

The year 2013 started very strongly and in January the US and European markets both gained an average of 5%. However, in February it was the US indices which continued to rally while the European and especially the emerging market indices fell back and underperformed considerably (Fig2). The debt and banking crises in Cypress produced further pressure on Europe in March. Emerging markets and related sectors had performed very strongly in the last quarter of 2012 and contributed handsomely to the performance in our client portfolios. However, less positive news from China regarding growth and worries about inflation led to a substantial set back in emerging market and commodity related equities this quarter.

Gold fell over 4% in the first quarter while oil rose almost 6%. Currencies remained volatile, as the Euro rose from 1.32 to over 1.37 to the US dollar in January and then fell to well below 1.3 by the end of the quarter. The Japanese Yen lost 8% versus the dollar and commodity currencies remained volatile.



Fig1: Global equity performance versus global bond and Gold performance Q1/2013

Source Bloomberg

The average performance of the EUR Balanced portfolios for the first quarter of 2013 was 1.13%, which is less than most clients would expect given the strong performance in global equities. However, what we must keep in mind is that it was the US and Japanese markets which performed best this quarter. US Markets make up over 50% of global equity indices and were up over 13% in Euro terms versus -0.45% in European large caps (Fig2) and 2.4% in the DAX. Emerging markets and gold fell almost 3%.

In order to be similarly positioned to the global index we would have to invest 25% of the clients' portfolios in US equities. It is very unusual at any time for a European client's balanced portfolio to have half its equity exposure invested in the US and with all the fiscal and deficit debates in the US in Q4/2012 and Q1/2013 we were of the opinion that increasing exposure to US equities after a strong 2012 was not advisable.

In general we took a more defensive stance this quarter after the very strong Q4/2012 and concentrated mostly on European large caps and cheap emerging market stocks. This position worked very well in Q4/2012 and in January and we believe that it will in the months ahead. However, the first quarter appears to be a transition quarter in which some overshooting in both directions is not unusual.

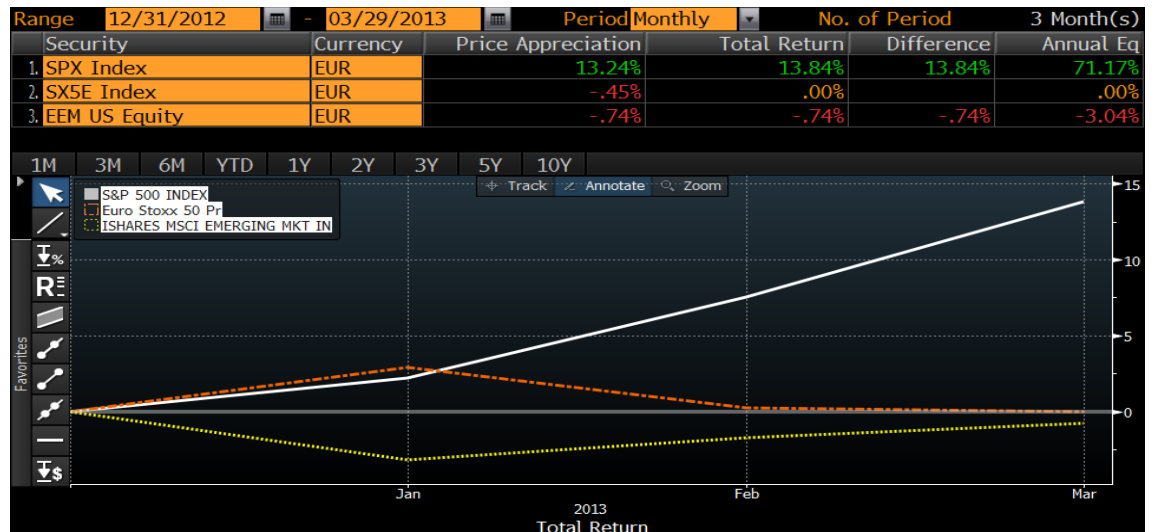


Fig2: US, European and Emerging market equity performance Q1/2013

Source Bloomberg

We have recently seen emerging markets, commodity related equities and gold stabilise and attempt to change direction. We believe that this move will continue to gain strength as the dollar consolidates after its recent strength and better news on growth and inflation out of China and other emerging markets makes the cheap valuation in emerging markets and commodity related stocks attractive to investors.

As we begin the second quarter of 2013, we are of the opinion that equities will continue to outperform bonds as they have done in the past year and that cyclical sectors will perform better than the defensive sectors. We remain underweight bonds and slightly underweight equities in developed markets while increasing our exposure to emerging markets.

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