RAI WEALTH

Commentary

January 26, 2015

The Markets

There may be potential for a reality television program starring central bankers and the making of economic policy. It could be called, ‘The Real Central Bankers of the European Economic Community.’ Just imagine the last two weeks’ episodes. Two weeks ago, the Swiss National Bank shocked markets by unpegging its currency and sending the value of the Swiss franc skyward.

Affairs last week were less unexpected. The European Central Bank (ECB) finally made up its mind and committed to a new round of quantitative easing (QE). There was no exchange of rings embedded with multi-carat precious gems, but the ECB pledged to buy 60 billion euro of assets (public debt and government bonds, primarily) every month from March 2015 through September 2016. That’s quite a leap from the 10 billion euro of assets it was already buying.

The Economist pointed out Germany’s Bundesbank wasn’t thrilled about the commitment and insisted on an agreement that would limit its risk:

“When the ECB conducts monetary policy by lending to banks, any risk of losses is, as a rule, shared between the 19 national central banks that actually execute the policy, according to “capital keys,” which reflect their countries’ economic and demographic weight in the euro area; the Bundesbank’s for example is 26 percent whereas the Bank of Italy’s is 17.5 percent... But, QE will be conducted in a quite different way… each of the 19 national central banks, which together with the ECB constitute the Eurosystem, will buy the bonds of its own government and bear any risk of losses on it.”

Sure, it’s exciting, but let’s not lose sight of the reason behind the ECB’s decision. After watching the U.S. Federal Reserve Bank, the Bank of England, and the Bank of Japan engage in QE, the ECB decided it might be just the thing to reflate the Eurozone’s economy. Global markets seemed to think it’s a pretty good idea, too. Many finished the week higher.

Data as of 1/23/15	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	1.6%	-0.3%	12.2%	16.0%	13.4%	5.8%
10-year Treasury Note (Yield Only)	1.8	NA	2.8	2.1	3.6	4.1
Gold (per ounce)	1.4	8.0	2.5	-8.2	3.4	11.7
Bloomberg Commodity Index	-2.1	-3.1	-19.7	-11.0	-5.6	-3.7
DJ Equity All REIT Total Return Index	0.9	7.9	33.9	17.7	19.4	9.8

S&P 500, Gold, Bloomberg Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT Total Return Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.
Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.
Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable.

LAST WEEK, IN SWITZERLAND, A BIG MAC COST $7.54. *The Economist* invented the Big Mac Index in 1986 as an entertaining way to assess whether currencies were at the “correct” levels. The index uses purchasing power parity (PPP) to measure one currency against another. PPP is the idea that exchange rates should adjust so the same product (in this case, a hamburger) has the same price in two different countries when the price is denominated in the same currency. After updating the Index on January 22, 2015, *The Economist* reported:

“Two trends have dominated the world of burgernomics over the past six months: currency markets have bubbled like potatoes in a fryer as the oil price has fallen to finger-licking lows and central banks have cooked up new monetary stances. The currencies of commodity exporters have been burnt while those of big importers have sizzled. Meanwhile, the end of quantitative easing in America has supersized the dollar, whereas the mere prospect of it in Europe has made a happy meal of the euro.”

Since a Big Mac in the United States cost about $4.79 last week, the Swiss franc was quite overvalued. That’s not the case with currencies elsewhere, though. Here are the prices of a Big Mac in a few key locales:

Norway $6.30
Denmark $5.38
Brazil $5.21

Australia $4.32
Euro area $4.26
Mexico $3.35
China $2.77
India $1.89
Russia $1.36

It should be noted the Big Mac Index is not a perfect measurement tool. The price of a burger should be less in countries with lower labor costs and more in countries with higher labor costs. When prices are adjusted for labor, the Swiss franc is not the most overvalued currency in the world, the Brazilian real is.

Weekly Focus – Think About It

"The hardest skill to acquire in this sport is the one where you compete all out, give it all you have, and you are still getting beat no matter what you do. When you have the killer instinct to fight through that, it is very special."
--Eddie Reese, USA Olympic Swim Team Head Coach, 2004 and 2008

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* Government bonds and Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.
*Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features.
* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. You cannot invest directly in this index.
* The Standard & Poor's 500 (S&P 500) is an unmanaged index. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.
* The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.
* Gold represents the afternoon gold price as reported by the London Bullion Market Association. The gold price is set twice daily by the London Gold Fixing Company at 10:30 and 15:00 and is expressed in U.S. dollars per fine troy ounce.
* The Bloomberg Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.
* The DJ Equity All REIT Total Return Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.
* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
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