BRENT COUNCIL	**Pension Fund Sub-Committee** 26 February 2013 **Report from the Deputy Director of Finance**
For Information	Wards Affected: ALL

Monitoring report on fund activity for the quarter ended 31 December 2012

1. SUMMARY

1.1 This report provides a summary of the Fund's activity during the quarter ended 31 December 2012. It examines the actions taken, the economic and market background, and investment performance, as well as commenting on events in the quarter. The main points arising are:

a) The Fund has increased in value by £12.0m from £489.0m to £501.0m, and the Fund return of 2.6% was slightly ahead of its quarterly benchmark of 2.4%. The strong performance can be attributed to results in Emerging Market Equities, UK Smaller Companies Equities, UK Equities, Fixed Income and Diversified Growth which delivered returns of between 2.9% and 6.2%. Property has continued to achieve a negligible return. Whilst less clear to gauge performance in the short term, Private Equity appears to be delivering a reasonable underlying performance over the longer term.

b) The positive performance for the quarter ended 31 December 2012 has continued during the month of January 2013, where the Fund has continued to increase in value by an estimated £14.5m. An investment update for the month of January 2013, written by the Independent Adviser, is attached.

c) It should be noted that the Fund return of 2.6% represents an underperformance when compared to the WM Local Authority average fund return of 2.9% for the quarter, as a result of Brent's asset allocation with its relatively low exposure to Equities which had a strongly positive quarter and high exposure to Alternatives which performed rather less so.

2. RECOMMENDATION

2.1 Members are asked to note the investment report.

3. DETAIL

Economic and market background – quarter ended 31 December 2012

3.1 Against a still very uncertain backdrop, Equity and Credit markets made further gains in the quarter ended 31 December 2012. This rounded off what turned out to be a very positive year for risk assets.

3.2 Despite a lack of much encouraging news on the domestic front, UK Equities delivered 3.8% over the quarter, bringing the one year return to 12.3%. Large cap gains were outstripped by mid and small cap stocks, with the best returns offered in the Financials and Telecoms groups.

3.3 In the eurozone, positive steps were taken to address the region's debt crisis and ailing banking system. Consequently, European equities provided the best returns of the major regions, returning 8.0% for the quarter and 17.3% for the year.

3.4 Relative to the other equity regions, North America disappointed in the final quarter. Economic data was generally supportive of equity markets, but a muted response to both the outcome of the Presidential election and latest round of quantative easing combined with political brinkmanship over the looming 'fiscal cliff' pared back returns. The region returned -0.8% over the quarter but a strong 10.7% for the year.

3.5 In Japan, a landslide victory for the Liberal Democrat party in December brought renewed hope of decisive policymaking in respect of its ailing economy. Japanese equities returned 5.1% in the quarter but the weakness in the Yen masked a hugely positive local return of 17%. Excluding Japan, the Asia Pacific region posted a return of 5.4% over the quarter and 18.9% for 2012.

3.6 Whilst performance in aggregate within emerging equity markets was strong (4.9% for the quarter, 13.4% for the year), unsurprisingly, individual country performance varied widely. The star performer in the quarter was China, which returned 15.0% whilst in contrast; the poorest performer was Egypt with a return of -12.0%.

3.7 Government bond markets seen as 'safe haven' underperformed corporate bonds in the final quarter, as appetite for risk assets returned. In the UK, Gilts gave up 0.4% in the quarter whilst Sterling corporate bonds gained 2.2%. Over the year as a whole, Gilts have returned 2.7% compared to corporate bonds' 13.3%.

3.8 Property performance was lacklustre in the last quarter and over the year, where negligible returns point to continued downward pressure on capital values.

Outlook for 2013

3.9 Higher starting valuations probably mean an exact re-run of 2012 is unlikely, although there is widespread optimism that most asset classes will deliver positive returns in the year ahead.

3.10 Overall, the world grew in 2012 by around 2.5% and the US reaccelerated midyear. The UK has been sluggish and probably won't return to growth for some time, but even if a "triple-dip" recession occurred, it would only be a mild one. Gross domestic product for 2013 in the eurozone will be down slightly but there will be pockets of strength, such as Germany. China didn't come close to the widely feared 2012 hard landing, while emerging markets continue to grow briskly.

3.11 Despite world economic growth being below most estimates of trend growth, investors seem happy to move away from safe havens and into more risky or economically exposed assets – global equities, credit markets and emerging market bonds, while gold and developed world government bonds are attracting less interest.

3.12 The global economy is split between a weak developed world (encumbered by high debt levels, fiscal austerity and a dysfunctional banking system) and a strong developing world. In broad terms, this divide is expected to persist. However, the picture is gradually changing in that growth in some developing economies has slowed, while there are signs of recovery in the United States. Progress is also being made on the big economic challenges that face the developed economies, and the direction of travel is encouraging.

3.13 Central banks have been very active, continuing with their quantitative easing programmes and intervening in bond markets. A commitment (real or perceived) to print money at any sign of trouble is a powerful stimulant for markets and seems to be the best explanation for what happened in 2012. Low returns on cash deposits and developed world governments have encouraged a move into higher-yielding investments, thus pushing asset prices up.

3.14 Broad expectations are for moderate growth in 2013 and for the first time in a few years, there is room to imagine a brighter and less unstable few years in which the private credit cycle starts to reinforce the credit cycle with an evolving pick-up in global growth.

Table 1: Asset allocation as at 31 December 2012 compared to the benchmark

Market (1)	Market Value 31.12.12 £M (2)	Market Value 31.12.12 % (3)	WM LA Average 31.12.12 % (4)	Fund Benchmark 31.12.12 % (5)	Market Value 30.09.12 £M (6)	Market Value 30.09.12 % (7)	WM LA Average 30.09.12 % (8)
Fixed Income							
Henderson – Total Return Bond Fund	81.6	16.3	18.6	15.0	79.1	16.2	19.1
Equities							
UK – Legal & General	70.8	14.1	26.2	13.0	68.2	13.9	25.8
UK - Small Companies Henderson	19.0	3.8	*	4.0	18.2	3.7	*
O/seas – developed Legal & General	108.1	21.6	30.6	22.0	105.9	21.7	30.4
O/seas – emerging Dimensional	31.3	6.2	6.0	8.0	29.5	6.0	5.4
Property							
Aviva	33.5	6.7	6.7	8.0	33.7	6.9	6.8
Private Equity							
Capital Dynamics	61.1	12.2	4.0	10.0	60.0	12.3	3.7
Yorkshire Fund	1.3	0.3	*		1.3	0.3	*
Hedge Funds							
Fauchier	41.2	8.2	2.0	5.0	40.2	8.2	2.7
Infrastructure							
Alinda	15.3	3.0	0.9	6.0	15.2	3.1	1.5
Capital Dynamics	8.4	1.7	*		4.4	0.9	*
Henderson PFI Fund II	1.1	0.2	*		1.1	0.2	*
Pooled Multi Asset							
Baillie Gifford DGF	28.5	5.7	1.5	8.0	27.8	5.7	0.8
Cash	-0.2	0.0	3.5	1.0	4.4	0.9	3.8
Total	**501.0**	**100.0**	**100.0**	**100.0**	**489.0**	**100.0**	**100.0**

3.15 Table 1 shows the changes in asset allocation, how asset allocation compares with the benchmark and with the average fund (WM Local Authority average), and how the change in the market value during the quarter is allocated across asset classes. Items marked (*) in columns 4 and 8 cannot be separately analysed, but are included within the relevant asset class. Aside from market movements, there have been no investment changes to the Brent Pension Fund during the quarter.

Asset allocation of the Fund

3.16 The WM Local Authority average asset analysis for the quarter ended 31 December 2012 shows increased allocations into the following asset classes:

Asset class	**Increase in percentage allocation**
Overseas Equities	+0.8%
Diversified Growth	+0.7%
UK Equities	+0.4%
Private Equity	+0.3%

3.17 Those asset classes out of favour with the WM Local Authority average during the quarter are shown as follows:

Asset class	**Reduction in percentage allocation**
Hedge Funds	-0.7%
Infrastructure	-0.6%
Fixed Income	-0.5%
Cash	-0.3%
Property	-0.1%

3.18 The independent WM Company measures the returns on the Brent Pension Fund. Table 2 sets out returns for the quarter to 31 December 2012.

Table 2: Investment Returns in Individual Markets

Investment Category	RETURNS						Benchmark/ Index Description
	Quarter Ending 31.12.12			Year Ended 31.12.12			
	Fund %	Benchmark %	WM Local Auth %	Fund %	Benchmark %	WM Local Auth %	
Fixed Income							
Total Return Bond Fund Henderson	3.2	1.5	2.4	8.5	6.0	6.8	Absolute return 6% p.a.
Equities							
UK – Legal & General	3.8	3.8	3.8	12.3	12.3	12.3	FTSE All share
UK - Small Companies Henderson	4.7	8.3	n/a	25.6	36.3	n/a	FTSE Small Cap
O/seas – developed Legal & General	2.0	2.0	2.0	12.0	12.0	12.0	FTSE Dev World ex UK
O/seas – emerging Dimensional	6.2	4.9	4.5	12.9	13.4	14.0	MSCI Emerging Markets
Property							
Aviva	0.2	0.9	0.8	-0.2	2.6	2.5	IPD All Properties Index
Private Equity							
Capital Dynamics	0.8	2.0	3.6	3.2	8.0	5.9	Absolute return 8% p.a.
Yorkshire Fund Managers	-1.5	2.0	*	-6.0	8.0	*	Absolute return 8% p.a.
Hedge Funds							
Fauchier	2.6	1.4	1.5	4.3	5.5	4.5	LIBOR + 5% p.a.
Infrastructure							
Alinda	1.9	2.0	1.0	7.6	8.0	4.6	Absolute return 8% p.a.
Capital Dynamics	-1.3	2.0	*	-5.1	8.0	*	Absolute return 8% p.a.
Henderson PFI Fund II	1.0	2.0	*	-2.2	8.0	*	Absolute return 8% p.a.
Pooled Multi Asset							
Baillie Gifford DGF	2.9	1.0	1.8	10.8	4.0	6.7	Base Rate + 3.5% p.a.
Cash	0.2	0.1	0.6	0.6	0.5	1.6	Base Rate
Total	**2.6**	**2.4**	**2.9**	**9.0**	**9.8**	**10.2**	

3.19 The Fund's overall return of 2.6% outperformed its quarterly benchmark of 2.4%. Diversified Growth, Fixed Income, Emerging Market Equities and Fund of Hedge Funds outperformed their respective benchmarks, whilst UK Smaller Companies Equities, Private Equity and Property underperformed against their benchmarks.

3.20 The Fund outperformed the WM Local Authority average in the asset classes of Emerging Market Equities, Diversified Growth, Fund of Hedge Funds, Infrastructure and Fixed Income. The Fund underperformed the WM Local Authority average in the asset classes of Private Equity and Property.

3.21 Over one year, the Fund return of 9.0% when compared to its benchmark of 9.8% equated to a net underperformance of -0.8%. Fixed Income and Diversified Growth performed well over the period and outperformed their benchmarks. Equities and Infrastructure were broadly in line with their benchmarks. Private Equity, Fund of Hedge Funds and Property underperformed their benchmarks. The Brent Fund's return of 9.0% has also underperformed when compared to the WM Local Authority average fund return of 10.2%, mainly due to the strongly positive performance of publicly quoted Equities for which Brent has a lower proportionate exposure and poor performance of Alternative assets where Brent has invested to a greater extent.

Indicative performance of the Fund since December 2012

3.22 Following a strongly positive quarter ended 31 December 2012, the Fund has continued to increase in value by an estimated £14.5m:

	As at 31 January 2013 £M	**As at 31 December 2012 £M**	**Movement**
Fixed Income			
Henderson	82.0	81.6	↑
Equities			
UK - Legal & General	75.4	70.8	↑
UK - Small Companies Henderson	20.4	19.0	↑
O/seas – developed Legal & General	116.3	108.1	↑
O/seas – emerging markets Dimensional	32.7	31.3	↑
Property			
Aviva	33.5	33.5	=
Private Equity			
Capital Dynamics	61.1	61.1	=
Yorkshire Fund Managers	1.3	1.3	=
Hedge Funds			
Fauchier	26.9 *	41.2 *	↓
Infrastructure			
Alinda	15.3	15.3	=
Capital Dynamics	8.4	8.4	=
Henderson PFI Fund II	1.1	1.1	=
Pooled Multi Asset			
Baillie Gifford DGF	29.2	28.5	↑
Cash	11.9 *	-0.2 *	↑
Total	**515.5**	**501.0**	↑

* recall of £15m from Fauchier following a decision by the Pension Fund Sub-Committee at its meeting of 25 September 2012 to reduce the Fund's strategic allocation to Fund of Hedge Funds from 10% to 5%.

4. FINANCIAL IMPLICATIONS

4.1 These are included within the report.

5. DIVERSITY IMPLICATIONS

5.1 The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from them.

6. STAFFING IMPLICATIONS

6.1 None.

7. LEGAL IMPLICATIONS

7.1 There are no legal implications arising from this report.

8. BACKGROUND INFORMATION

Henderson Investors – December 2012 quarter report
Legal & General – December 2012 quarter report
Fauchier Partners – December 2012 quarter report
Dimensional Asset Management – December 2012 quarter report

9. CONTACT OFFICERS

9.1 Persons wishing to discuss the above should contact the Exchequer and Investment Section, Brent Financial Services, on 020 8937 1472 at Brent Town Hall.

MICK BOWDEN
Deputy Director of Finance

ANTHONY DODRIDGE
Head of Exchequer and Investment

Report from the Independent Advisor

Investment Update for the Month of January 2013

The index returns and exchange rate movements for the month of January are shown in the tables below.

	Indices	**Month ended 31st January 2013**
		%
Equities		
Europe	FTSE Developed Europe (ex UK)	9.6
North America	FTSE North America	7.7
UK	FTSE All Share	6.4
Japan	FTSE Developed Japan	6.3
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	5.3
Emerging Markets	MSCI Emerging Markets Free	4.0
Fixed Interest		
UK Index Linked Gilts	FTSE British Government Index Linked Over 5 years	4.5
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	-1.0
UK Gilts	FTSE British Government All Stocks	-1.9
Property	IPD*	Not available
Cash	Merrill Lynch LIBOR 3 Month	0.0

* The IPD UK Property return over December 2012 was 0.3%. The returns for January 2013 are currently unavailable.

Currency movements for month ended 31st January 2013

Currency	**31st December 2012**	**31st January 2013**	**Change %**
USD/GBP	1.626	1.585	-2.5
EUR/GBP	1.233	1.168	-5.3
USD/EUR	1.318	1.357	3.0
YEN/USD	86.465	91.260	5.5

As can be seen from the above table, January proved to be a truly banner start to the year with all regional equity returns well into positive territory. This was all the more impressive given the very robust performances already recorded for the quarter ended 31st December 2012. The main explanations for the powerful returns were as follows. There is little doubt that equity investors, both in the UK and elsewhere, had allowed themselves to become too pessimistic in the autumn of last year due to a combination of the Fiscal Cliff concerns in the USA, the continuing crisis management in the Eurozone, the worries over a possible Chinese hard landing and the negative effects of the UK’s harsh austerity measures with the retail sector particularly under pressure. It is therefore not surprising that, as has happened so often in the past, equity levels became markedly over sold; even the equities of high quality companies. As a consequence of all the apprehension and gloom at that time investing institutions and individuals had allowed their portfolio’s liquidity to build up to historically high levels, even at a time of extremely low returns both on cash and the presumed safe haven of gilts and sovereign debt, particularly in the 10 year area with negative real returns. In retrospect, it was just a matter of time before this fixed interest bubble was burst. There has been an increasing investor appetite for high yield low grade bonds. This risk will have to be carefully watched.

In the light of the above and the improving market background both in the UK and globally it is no wonder that equity levels continued to surge in the month of January, buoyed by the head of steam built up in the previous quarter. Investors in general were prepared to take on more risk as they did not wish to miss a meaningful market upturn and were prepared to buy equities at attractive levels based on the measures of attractive yields, low price earnings ratios and improving balance sheets. Investors were also prepared to sell seemingly over bought and low yielding fixed interest stocks.

The returns table really speaks for itself. It seems fitting that the largest return of 9.6% was achieved in Europe as fears for the collapse of the Eurozone and the Euro diminished. For the first time for many years investors exhibited increased confidence in Japan (+6.3%). This was down to a belief that, this time round, the recently elected prime minister, Shinzo Abe, really would at last be successful in applying a greater dynamism to the erstwhile anaemic and deflation prone economy.

Fixed Interest returns were negative with the clear exception of Index Linked Gilts which recorded a worthwhile 4.5% rise on inflation expectations. Property continued its most pedestrian recovery with a modest 0.3% return.

As can be seen from the content to this investment brief the month of January has indeed been most eventful. During the month the principal events, macro-economic data and forecasts within the regions were as follows:-

UK

- HMV fell into administration with the possibility of 4,000 job losses.

- Jessops, the camera retailer, became bankrupt with the loss of 1,400 jobs.

- Prime Minister Cameron plans to put membership of the European Union to a national referendum if the Conservatives win the next General Election in 2015.

- A decision was taken by the National Statistician to keep unchanged the way in which the Retail Price Index (RPI) is calculated. However, the Office for National Statistics (ONS) is to introduce a new measure of inflation to be known as RPIJ, but this will not be used as a basis for inflation-linked bond calculations. Historically RPI has been higher than the Consumer Price Index (CPI).

- The ONS reported that manufacturing (which represents more than 10% of the economy) fell by 0.3% in November (October -1.2%). This compared with consensus estimates of +0.5%.

- The FTSE 100 index ended the first trading week of the year up 3.8% at 6,121. This was the best start to a year since 1999. This level was last reached in May 2008.

- Parts of the retail sector came under pressure over the festive season with very poor figures from Marks & Spencers in strict contrast to excellent results from the John Lewis Partnership.

- The government has finally lost patience with the control of the UK's banks. The last straw appears to have been the LIBOR manipulation scandal together with the mis-selling of products. As a direct consequence a new framework has been introduced. It has been suggested that the mooted ring-fence round their non banking activities should be electrified! The banks may at last be forced to clear cheques in a timely manner. At long last.

- There remains continuing anger with regard to multi-national corporations and individuals setting up schemes specifically to reduce tax or avoid it altogether. Such "tax minimisation schemes" are coming under increasing scrutiny by the government. Indeed, a purge is taking place whereby fiscal havens like the Cayman Islands will have to show full fiscal transparency.

- The Society of Motor Manufacturers and Traders reported that slightly more than 2M new cars were registered in 2012 representing a 5.3% rise on 2011.

- For the fourth quarter of 2012 the rate of GDP growth fell by a most disappointing -0.3% compared with estimates of -0.1%. By comparison the third quarter GDP growth advanced by 0.9% in part due to the Olympic Games.

- For the quarter to November 2012 unemployment fell by 37,000 to 2.49M, the lowest level for 18 months. The unemployment rate inched back to 7.7% from 7.8%.

- Property developers are to be allowed to convert office buildings into blocks of flats without asking Councils for permission.

- Citizens appear to be coping with the grinding austerity conditions better than originally feared. Although there are marked differences from region to region.

- There are ambitious plans for the construction of a £4B London super sewer. But who will pay for it?

- The CPI measure for inflation in December was unchanged at 2.7% whilst the RPI measure rose to 3.1% from November's 3.0%.

- The ONS reported that retail sales volumes for the final quarter of 2012 fell by 0.6%. Scarcely surprising.

- It has been confirmed that Mark Carney, Governor of the Bank of Canada, is to be officially installed as the new Governor of the Bank of England on 1st July this year. Much is expected of him as he has an inspiring record in Canada.

- On 23rd January Prime Minister Cameron's landmark speech with regard to the European Union contained the following highlights:-

  - If the Conservative Party wins the next election it is intended to hold an "in or out" referendum by the end of 2017 with the hope that other EU members might offer the UK better terms in the meanwhile. In that regard, Angela Merkel, the German Chancellor, stated "we are naturally ready to discuss the British wishes, but one should bear in mind that other countries have their own wishes too"

  - The government proposes to construct a £32.7B high speed rail link (HS2) between London and the North of England claiming it to be vital to the country's future economic prosperity. This will indeed be a boost to a more efficient transport structure and at last enable the UK to compete with the main competitor rail links in Europe.

- On the 28th January, sterling hit its lowest level for more than 5 months against the US$ due to the better sentiment within the US economy versus that of the UK.

USA

- The rate of GDP growth in the final quarter of 2012 fell 0.1% against a consensus estimate of 1.1% growth. This upset was caused by federal defence spending and also business inventory accumulation – two notoriously volatile sectors. This time they had a negative 1.3% effect on growth. However, a 2.7% positive effect was achieved by a combination of strong returns from consumption, business investment and construction.

- New home sales advanced by 12.1% in December, the fastest pace since June 2008.

- President Obama was inaugurated for a second term of office on 21st January. You do have to wonder why the inauguration procedure is held so long after the election day which was back in November.

- The International Energy Agency predicts that the USA will become the largest producer of oil by 2030 and will overtake Russia and Saudi Arabia, thanks to the burgeoning production of shale oil.

- On 16th January, the Federal Reserve Board's Beige Book Survey reported growth right across the country with all the districts showing moderate levels of growth, thus producing a degree of momentum at the start of the year.

- Durable goods orders rose 4.6% in December. This was much better than expected.

- The Institute for Supply Management’s manufacturing index for January advanced to 53.1 from 50.2 in December which was a much better result than expected.

<u>Europe</u>

- The German Bundesbank is planning to move 54,000 gold bars worth some $27B from Paris and New York to its headquarters in Frankfurt.

- Opinion polls in Germany are showing that Chancellor Angela Merkel’s Christian Democrat coalition party (which includes the Christian Social Union party based in Bavaria) is gaining the strongest support since she was elected in 2005.

- In Italy, ex Prime Minister Silvio Berlusconi’s pending court case is to go ahead. The verdict could be known before the general election day. Unfortunate timing for him you might think or hope.

- On 11th January, the European Central Bank, as expected, kept its interest rate on hold at ¾% and indicated no plans for further rate cutting in the medium term.

<u>Japan</u>

- The new Prime Minister, Shinzo Abe, has started the way he means to go on by pressurising the Bank of Japan to impose a 2% inflation target in the medium term. Indeed this policy has been successful as the Bank has recently agreed to change to the suggested target from its previous target of only 1.0%.

- Mr Abe has pledged $116B of fresh stimulus pending in an attempt to boost the nation’s economic growth rate.

- In the year 2012 Japan’s trade deficit nearly tripled to $77B.

- On the back of a weakening yen the equities of export companies have registered strong rises.

<u>Asia/Pacific</u>

- China’s rate of GDP growth in the fourth quarter of 2012 was a very respectable 7.9% p.a.

- Chinese newspapers are battling with government censorship. As a result of the Press’s increasingly powerful voice, further reform is likely. Not what Chinese political leaders have been used to.

- China’s biggest export market was South East Asia. This grew by 20% in 2012. This underlines the importance of regional trade within Asia.

- China's trade surplus ballooned to $31.6B in December (November $19.6B). For 2012 as a whole the trade surplus was a staggering 50% higher than in 2011 at $231B. By way of contrast, Chinese exports to Europe in December were up 2.3% whilst those to the USA grew by 10.3%.

- The Beijing Water Authority is considering a bid for the UK's Sutton and East Surrey Water Utility. This appears somewhat bizarre, but many of the UK's utility companies are in foreign ownership.

- Earnings by China's leading industrial companies rose 17.3% in 2012 according to the government.

- On 29th January the Reserve Bank of India cut interest rates to 7.75% from 8.0%.

Conclusion

Global observations are as follows:-

In the UK

Adverse weather can be blamed for many things, but realistically it just could increase the likelihood of a triple dip recession.

With regard to the EU membership dilemma, will Cameron be able to forge a better and more advantageous deal with Germany and France remaining sufficiently supportive! Probably not. Needless to say the debate will run and run, even to 2017.

In the USA

President Obama's second term of office appears likely to be more successful than the first. Particularly if he can reach a successful agreement with the Republicans over the dreaded Fiscal Cliff. This seems likely to be resolved, but American debt levels will be a constant worry to future incumbents of the White House for many years to come unless much needed amendments can be made to the hallowed American Constitution. This seems unlikely to occur for many years. It seems probable that an invigorated Obama will be determined to concentrate far more on domestic issues, not the least of which will be to change the farcical laws on gun control.

All things considered it seems possible that America's rate of GDP growth may surprise on the upside.

In Europe

The Eurozone worries are less than they were, but they are still very real. For a successful conclusion (and it will take time) so much will continue to depend on the actions of the IMF, the ECB and the Bundesbank.

Angela’s Merkel’s re-election as Chancellor of Germany is not certain but it appears likely that she will be able to retain her post, albeit through a “grand coalition”.

As always, Germany will continue to be the anchor economy of Europe and its major influence on economic growth.

In Japan

There is no doubt that the single most important influence on Japan’s stock market and currency direction will be the ability of the newly appointed government lead by Shinzo Abe to live up to his prior and post election promises to deliver sufficient stimulation to the down trodden and moribund economy and also to impose much stronger control of the Bank of Japan in order for it to concentrate far more on economic growth and to allow inflation to increase. In the past there have been so many political false dawns. Will it be any different this time? Or is the nation in the last chance saloon? The stock markets suggest that the outlook is better than it has been for many years and is encouraged over prospects for Japan’s leading exporters and the economy as a whole which should be enhanced by a weaker yen.

In Asia/Pacific

China will almost certainly continue along the course of becoming a greater influence on the global scene. Indeed, it is only a matter of time before it becomes one of the largest and most influential economies. It appears likely that the new leadership will continue in much the same vein as the previous leadership who were able to manage an enviable rate of GDP growth and also to exercise control of the renminbi currency. No mean achievement for a nation as large as China. One area of concern is the growing pains that the nation might experience, particularly with regard to its large population and its preparedness to accept the current political dictats. As mentioned, there have been signs of public unrest including protest meetings. The new regime under Xi Jinping will have to tread carefully in that regard. Chinese companies will likely continue with foreign takeovers. Very recently, China acquired Manganese Bronze the famous London black cab company.

Elsewhere in the Asia/Pacific region, most countries are experiencing strong economic growth accompanied by healthy levels of trade. India is one of the exceptions with its government finding it difficult to maintain the strong rates of GDP growth. The country desperately needs to build a more modern transport infrastructure.

In General

The World Economic Forum in Davos came up with the usual platitudes and voicing of co-operation – but how effective they will be remains to be seen.

In the IMF’s global economic outlook it estimates an acceptable rate of world economic growth in 2013 of 3.5%. Its country estimates includes growth in the UK of 1.0% with that of the Eurozone to be down 3.5%.

At long last Hedge Fund fee structures have increasingly become under the microscope with pressure to make reductions to a more realistic level. Not before time.

As so often happens after a strong market run, it is inevitably followed by a correction the timing and size of which is hard to deduce. However, in the current case, when the correction occurs, and it surely will, the downside is likely to be limited to an extent by investors who missed the recent market surge and will now attempt to get on board at lower levels. Whatever transpires it still seems safe to predict that, by the calendar year end, equities will have markedly outperformed fixed interest. They should also outperform corporate bonds and index linked, but to a lesser extent.

The outlook for other asset classes remains the same as described in my quarterly report for the quarter ended 31st December 2012. What has changed since then is the possibility of an increased number of corporate mergers and acquisitions.

In sum, a position of full investment appears justified at this time.

Valentine Furniss
6th February 2013