Investment Insight

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ARIA | CAPITAL

Absolutely: *At the higher end of the risk spectrum, equities have delivered strong local-currency returns so far this year, albeit currency movements have cancelled out much of these gains for Euro investors. However, we have been particularly encouraged by the strong performance of the more non-traditional and, indeed, considerably lower-risk elements of client portfolios this year. One such example is the Old Mutual Global Equity Absolute Return Fund which has delivered extremely attractive returns for what is a relatively low-risk investment. In this* ***Week's Inside Track*** *we hear from the fund's manager, Ian Heslop.*

What if: *Many investors appear to accept that inflation is low and will stay that way for the foreseeable future. The reasons being cited include: central banks will keep interest rates near-zero, technology has a materially deflationary effect, globalisation is deflationary… However, in more recent times we have seen a number of long-term investors begin to position themselves for a more inflationary environment with rising interest rates and increasing commodity prices. In* ***Pic of the Week*** *we look at an interesting chart that shows a marked contrast between asset price and "real economy" inflation since 2009.*

Quoted…

"Even though it may sound counterintuitive, a comfort zone is a dangerous place to be." - *Mary Lou Retton, 1984 Olympic Champion in Gymnastics*

The Inside Track

Ian Heslop, the highly regarded fund manager of the Old Mutual Global Equity Absolute Return Fund, provides an interesting comparison of investor sentiment and associated risk appetite in various markets in the period up to the end of September.

Most regions continued to exhibit low volatility characteristics, according to our market environment analysis. North America once again exhibited a more elevated volatility state, remaining anchored to medium levels of volatility.

While Europe remained positioned on the border between neutral and positive market sentiment, North America, by contrast, experienced a noticeable improvement in market sentiment, demonstrating its most optimistic market sentiment so far this year. This familiar pattern has persisted in recent months, with the remaining regions all exhibiting optimistic sentiment. This represents a continuation of the market state, where there are low levels of realised and implied volatility and where cross sectional volatility remains consistently low. Nonetheless, North America continues to exhibit something of a contrasting profile which is explicable in part by the regional divergence in monetary and policy outlooks.

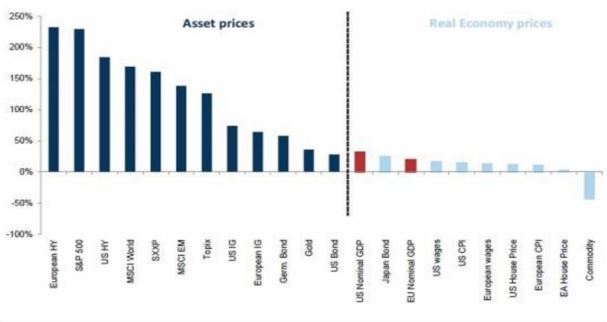
Risk profiles across the investment universe showed evidence of some convergence during the past month. Investors' tolerance of risk is currently most elevated within Japan, at below three-quarters risk on, having increased marginally in the past month. Of the remaining regions, the risk appetite within Asia Pacific moderated from its previous elevated levels. European risk tolerance remained broadly in line over this period, marginally below a 60:40 risk on profile.

By contrast, North America demonstrated the most pronounced improvement in risk tolerance to finish the month marginally short of 50:50 risk on/off. This was in contrast to the previous month, when it was positioned below one-third risk on. It is worth highlighting how the somewhat unusual environment of positive sentiment and low volatility, accompanied by moderate or depressed risk appetite that pervaded many parts of the market environment in recent months, appears to have abated with the gradual aggregate improvement in risk tolerance over this time.

Pic of the Week

Asset prices, including equities and bonds, have inflated very strongly since 2009, albeit this was immediately preceded by sharp deflationary moves in 2008. However, by contrast, as the chart from Goldman Sachs illustrates, real-world inflation barely registered in comparison. Indeed, commodities have deflated quite significantly over the period. Many commodity markets continue to have surplus supply but as the supply/demand equation eventually adjusts, we may see an upward move in commodity prices and a consequent rise in inflation. If this coincides with a de-rating of expensive equity and bond markets it could make for a less-than-pleasant environment.

Exhibit 17: Wide dispersion between asset price inflation and 'real economy' inflation
Total return performance in local currency since January 2009



Source: Goldman Sachs Global Investment Research

Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	+1.2%	+16.6%	+12.8%	+9.8%
US equities	+1.5%	+18.0%	+13.9%	+11.8%
European equities	+1.0%	+13.3%	+7.6%	+6.9%
EM equities	+2.7%	+20.4%	+27.8%	+1.8%
Irish equities	+1.2%	+14.7%	+5.9%	+15.6%
Commodities	+0.0%	+0.5%	-3.2%	-10.5%
Hedge funds	+0.4%	+5.9%	+4.8%	+2.0%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.7%	+0.4%	+5.8%
Germany	+0.5%	+1.8%	+2.1%
USA	+2.3%	+1.9%	+2.2%
China	+3.6%	+1.8%	+6.9%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.17	+11.3%
EUR:GBP	0.89	+4.5%
EUR:CNY	7.79	+6.2%
GBP:USD	1.31	+6.4%
Bitcoin	4,306.58	+352.4%

Week ahead: Key events

09/10 UK Regional PMI
09/10 Germany Industrial Production & US Employment Trends
10/10 US Retail Sales
11/10 US Mortgage Applications
12/10 Eurostat Industrial Production
13/10 US Labour & Manufacturing Data

Commodities	*Current*	*YTD Δ*
Gold	1,273.26	+10.5%
Copper	6,471.25	+17.2%
Oil	57.04	-2.9%
Wheat	441.75	-5.0%

Central Bank rates	*Current*
Eurozone	0.00%
USA	1.25%
UK	0.25%

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