

Q4 & December 2011

Month-end Exchange Rates

	November 30, 2011	December 30, 2011
EUR/USD	1.346150	1.298150
USD/JPY	77.63	76.940000
GBP/USD	1.5728	1.554100
EUR/JPY	104.50165	99.879700
EUR/GBP	0.8559	0.835300
USD/CHF	0.91015	0.935100
USD/CAD	1.01675	1.018250
AUD/USD	1.0273	1.025200
NZD/USD	0.7775	0.780100

Market Commentary – Q4 & December 2011

The year ended in a rather unseasonal fashion with the USD ending the month as the best performing of the G10 currencies. As Eurozone debt crisis continued to dominate, with the possibility of further rating downgrades, and better than expected economic data emerging out of US, safe haven flows continued to make the USD a more attractive destination. For the month EURUSD ended 3.57% lower, which leaves it down 3.25% for the fourth quarter having been in positive territory in October but those gains being offset in November. From its peak on October 27th, EURUSD fell more than 9% over the remainder of the quarter, ending the year as the weakest G10 currency.

Risk appetite has ebbed and flowed throughout Q4 with risk aversion dominating in December as EU struggled to contain possible contagion of the debt crisis that had started in Greece, spread to Ireland and during the later part of 2011 to Italy, Spain and Portugal. Hampering the efforts to resolve the crisis facing EU leaders has been a continuing series of downgrades by the 3 major rating agencies of European sovereign debt, as well as that of individual banks. Indeed, it was the Fitch rating agency who noted towards the end of December in a warning to the EZ that a “comprehensive solution to the EZ crisis appeared beyond reach”, and risked a “self-fulfilling liquidity crisis for potentially illiquid but solvent EZ Member States”, unless the ECB provided a credible backstop. Following this statement, and in the last few trading sessions before the Christmas break, the ECB cut rates 25bps and provided €490 billion in 3 year loans to over 500+ banks in a massive liquidity injection. Although the result of this was not a spectacular reversal in the dwindling fortunes of the single currency, it certainly eased bank contagion risk and constrained monetary expansion concerns. Since the half way mark of 2011, Eurozone economies have seen a divergence in economic activity. Signs of better recovery in Germany, and to a lesser extent France, have been overshadowed by the weakening environment of the other major Member States such as Italy and Spain. This has clearly increased political tensions, no more so than at the latest EU summit in December which once again failed to provide the markets with a convincing plan to resolve the debt crisis or to stimulate economic activity, despite taking some steps towards closer fiscal union.

By contrast, US data has been showing increasing signs of improvement over the last quarter, but in December in particular. As has been the case in recent months, headline US employment report has, on the surface, seemed disappointing; however, a series of strong underlying components would appear to give a different story. New jobs added were 120k, having been +100k the previous month and an upward revision of +72k to September and October suggesting there is strong underlying trend of recovery. This was most evidently underlined with the release in the last few weeks of December for the unemployment rate which dramatically fell from 9% to 8.6%. USD, however, has been more strongly influenced by the events in Europe and risk appetite levels, and as a consequence was not able to significantly capitalise more on the improving economic outlook. With a small gain in retail sales in November, and expected further uptick in December, release of Q4 data in early January may prove to be the catalyst that injects upward momentum for the US currency.

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GBP was also constrained by the risk averse markets during December, although fared much better than its European neighbours with coalition governments austerity measures seen as the right medicine to be taken, albeit leaving many with a sour taste, as well as the action taken by the Bank of England who left rates unchanged during the month. Rating agencies confirmed UK AAA sovereign debt, however, as many expected it was put on negative watch with the unfolding Eurozone crisis sited as the major concern, and mixed economic data (as a result of austerity measures) tainted the outlook somewhat. This economic weakness has escalated throughout the quarter as the spending cuts take effect and tax revenues decline. Highlighting this has been a downturn in both manufacturing as well as industrial production in October (-0.7%), a weak but unchanged services PMI in November (47.6), but a positive revision to Q3 GDP (+0.5% to +0.6%). For now at least, GBP remains a “safe-haven” currency ending the month just 1.2% lower vs. USD, but 2.4% higher vs. EUR. For the quarter, Sterling was essentially flat against USD and +3% vs. EUR; and the year as a whole showed a similar story ending slightly down vs. USD (-0.7%) and +2.5% vs. EUR.

The overwhelming dominance in the currency markets of the events in the Eurozone again dominated the direction for JPY during December as it has throughout Q4. Market uncertainty continued to result in flight to safety, with risk on / risk off trades also having a major impact on Yen direction throughout. Despite their best efforts early on in the quarter when they intervened in late October, BoJ and MoF’s resolve to limit JPY appreciation had no material effect during the last month of the year. With limited US rate support, USDJPY traded in a very tight range ending the month just 0.9% lower. Indeed the December range was the narrowest high-low range since 1980, underlying the difficult conditions. *It should also be noted that 2011 as a whole has seen the second narrowest high-low divergence amongst G10 currencies since the EUR was introduced some 10 years ago.* USDJPY ended the month just 0.9% lower and was essentially flat for Q\$. For the year 2011, the JPY appreciated 5.14% making it the strongest of eth G10 currencies overall.

Like the authorities in Japan, the Swiss National Bank has also been heavily inclined to keep the CHF from appreciating significantly. Having taken the measure in late September to cap any CHF gains by imposing a floor on EURCHF, the SNB have maintained their presence throughout Q4. Domestic economic data remained weak during the month and quarter, with manufacturing PMI recording its 3rd consecutive monthly print below 50 (latest reading being 44.8). Overall, the economy grew at just +0.2% qoq during Q3, with the likelihood that Q4 may move into contraction. Despite this, however, and in line with the general level of uncertainty pertaining to the EZ crisis, CHF retained its safe haven status during this latest period, as it has throughout 2011. Only the USD and JPY outperformed the Swiss Franc during December and Q4 as well as 2011 as a whole.

With Gold ending the year as the best performing precious and base metal, rising 10% in USD terms during the year, despite falling 10% in December; it is no surprise that AUD was amongst the best performing currencies overall in 2011 along with the more traditional safe haven currencies. In December, the RBA cut rates a further 25bps to 4.25%, having already cut previously in the Q4. Whilst the minutes of the meeting noted the Board still maintains a positive outlook for the domestic economy, the crisis in Eurozone was noted as a significant downside risk, and that this was the primary reason for the latest rate cut. AUDUSD ended the month just 0.2% weaker whilst the currency pair managed a healthy +5.48% appreciation during the last quarter. For the year as a whole, AUDUSD started where it finished at a rate of 1.025.

As has been the case throughout Q4 and indeed since the early part of 2011, market focus remains on when and importantly how the European leaders and Central bank can provide an authoritative and concrete workable solution to the debt and banking crisis. Rating agencies have made their intentions clear, as have the authorities around the world that unless the situation is resolved quickly and that measures are put in place for the longer term effectiveness and supervision of such a situation not repeating itself, the global recovery will stall, and many countries will return to recession. To heighten the tensions amongst the EU leaders that already exist, 2012 sees several key political votes taking place (most notably in France and Germany), which will most certainly have a part to play in how the crisis is resolved. Economic activity in the US appears to be gaining a solid footing, and this may prove to be the necessary stimulant that the rest of the world (Emerging markets in particular) can seize upon to kick start their own economies.