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INVESTMENT UPDATE - JANUARY 2012



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Firstly may I wish all of our clients, referral partners, advisers and fellow professionals a healthy and prosperous 2012.

As we start the New Year we are delighted to publish this, our first Investment Update, in order to provide you with an overview of the deliberations of our Investment Committee and the most pressing issues that we are concerned with. It is not intended to provide an in-depth analysis but if any further detail is required, please do not hesitate to contact us.

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Conundrums and Contradictions...

The most striking data from the markets is the huge contradiction of record low yields on gilt and AAA rated sovereign debt compared to the apparent abandon of equity markets, whose rallies have moved from being tentative to sustained.

Falling and low gilt yields are classic signs of investor fright and the desire to seek so called 'safe havens' and this is usually coupled with a decline in higher risk assets such as shares and commodities, whereas conversely rallies in equities are usually coupled with increasing yields in the 'safe haven' assets.

So what is going on?

One explanation is that the decision by the European Central Bank to provide unprecedented levels of liquidity to European banks, has provided the equity markets with the tangible proof of action by a credible Eurozone institution that has been lacking from the Eurozone's politicians. The action can be interpreted as the ECB becoming the de facto lender of last resort to the Eurozone albeit via the secondary route of lender to the banks.

This confidence boosting action however is possibly responsible for the reduction in investment grade sovereign debt yields. It remains to be seen exactly how the liquidity from the ECB has been deployed by the banks but one explanation is that it has, to an unknown extent, been spent on acquiring this debt which can be used to bolster the banks' capital.

This explanation is in our view a relatively compelling explanation as it is the only one that apparently unifies the contradictions we are seeing.

Other pertinent factors in our opinion are that the rally in risk assets has also received support from some consistently encouraging data on growth, jobs and confidence coming out of USA, UK and Germany. Chinese inflation appears to be under control as signalled by Beijing's easing of its hitherto tight monetary policy and the rest of the Pacific region has continued its steady growth pattern. All of these factors provide encouraging signs that growth may at last be on the horizon.

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What are we monitoring this month?

As has been the case for all of 2011 any developments in the Eurozone crisis are very high on our watch list. There are various political meetings and summits planned and we believe that any tangible steps forward in the painful implementation of the European Financial Stability Fund or the European Stability Mechanism will help add weight to tangible but fragile confidence that has recently emerged. Also any sign of closer political cohesion will be welcomed.

Any announcement of extending or even making open ended the ECB's commitment to purchase distressed sovereign debt and provide continued support to the Banks will also be very welcome.

The major corporate reporting season is about to get underway and we will be watching closely for any signs that earnings and balance sheet strength has significantly shifted. A general trend of deterioration will be unwelcome but any improvement (or indeed any lack of deterioration) will add to the improving feeling.

If, as expected, the ECB reduces the repo rate to below 1% for the first time, we will see a continuation of the recent weakness of the Euro against the major currencies. This weakness is not really surprising and in fact our view is that the only surprising thing is how long the Euro has managed to retain its strength. This devaluation will of course make the Eurozone's exports more attractive and should lend support to growth in the Eurozone generally and the northern states especially.

What is our stance on portfolios?

Given the continued uncertainty and support for both ends of the contradictory spectrum discussed above, our view is that maintaining a properly diversified portfolio is the only way to firstly limit downside risk but also ensure that any gains in an asset class are captured.

We therefore are not recommending any changes to any of our portfolios although we have 5 specific funds currently on our watch list as they are not performing as expected. If any changes become necessary as a result of this monitoring we will of course advise you.

Conclusion

2012 will continue to provide volatile investment conditions but at present our view is that, little by little, confidence is returning to the markets and, as the Eurozone takes each step however small, towards dealing with its crisis, fears of a financial meltdown will continue to recede.

Unfortunately this progress is unlikely to be a smooth transition and there will be announcements that mean that the whole rehabilitation of the markets will be a case of "two steps forward, one step back".

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