlook given that market based inflation expectations had weakened. These comments and global growth concerns suggest the Fed may hold off on rate increases until December. This should be positive for equities in the short term.

China

Chinese stockmarkets were again very weak in August despite the Chinese authorities reducing interest rates and devaluing the yuan. The Shanghai Index fell 12.49% in August, while the Shenzhen Index fell 15.18% and the Hang Seng Hong Kong Index fell 12.04%.

The table below illustrates the sensitivity of equity and commodity markets to changes in China's economic growth relative to current growth expectations. While it is difficult to ascertain the extent and pace of a Chinese slowdown at this point, the effect on corporate earnings may not be very large. A significant correction would clearly have a significant impact on commodity markets however. The impact on equity markets as represented by the German DAX index below only reflects the direct impact of slower Chinese growth on German exports to China and does not factor in any second round impacts such as impact on demand from other countries exposed to the Chinese economy or German corporate earnings from operations overseas including China.

Direct Impact of Changes in Chinese Economic Growth relative to Current Expectations

China Annual Economic Growth Scenarios	DAX Index level	Copper Sensitivity	Oil Sensitivity
6% Annual GDP Growth	0.00%	-2.27%	-1.90%
3% Annual GDP Growth	-0.51%	-6.81%	-5.70%
0% Annual GDP Growth	-1.02%	-13.62%	-11.40%
2% Annual GDP Decline	-1.36%	-18.16%	-15.20%

* Assumes the DAX Index P/E multiple remains constant

Source: IMF Working Paper WP/12/15 "China's Impact on World Commodity Markets"

Oil Outlook

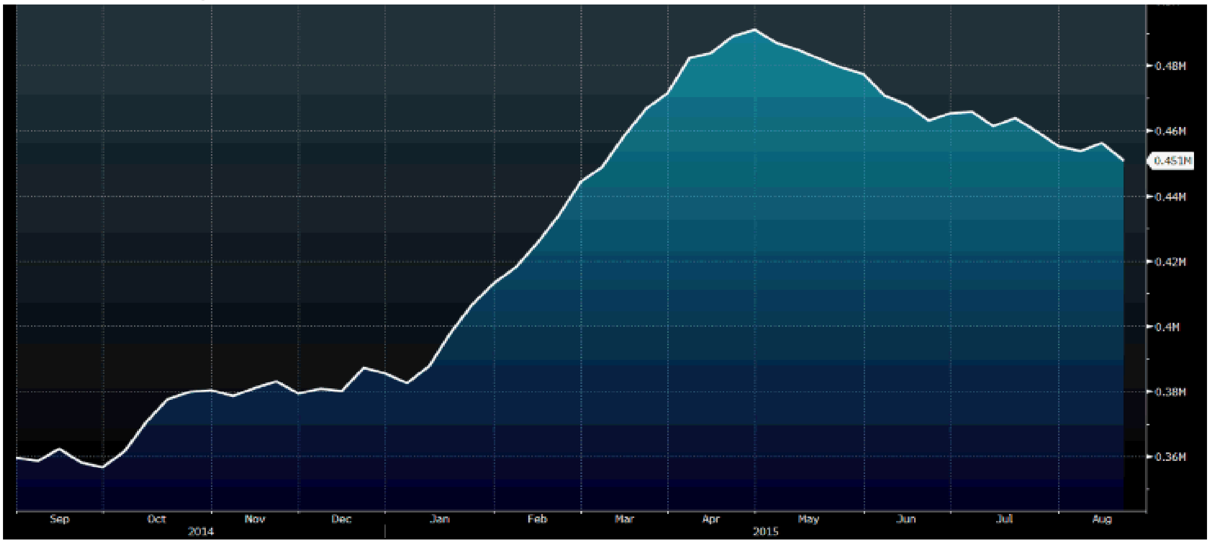
Oil was exceptionally volatile in August, dipping below $40 per barrel for West Texas Intermediate ("WTI") before rallying sharply to end the month in positive territory. With oil supplies remaining high, concerns around Chinese demand hit all commodities, including oil, mid-month.

WTI Oil Price since 2000

Source: Bloomberg

In the short term, US and OPEC production is set to remain high but, at current prices, production is expected to fall sharply in the medium term. In addition, US inventories have fallen from historic highs over the last few months and this is forecast to continue.

US Dept. of Energy Crude Oil Stock levels over the last 12 months



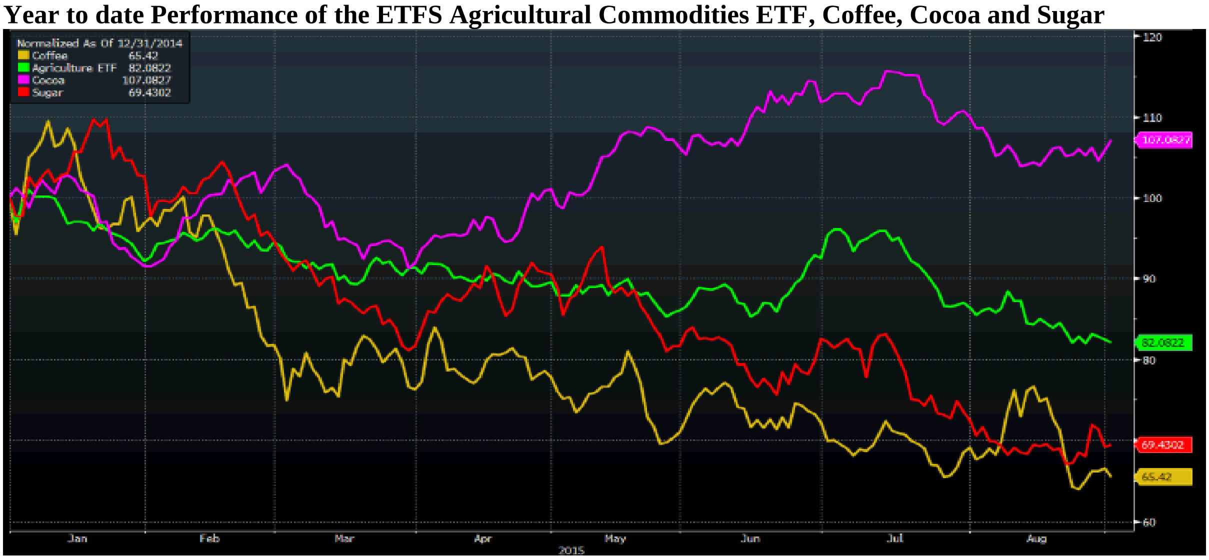
Source: Bloomberg

While continued strong production will likely put a ceiling on further oil price gains in the near term, the International Energy Agency predict a WTI oil price of $56 by mid-2016 as oversupply eases and global demand gradually increases driven mainly by US growth. UBS have cited a price level of $70 per barrel as being a level where the cost of production matches demand and ultimately we believe that prices must move back towards these levels.

Agricultural Commodities

Agricultural commodities fell modestly on the back of the latest USDA report, which shows crop yields rising across the US due to favourable July weather. Coffee and sugar, dominated globally by Brazilian production, fell on the weakening of the Brazilian Real. Cocoa declined this month by 5.37% in euro terms, as elections in the Ivory Coast, the world's top producer of cocoa, created uncertainty in the market.

Year to date Performance of the ETFS Agricultural Commodities ETF, Coffee, Cocoa and Sugar



Source: Bloomberg

It looks increasingly likely that a very strong El Nino event is occurring this year. The IRI/CPC has indicated a 100% probability of the occurrence of El Nino up until the December January February season. The table below summarises the average of the temperature deviations for each of the 3-month seasons for the central Pacific Ocean. It supports a strong El Nino and a possible so-called "super event" that may be more severe that those seen in 1997 and 2009.

Table 2: IRI/CPC ENSO predictive model average results

	ASO	SON	OND	NDJ	DJF	JFM	FMA	MAM	AMJ
Average Dynamic Model	2.2	2.4	2.5	2.5	2.3	2	1.7	1.2	0.7
Actual El Nino Year 1997/98	2	2.2	2.3	2.3	2.1	1.8	1.4	1	0.5
Actual El Nino Year 2009/10	0.7	1	1.2	1.3	1.3	1.1	0.9	0.5	0

Source: IRI/CPC

We remain bullish on our agricultural commodities holdings into the end of the year and early 2016 given the likelihood of El Nino weather disruption in the agricultural commodity market.