Investment Insight

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ARIA | CAPITAL

Oil's well. *2015 is off to a very interesting start. Carrying over from the end of last year, oil prices, one of the most important inputs to the global economic equation, have fallen to levels that have far reaching ramifications. At the start of the week, the Swiss National Bank abandoned its Euro peg resulting in a 20% appreciation in the value of the Swiss Franc. As we write, the ECB has announced long-anticipated quantitative easing in the form of a €1.26 trillion injection into the European economy.*

So, no shortage of macroeconomic influences for investors to grapple with. The ramifications are already being seen, for example the significant divergence between the performance of European (up 6%) and US (down 1%) equity markets since the start of the year. In this week's ***Inside Track*** *we get perspectives from two of Schroder's leading investment strategists.*

Ruble trouble: *It's not much fun being a Russian consumer at the moment. The value of the Ruble has plummeted, consumer prices have sky-rocketed and the country's biggest export, oil, has more than halved in value. Despite the negative backdrop, thus far employment levels have been stable to improving.*

The so-called "Misery Index" measures the combined impact of changes in inflation and employment. In this week's ***Pic of the Week*** *we see how the index has responded to Russia's woes.*

The Inside Track

Peter Harrison (*PH*) is Head of Investment at Schroder, having previously held senior investment roles at JP Morgan, Deutsche Asset Management and RWC Partners. Keith Wade (*KW*) is Schroder's Chief Economist and Strategist. The following are some of their thoughts on issues currently facing investors.

Oil weighing on sentiment

KW: As an economist, I think a fall in oil prices is really positive for the world economy and it is exactly like a tax cut. For the US consumer for example, it is a boost to disposable income of just over 1%. Given that US consumers spend nearly all the income they get, this will flow through to consumer spending and into stronger GDP growth.

Equity volatility

PH: Economists got it so wrong and there is such a worry about why oil prices are where they are. There is concern in equity markets about whether it is a supply issue, a geopolitical issue, or a demand issue. One of the nagging doubts among equity investors currently is whether the world economy is soggier than they thought. Just as we thought we had a clear roadmap ahead, we now have one of the most important variables shifting by the third largest move since 1900.

Impact on Emerging Markets

PH: Investors need to consider the specifics of each individual country. But in aggregate, lower energy prices are probably not good news for emerging relative to developed markets.

Is deflation a threat?

PH: UK inflation data released this week showed a sharp fall in inflation from 1% to 0.5%. We've adjusted ourselves to a new lower level of wage growth. Although we're going to have some very low inflation numbers over the next 12 months, I do not think it will cause a crisis of confidence.

KW: Mario Draghi and the ECB are concerned that it [deflation] will feed into expectations and people will begin to expect that prices will fall further, which will change wage behaviour and consumer spending behaviour, and start to make the eurozone look like Japan. I do not think this will happen and I do not see it in the data. But that is what they are worried about.

Will Greece leave the euro?

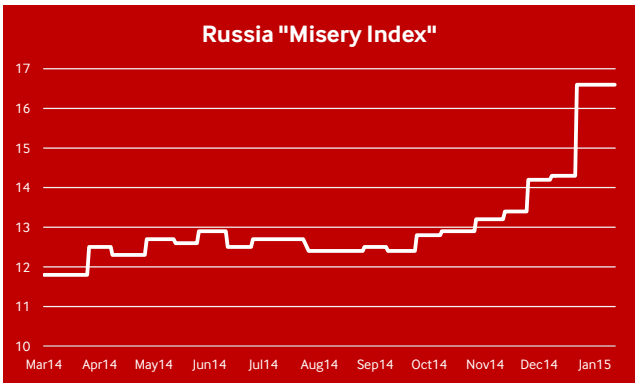
KW: Remarkably the Greek economy is starting to grow as the benefits of austerity and cost cutting are starting to come through. There will be some volatility around it as Syriza try to negotiate its bailout programme. They may be able to improve it but I don't think it will cause a wider problem.

Investment opportunities ahead

PH: There will be a higher level of volatility than we've seen in past years, and I think that despite value not being clear, nobody is pointing to markets being egregiously expensive. If you think 12 months ahead, some of the negativity about oil may start to wash over and people will start to pick through the remnants of that and find areas that could perform well.

Pic of the Week

Even though recent unemployment data in Russia has been surprisingly positive, Russians may be more miserable than that data suggests. The graph below shows the Misery Index - inflation plus unemployment - for Russia jumped sharply at the end of 2014. It is fast catching up with the equivalent measures for Greece and Turkey. However, the weaker ruble and dramatically reduced oil export revenues may well be the precursor to significantly more "misery".



Market View

	Last 7 days	YTD	5Y Ann.
Global equities	+3.1%	+0.9%	+8.7%
US equities	+2.6%	+0.2%	+13.6%
European equities	+3.3%	+6.3%	+7.4%
Emerging market equities	+2.7%	+2.8%	+0.4%
Irish equities	+3.4%	+4.5%	+12.5%
Commodities	+0.2%	-2.4%	-5.5%
Hedge funds	-0.1%	-0.6%	+0.8%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+1.1%	-0.3%	+3.5%
Germany	+0.4%	+0.2%	+1.2%
USA	+1.8%	+0.8%	+2.7%
China	+3.4%	+1.5%	+7.3%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.13	-6.3%
EUR:GBP	0.76	-2.6%
EUR:CNY	7.06	-6.4%
GBP:USD	1.50	-3.7%
Bitcoin	229.66	-27.6%

Commodities	*Current*	*YTD Δ*
Gold	1,296.09	+9.4%
Copper	5,696.50	-10.5%
Oil	49.41	-15.1%
Wheat	531.50	-9.9%

Week ahead: Key events

26/01 Germany IFO Business Climate
26/01 Ireland Property Prices
27/01 UK GDP & US Durable Goods Orders
27/01 US Consumer Confidence Index & New Home Sales
28/01 US FOMC Rate Decision & Japan Retail Sales
29/01 Germany Unemployment Rate & EU Economic Confidence
29/01 US Initial Jobless Claims & Pending Home Sales
30/01 EU CPI
30/01 US University of Michigan Sentiment & Chicago Purchasing Power

Central Bank rates	*Current*
Eurozone	0.05%
USA	0.25%
UK	0.50%

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