



FINANCIAL
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RMB
ASSET MANAGEMENT

Weekly Review

Week ending 21st January 2011

As has been the case for most of 2011 so far, headlines last week were heavily focused on the outlook for inflation and monetary policy globally. Key economies where market participants have been worrying most about high rates of inflation are China and the UK – and indeed last week saw further data points suggesting that there is cause for concern – but the various factors at play and resultant likely policy responses are substantially different. Inflation seems to be a looming problem for emerging markets in general, with China currently at the forefront of this battle to reign in rampant growth, especially in the minds of many investors as markets have come to rely on the East for meaningful rates of expansion. The world's second largest economy increased the minimum reserve requirement for banks, a tool that enables control of lending growth, by a further 50 bps recently bringing the ratio to 19% today. This marks the seventh such hike since the People's Bank of China (PBOC) first began tightening from a level of 15.5% just over twelve months ago, and a number of other policy tools have also been employed in order to cool the economy particularly targeting the real estate market. With few other countries having reached this stage in their economic cycle yet, China was understandably a laggard amongst emerging market equity returns last year, with a rise of 4.9% in 2010 compared to 18.9% for the MSCI Emerging Markets index in local currency terms. However, with data released last week showing that China's GDP expanded at a faster than expected annual rate of 9.8% in the fourth quarter of 2010, meaning output grew by 10.3% in 2010, it seems that fears of overheating were not unfounded and the PBOC was right to move early. Inflation as measured by the consumer price index (CPI) did slow in December to a year-on-year rate of 4.6% from 5.1% in November, aided by a decline in food price rises, but investors continue to worry about further policy tightening. The Shanghai Composite Index is currently trading on a valuation of approximately 12.5 times current year estimated earnings, its weakest level in two years.

Over in the West, last week it emerged that CPI inflation in the UK reached a year-on-year rate of 3.7% in December compared to consensus expectations of 3.4%, with the key contributors

to the higher than expected rate being higher home energy and transport costs. Indeed the price of oil rose by over 20% in US Dollar terms last year and further rises from this point would significantly increase inflation fears globally. The beginning of 2011 also saw value added tax (VAT) increase by 2.5% in the UK which is expected to feed into yet further inflation rises. The current CPI level is not far off double the Bank of England's (BoE) 2% target and has actually exceeded this level for 54 of the last 66 months. This latest inflation surprise has further increased the policy dilemma for the BoE since the normal response would be to increase interest rates from the ultra-low 0.5% level they have been at for almost two years now, but the risks of doing so are significant at a time when fiscal austerity is biting and the banking sector remains vulnerable. The risk of a policy mistake at this stage is elevated and indeed this could be a situation that a number of countries are set to face over the coming year.

Major equity markets mostly declined last week with Japan and global emerging markets leading the way with falls of -2.1% and -2.0% respectively, whilst in the US the S&P 500 declined by -0.8% despite a strong start to the quarterly earnings season. Continental Europe was the only region to post a marginally positive return (+0.1%) on the back of a few positive events including successful bond auctions from peripheral countries as well as recent statements from Japan and China declaring their intention to buy these countries' bonds. It is interesting to note that the considerably worse growth outlook for peripheral Europe relative to emerging countries has not translated into equity market underperformance so far this year; equity indices in Spain, Italy and Greece have all produced returns in excess of 9% in local currency terms year to date, while India and Indonesia have declined by -7.0% and -10.5% respectively. Looking at other asset classes, most fixed income indices also posted declines last week, although high yield bonds in the US and Europe delivered small gains. The US Dollar weakened against most majors, with the euro in particular enjoying strong appreciation of 1.7% versus the greenback, while gold also extended its decline in 2011 with a return of -1.7% bringing the year to date loss to -4.8%.

Returns to 21 January 2011

Asset Class/Region	Index	Currency	Week	Month to date	Year to date
Equities					
United States	S&P 500 NR	USD	-0.8	2.1	2.1
United Kingdom	FTSE All Share TR	GBP	-1.7	0.0	0.0
Continental Europe	MSCI Europe ex UK NR	EUR	0.1	2.7	2.7
Japan	Topix TR	JPY	-2.1	1.3	1.3
Australia	S&P/ASX 300 TR	AUD	-1.0	0.2	0.2
Global	MSCI World NR	USD	-0.5	1.8	1.8
Global emerging markets	MSCI World Emerging markets TR	USD	-2.0	-1.2	-1.2
Bonds					
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.3	-0.4	-0.4
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	-0.8	-0.3	-0.3
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-0.2	-0.1	-0.1
US High yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.2	1.6	1.6
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	-0.4	-2.2	-2.2
UK Corporate (investment grade)	Merrill Lynch Sterling Non Gilts TR	GBP	-0.2	-1.0	-1.0
Euro Government Bonds	Citigroup EMU GBI TR	EUR	-0.3	-0.2	-0.2
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	-0.1	-0.6	-0.6
Euro High yield	Merrill Lynch Euro High Yield 3% constrained TR	EUR	0.5	2.2	2.2
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.0	-0.6	-0.6
Australian Government	JP Morgan Australia GBI TR	AUD	-0.4	0.1	0.1
Global Government bonds	JP Morgan Global GBI	USD	0.4	-0.7	-0.7
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	0.4	-0.3	-0.3
Global Convertible bonds	UBS Global Convertible Bond	USD	-0.3	1.2	1.2
Emerging Market Bonds	JP Morgan EMBI +	USD	-0.8	0.1	0.1

Source: RMB Asset Management / Bloomberg / Lipper Hindsight. January 2011.

Returns to 21 January 2011

Asset Class/Region	Index	Currency	Week	Month to date	Year to date
Property					
US Property securities	MSCI US REIT TR	USD	-0.3	0.3	0.3
UK Property securities	FTSE EPRA/NAREIT United Kingdom TR	GBP	-1.6	-0.7	-0.7
Europe ex UK Property securities	FTSE EPRA/NAREIT Developed Europe ex UK TR	EUR	-2.2	-2.3	-2.3
Australian property securities	FTSE EPRA/NAREIT Australia TR	AUD	-1.0	1.0	1.0
Asia Property securities	FTSE EPRA/NAREIT Developed Asia TR	USD	-1.0	0.8	0.8
Global Property securities	FTSE EPRA/NAREIT Developed CR	USD	-0.8	0.4	0.4
Currencies					
Euro		USD	1.7	1.3	1.3
Sterling		USD	0.7	2.1	2.1
Yen		USD	0.2	-1.9	-1.9
Australian Dollar		USD	0.2	-3.3	-3.3
Rand		USD	-1.9	-6.6	-6.6
Commodities					
Commodities	RICI TR	USD	0.0	0.7	0.7
Agricultural Commodities	RICI Agriculture TR	USD	3.6	3.3	3.3
Oil	Brent Crude Index (ICE) CR	USD	-1.3	3.9	3.9
Gold	Gold index	USD	-1.7	-4.8	-4.8

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