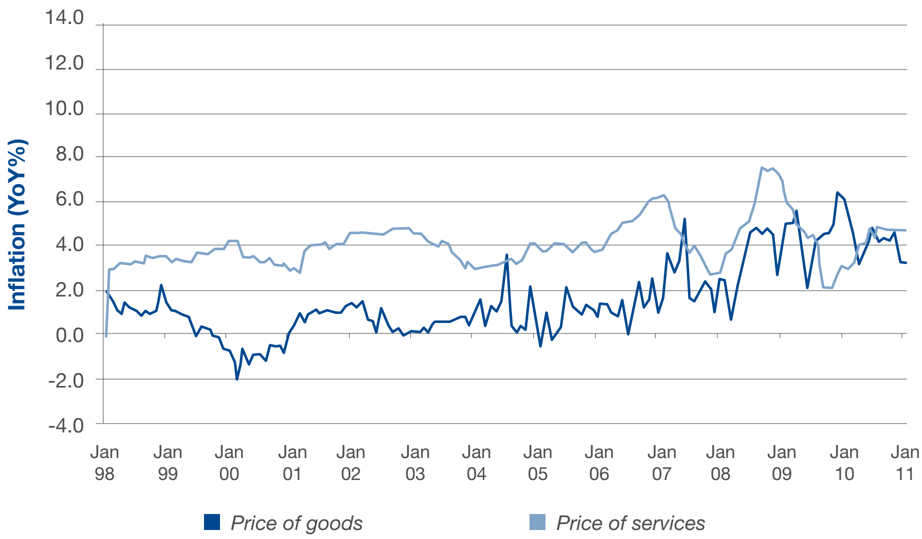
Weekly Review

Week ending 11th February 2011

With apologies to readers who have already digested a glut of comments on the topic, let us return – again – to the question of inflation. Markets are always looking for the next big theme and in the course of this pursuit have a tendency to build mountains out of molehills. Whilst this tendency is always significant – one might say it is the defining characteristic of markets – it is never more so than in the case of inflation. This is because large and protracted increases in the general price level are as much about individuals' expectations as they are about real constraints. Inflation is firmly back on the agenda in the wake of rising food and oil prices. Were these rises to be offset by falls in the prices of other goods, we would not be looking at inflation but merely a rebalancing of the relative proportions in which goods are exchanged. The data, however, points to increases in the aggregate price level in both emerging and developed markets. Historically inflation has been associated with poorer equity market performance alongside its erosive effects on the fixed monetary returns to creditors, and resultantly both emerging market equities and bonds fell back over the past week.

What, then, are the prospects for this nascent inflation gaining pace? Monetary policy in western economies has been accommodative of higher inflation for some time. Policy makers now face question marks over their ability, and willingness, to remove the excess liquidity that they have pumped into markets. The timing of these moves is a much discussed topic. Hikes in interest rates in the near term would inflict pain on electorates, and whilst the coalition in the UK has gone ahead with the hard medicine regardless, it remains to be seen whether other administrations will take similar action. Real forces in the past two decades have kept inflation low and stable, chief among them being globalization and deregulation. Added to these has been the effect of low cost production in China. The below graph shows (from a UK-perspective) that whilst the price of domestically provided services has been going up, the aggregate price of the national basket of goods has been kept lower by the price of imported goods, particularly goods from the Peoples' Republic. This effect looks unlikely to continue as China switches from export-led growth to higher domestic consumption, with the emergence of a more demanding middle class. Governments have put themselves firmly on the side of inflation; having to some extent engineered higher prices, it now remains to be seen whether they are able to control them.

In other news, equities in developed markets moved higher by 0.8% in US Dollar terms over the week, led by the US which gained 1.4%. Government bonds continued to rerate as investors sought higher yields in light of the rising visibility of the economic recovery, falling by -0.8%. US property securities rose by 2.7%, whilst in the single biggest move for the week Asian property securities lost -4.5%. The US Dollar gained ground against most other major currencies, including the yen which closed at 83.4 JPY/USD.



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

Returns to 11 February 2011

Asset Class/Region	Index	Currency	Week	Month to date	Year to date
Equities					
United States	S&P 500 NR	**USD**	1.4	3.4	5.8
United Kingdom	FTSE All Share TR	**GBP**	1.3	3.6	3.0
Continental Europe	MSCI Europe ex UK NR	**EUR**	0.7	2.0	4.7
Japan	Topix TR	**JPY**	1.2	4.0	5.3
Australia	S&P/ASX 300 TR	**AUD**	0.4	2.8	2.9
Global	MSCI World NR	**USD**	0.8	2.6	4.9
Global emerging markets	MSCI World Emerging markets TR	**USD**	-3.4	-2.5	-5.1
Bonds					
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	-0.1	-1.4	-1.4
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	-0.6	-1.9	-1.7
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	0.3	-0.8	-0.6
US High yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	0.3	0.8	3.0
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	0.1	-0.9	-2.8
UK Corporate (investment grade)	Merrill Lynch Sterling Non Gilts TR	**GBP**	0.1	-0.6	-1.1
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	-0.5	-0.4	-0.9
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	0.3	0.4	-0.1
Euro High yield	Merrill Lynch Euro High Yield 3% constrained TR	**EUR**	0.4	1.1	3.5
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	-0.2	-0.5	-1.1
Australian Government	JP Morgan Australia GBI TR	**AUD**	0.1	-0.6	0.2
Global Government bonds	JP Morgan Global GBI	**USD**	-0.8	-1.6	-1.7
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	-0.5	-1.3	-1.1
Global Convertible bonds	UBS Global Convertible Bond	**USD**	0.3	1.4	3.2
Emerging Market Bonds	JP Morgan EMBI +	**USD**	-1.0	-0.8	-1.3

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

Returns to 11 February 2011

Asset Class/Region	Index	Currency	Week	Month to date	Year to date
Property					
US Property securities	MSCI US REIT TR	USD	2.7	2.3	5.6
UK Property securities	FTSE EPRA/NAREIT United Kingdom TR	GBP	1.0	2.6	1.6
Europe ex UK Property securities	FTSE EPRA/NAREIT Developed Europe ex UK TR	EUR	0.5	1.4	-0.3
Australian property securities	FTSE EPRA/NAREIT Australia TR	AUD	0.0	2.3	4.8
Asia Property securities	FTSE EPRA/NAREIT Developed Asia TR	USD	-4.5	-2.4	-2.8
Global Property securities	FTSE EPRA/NAREIT Developed CR	USD	-0.7	0.1	1.3
Currencies					
Euro		USD	0.0	-1.2	1.0
Sterling		USD	-0.4	-0.1	2.2
Yen		USD	-1.7	-1.8	-2.7
Australian Dollar		USD	-1.2	0.5	-2.3
Rand		USD	-0.6	-1.7	-9.4
Commodities					
Commodities	RICI TR	USD	-0.1	-0.1	3.1
Agricultural Commodities	RICI Agriculture TR	USD	2.3	3.3	9.2
Oil	Brent Crude Index (ICE) CR	USD	-0.9	3.5	8.8
Gold	Gold index	USD	0.7	2.8	-3.3

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