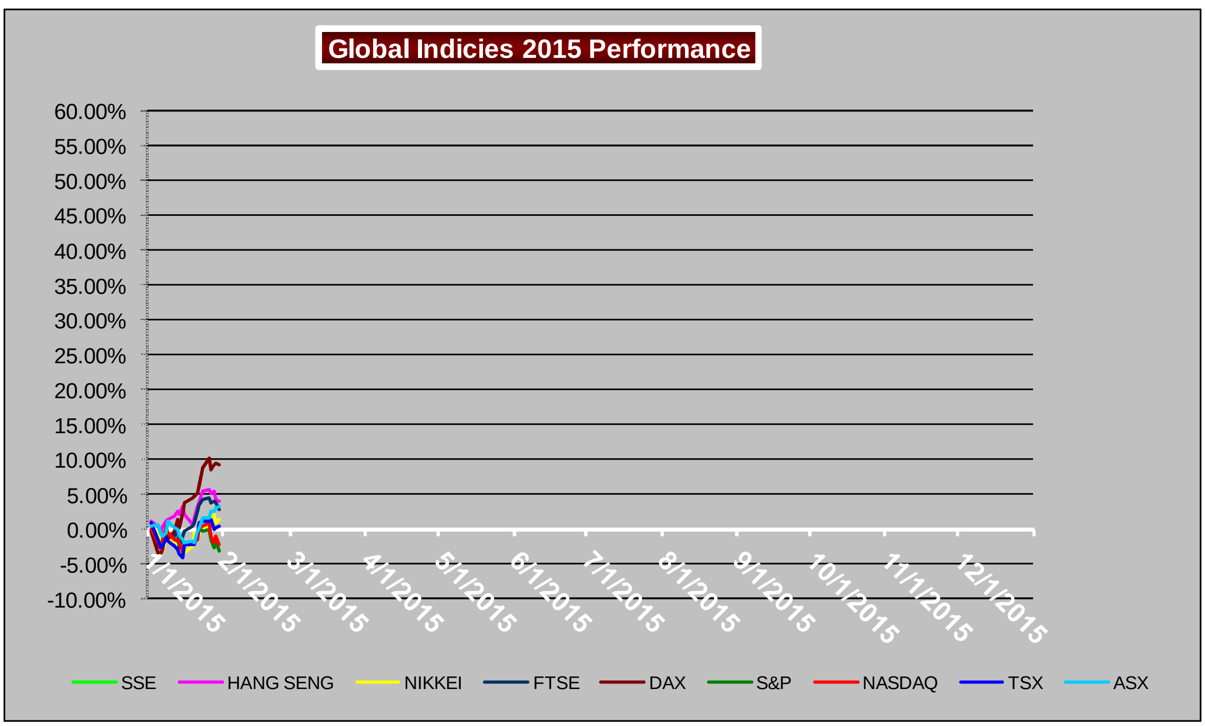
GDB February 2015 Newsletter

Monthly Market Summary:

2015 January Market Activity		
SSE COMPOSITE	***3,210.36***	-24.31 (-0.75%)
HANG SENG	***24,507.05***	+902.01 (+3.82%)
NIKKEI 225	***17,674.39***	+223.62 (+1.28%)
FTSE 100	***6,749.40***	+183.30 (+2.79%)
DAX	***10,694.32***	+888.77 (+9.06%)
DOW	***17,164.95***	-658.12 (-3.69%)
S&P 500	***1,994.99***	-63.91 (-3.10%)
NASDAQ COMPOSITE	***4,635.24***	-100.81 (-2.13%)
ASX 200	***5,588.30***	-177.30 (-3.28%)
TSX COMPOSITE	***14,673.50***	+41.10 (+0.28%)



Investment Themes:

Despite the Greek and Eurozone drama that took center stage in February, many equity markets around the world have shrugged off the danger of a possible Greexit, and have reached multi-year highs.

In large, we attribute this market euphoria to the latest round of quantitative easing (QE) announced by the ECB in late January. The ECB has launched a 60 billion Euro a month ($67 billion) QE program that is to start from March 2015 to September 2016. This figure adds to the 10 billion euro a month of re-bundled debt, asset-backed securities, and covered bonds that the ECB has already been buying since late last year by an additional 50 billion Euro a month in sovereign debt. The QE termination date is said to be open-ended until there is sustained adjustment in the consumer price inflation to ECB's goal of just under 2% over the medium term.

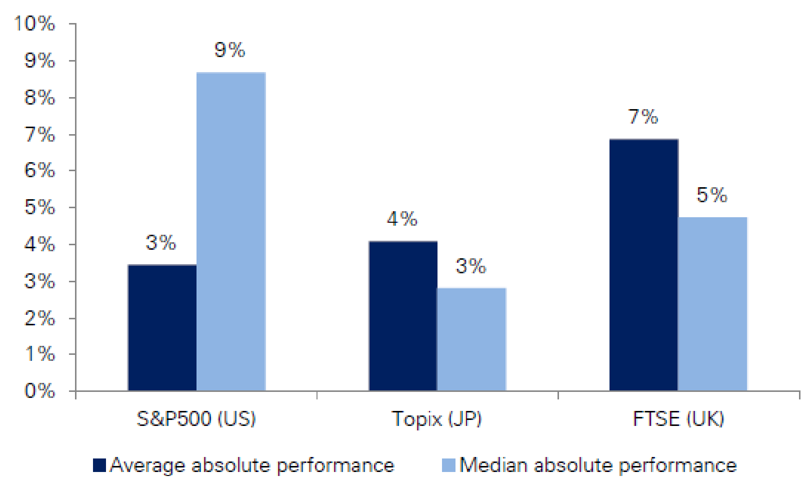
The QE embarked by the Fed and the Bank of England have been credited to bring the US and UK economies back from the brinks of the 2008 financial crisis. So will the QE planned by the ECB resurrect the Eurozone's economies from doldrums? Unlike the US or the UK, the Eurozone is a segmented region with multiple fractions, thus, the liquidity from the QE will not flow equally to the different participating states. In fact, the non-core peripheral countries that are most in need of external boost will likely reap the least benefits. Under the construction of European monetary union, the ECB is owned by the central banks of the EU member countries. The risk and reward from any ECB monetary policy are to be born and shared between these 19 national central banks according to their "capital keys", which reflect their countries' economic and demographic weighting in the Euro area. For instance, the German Bundesbank has a capital key of 26%; whereas the Bank of Greece has a capital key of 2.9%. So under this risk sharing scheme, any losses on the debt purchased by the ECB would be shared by the 19 national central banks.

However, the announced European QE will be conducted in a different manner. Instead of collaborating risk sharing and purchasing debt of the Eurozone countries most in need of liquidity injections such as the PIIGS countries (Portugal, Ireland, Italy, and Greece), only 12% of the total buying in the secured debt of European institutions (the European Investment Bank, and funds set up during the European debt crisis – the European Stability Mechanism, and the European Financial Stability

Facility) and a further 8% of the overall QE allocated to government bonds purchased by the ECB will be shared across the 19 national central banks. The majority 80% of the QE in government bonds will be purchased and held on the balance sheet of each nation's own central banks. The capital key will still determine the amount of sovereign debt that is bought in each country; Germany for instance, will purchase 25% of the 80% of the QE according to its capital key. Furthermore, bonds with a credit rating of BBB- will not qualify, unless the country is in an aid program. Also, maximum of 33% of the bonds issued by a country may be bought. This means that Greece would not qualify in the immediate future given Eurosystem's current holdings of Greek debt which exceeds the 33% threshold.

As we can see, in accordance to the capital key allotment, German government debt will make up about a fifth of the monthly QE or about 20 billion Euros. On the other hand, Greece, the weakest link of the Eurozone nations will receive no additional stimulus through the latest QE. With the flood of additional liquidity being channeled into the already low yielding German bund (10 year bund yield barely above zero at the end of February), we expect the QE to be a net positive for German equities - the DAX. According to Deutsche Bank, the absolute performance of local equity markets in reaction to central bank QE announcement ranges between 3%-7% over a three month time period after initial announcement:

Figure 107: Absolute performance of US, Japanese, UK equity benchmarks 3 months post QE announcements



Note: Average and median values are used across events for each equity region.
Source: DataStream, Deutsche Bank

As for Greece, we believe the agreement that was just reached between the newly elected anti-austerity Syriza-led government and the European institutions has not dramatically changed the outlook of the Greece’s fortune. The four months extension is merely a kick the can down the road strategy and we are likely to see more volatility in the markets as the Greece story unfolds.