April 2023

MarketWatch

Brace for landing?

Editor's note

Welcome to the latest edition of MarketWatch.

Since our outlook edition of MarketWatch at the beginning of the year, the world economy has proven to be more resilient than expected. Europe and the UK managed to avoid recession over the winter, US growth is rebounding, and China finally exited its COVID-19 related slowdown. Unfortunately, good news can be bad news, as a stronger economy has kept inflation well above central bank targets. The key question for investors is whether the central banks can engineer a 'soft landing' from high inflation to lower inflation without crashing the economy?

The persistence of growth in the face of the sharpest interest rate increases in decades is encouraging, but vulnerabilities have emerged. The global property sector is struggling and, in flashbacks to 2008, we've recently had several bank failures. We note that these failures were very different from the GFC (global financial crisis) and that the financial system is in far better health now, but it does show that the economy is not immune to higher rates.

What are investors to make of all this? Usually, economic hard landings, or recessions, are associated with bear markets (down 20% or more) in stocks. But we've already experienced this, so there's less to fear from a hard landing now that valuations have adjusted downwards. Despite falling recently, bond yields are much higher now than for most of the last decade, so there is more cushion in safer assets too. Overall, investment assets are not cheap, but return prospects are higher than they've been for some time, if investors can look beyond near-term uncertainty.

In this edition of MarketWatch, we investigate the likelihood of a 'hard' or 'soft' landing in light of recent developments. We take a deeper look at the impact of the US dollar on our investment portfolios and examine what is happening to the shrinking UK stock market. We also explore money market funds, an alternative solution to bank deposits for short-term liquidity.

Should you have any questions in relation to the content within this quarter's edition, please contact your Davy Adviser.

Donough Kilmurray
Chief Investment Officer

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Donough Kilmurray
Chief Investment Officer

Global outlook - Brace for landing?

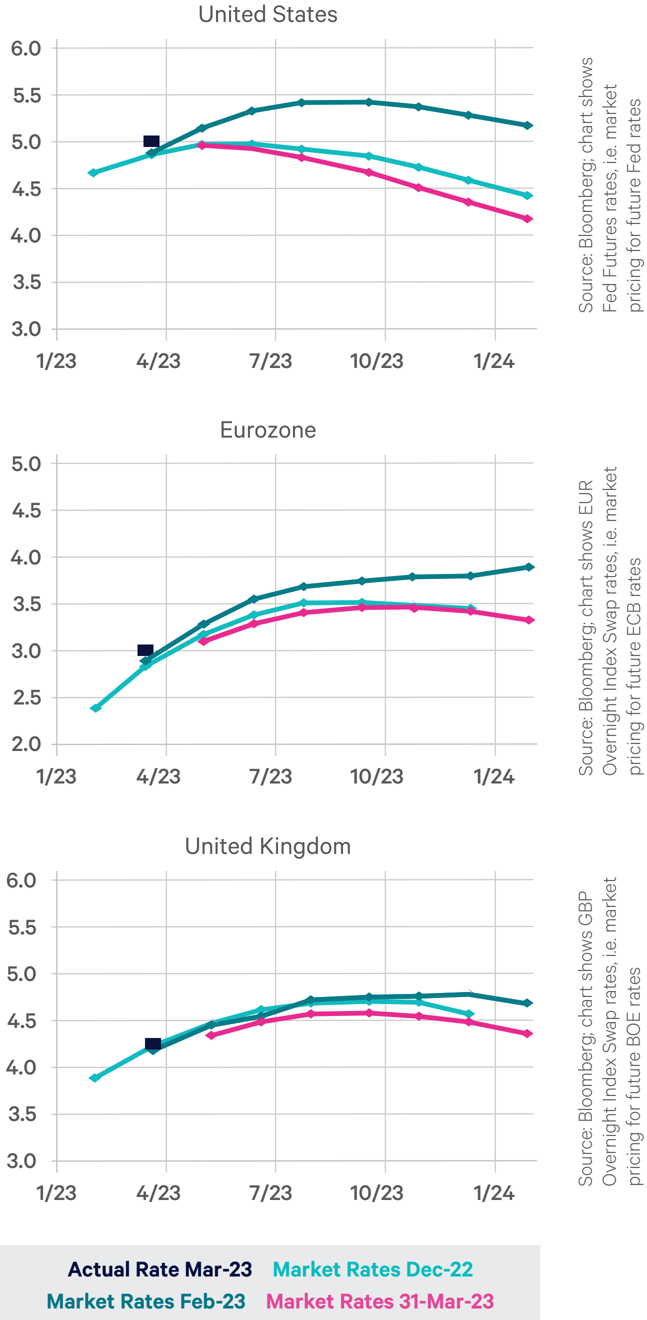
The post-COVID-19 economy has been a confusing one for investors. First in the recovery boom of 2021, we wondered whether the surge in inflation would be transitory or not? Then, in 2022, when we realised it was not, we wondered whether central banks could engineer a soft landing from high growth / high inflation or would we crash land into a recession? The markets assumed the worst and crashed in advance, but the recession never came.

2023 began in high spirits with inflation on the decline and the economy holding up – the ideal 'no landing' scenario. However, as growth continued and inflation remained high markets realised that 'no landing' would eventually lead to a 'hard landing', as central banks would have to continue hiking interest rates to cool down the economy. Stocks and bonds turned and fell again.

To make matters worse, even though higher rates haven't broken the economy, they have revealed fractures in the financial system. Three small American banks collapsed after depositors fled due to failures in risk management, and Credit Suisse was force-sold to its local rival for similar reasons. Amid flashbacks of 2008, central banks stepped in to shore up the system. Despite rising systemic fears, they did not turn from their fight against inflation, with the Federal Reserve (Fed), European Central Bank (ECB), and Bank of England (BoE) all raising rates in March.

Given the uncertainties of war, inflation and now the financial system, central banks are no longer providing forward guidance on their rate intentions. Instead, markets are again making their own minds up. This is most evident in the bond market, where interest rate expectations have flipped downwards again (see Figure 1). Are they right – should investors now brace for a crash landing?

Figure 1: Market pricing of central bank rate policy



Why no landing yet?

Six months ago the strong consensus was that winter would bring recession for Europe and the UK and that the US would likely follow eventually. Interest rates had never been hiked so far so fast without a downturn, yet rates are higher now than expected last year, and still no recession.

Warmer than-expected weather and alternative sourcing meant that Europe didn't run out of energy, and despite blowing out their budgets during COVID-19, governments borrowed more again to soften the hit to households and businesses. As a result, the economy kept going. Even still it was close. The UK saw almost no growth in the fourth quarter of 2022 and the Eurozone was saved from contraction by Ireland's out-sized multinational-fueled contribution.

Buoyed by COVID-19-era savings and higher wages, the US consumer continues to be the main engine of the global economy, although their spending growth is slowing. In the first quarter of this year, business surveys picked up across Europe and the US, more so in services than manufacturing. Higher rates have hit real estate though, especially in the commercial sector. However, China, the second engine of world growth, has thrown off its COVID-19 constraints to add impetus to the global rebound.

Jobs and wages still flying high

Economists refer to the decade after the GFC (global financial crisis) as the jobless recovery, as austerity and debt kept unemployment high and wage growth low. This helped to keep inflation and interest rates low, leading to a boom in corporate profits and above-average investment returns. Now, post COVID-19, we have the opposite macro conditions, and economists debate whether low unemployment and high inflation are the new normal for this decade.

Although wages are rarely linked directly to inflation anymore, large sectors of the workforce are reacting to higher inflation by demanding higher pay. The UK has been racked by strikes for months, and normally, sensible Germany, where unions and companies tend to cooperate, is seeing large-scale industrial action too. We expect more pay increases this year, which will keep service cost inflation high, and less next year as broader inflation fades.

However, there are longer-term demographic factors too. Aging and health issues are shrinking workforces. Political choices in the US and UK mean less immigration and fewer workers. In the US, Walmart raised its minimum wage by over 15% to attract workers, which will set a floor for other employers. Even in Japan, which has seen little wage growth for decades, companies are beginning to increase pay. Eventually, these trends will slow, but it is reasonable to expect lower unemployment and higher inflation in the 2020s than we had in the 2010s.

Will the banks crash the economy?

Given all the difficulties the global economy faces, the last thing we need is another financial crisis.

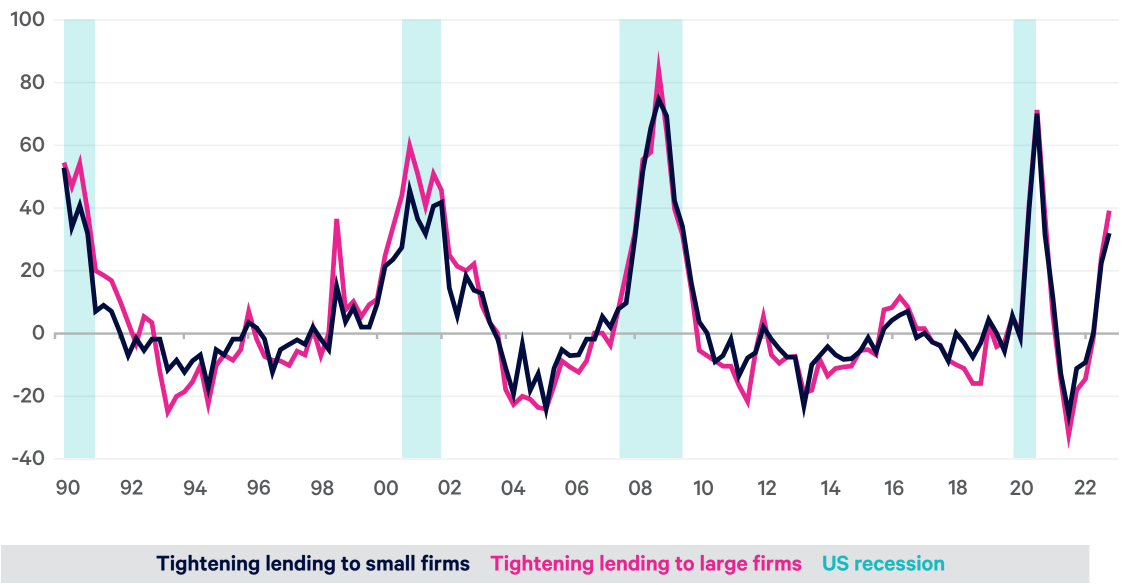
Especially as the cure for such a crisis – turning on the money taps – would only worsen the inflation situation. However, we do not believe that recent bank failures are the start of another 2008 situation.

An important distinction is in the nature of the current banking problems. The GFC was a credit crisis, where banks had over-loaded their bloated balance sheets with mortgages and dubious derivatives, whose value evaporated. This time their balance sheets are smaller and they carry interest rate risk from more solid bond holdings. Stricter post-GFC rules, which were later relaxed for smaller US banks, mean that last year's sell-off in bonds only dented bank capital rather than wiping it out.

Another important difference is the central bank's response. In 2008 they were always on the back foot, desperately inventing rescue schemes on the fly, whereas this time, they had a playbook and they reacted decisively. Such swift action can raise doubts too, and concerns of overreaction, but for a system built on confidence, maintaining credibility is key.

It would be naïve though to assume that recent events will have no consequences. The smaller US banks are responsible for over half of all commercial and industrial lending in the country, even more so in property, and they were already tightening lending standards. Such credit contractions have historically been linked

Figure 2: Credit contraction and recessions



US Federal Reserve; chart shows the percentage of US banks tightening lending to large and small US firms with recessions, although it's not always clear which causes which. Fed Chair Powell noted that slower bank lending would slow growth and inflation.

What does this all mean for investors?

Chair Powell also made it clear that rate cuts were not in the Fed's plans this year, as fighting inflation remains their primary objective. While increasing the risk of recession, this means that bond yields' recent decline may have been premature. However, weaker lending means that the peak in bond yields, and the risk of further loss from bonds, are lower than previously thought. We note that yields are still close to their highest level in over a decade, so bonds do warrant their place in a portfolio, especially in an eventual recession, where they should outperform cash.

Normally when the bond market expects a recession, longer-term yields dip below shorter-term yields, known as a yield curve inversion, and the credit spreads on lower-quality bonds increase. The yield curve has been inverted for some time, but yield spreads on lower-grade bonds are not far above average, meaning that credit investors are not being compensated for recession risk.

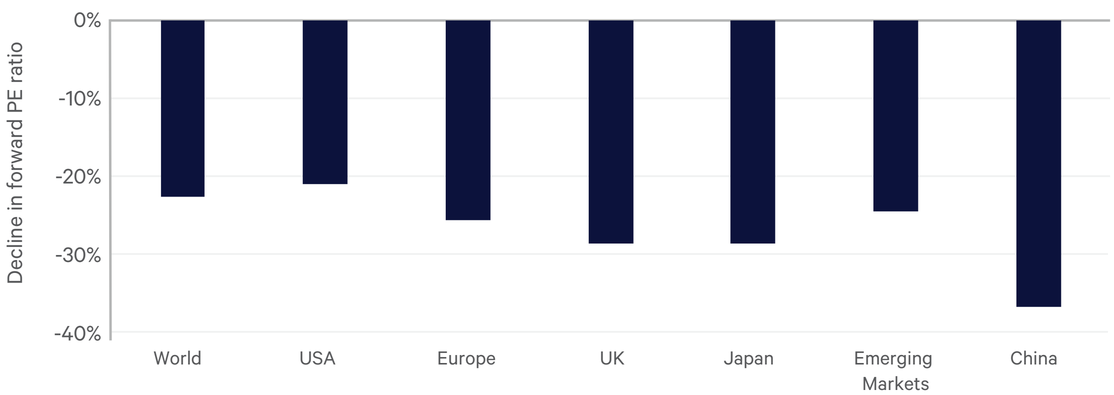
Similar to last year, the stock market has been driven by expectations for interest rates. The idea that central banks were close to their peak fueled the Q4 / Q1 rally until investors realised that the no-landing scenario meant higher rates. Now that banking fears have raised expectations of rate cuts, stocks have surged again, especially in the higher-growth sectors. Given that authorities have better ways to address banking issues, this feels over-enthusiastic to us.

Does this near-term exuberance mean that equity investors are headed for a crash landing? Economic downturns almost always see bear markets (down 20% or more), where earnings and valuations typically decline by 10-25% each. Corporate profits have stalled, but not fallen yet, which we would expect when slower growth meets higher wages and costs of capital. Valuations though have already fallen by circa 20% from their 2021 peaks, so markets are less vulnerable.

Let diversification be your life jacket

In conclusion, if the economy does suffer a hard landing, investors should have less to fear as markets have mostly descended in advance. Stocks are not particularly cheap, and some turbulence would be normal, but much of the typical decline already happened last year, and more modest valuations mean higher return prospects from here. At higher yields now, high grade bonds can once again provide some cushion in a portfolio, and alternatives showed last year that they can smooth the return experience too. So while we can't rule out a bumpy landing, let alone try to time it, we take comfort from knowing that well diversified portfolios are better able to see us through one now than they have been for some time.

Figure 3: Declines in price / forward earnings ratios from 2021-22 highs, as of end March 2023



MSCI. All in local currency; chart shows the decline in the ratio of Price to Forward Earnings, as of end March 2023

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Conall MacCoille
Chief Economist

Ireland's economy outperforms again in 2022

The news that Irish GDP (Gross Domestic Product) grew by 12% in 2022 was greeted with scepticism, as ever, skewed by buoyant exports and the multinational sector. However, there is no denying that employment grew by 2.7% to a fresh record high of 2.69 million. This means that Irish employment is now 9% above pre-pandemic levels, a feat that no other European economy has come close to.

Despite a very challenging global environment, Ireland continued to attract a healthy flow of foreign direct investment last year. Employment in the multinational sector grew by 9%, or by 24,000 jobs to 301,500. Notably, 60% of these additional jobs didn't come from the information, and communications technology (ICT) sector, but from pharmaceuticals, medical technology and business/financial services firms.

Ireland was also one of just a couple of OECD (Organisation for Economic Co-operation and Development) countries to run a budget surplus in 2022, of €5bn, or circa 1% of GDP. This gave the coalition government flexibility to implement tax cuts, the €200 energy price credits and one-off social welfare payments to help households with higher energy bills. Ireland's strong fiscal position has been recognised by bond markets, with 10-year yields trading through France and now close to triple-A rated Netherlands.

The one sector that has been vulnerable to higher interest rates and cost inflation has been construction. Ireland's construction PMI (Purchasing Managers' Index) moved below the 50 no-change level in the second half of 2022 as viability issues led to the flow of apartment and office development starting to dry up. This could still be a challenge in 2024 and beyond. That said, housing completions rose close to 30,000 in 2022, still not sufficient to satiate pent-up demand, but well ahead of expectations.

Dealing with higher energy prices

Irish energy companies announced a flurry of price increases throughout last summer, so the average household energy bills were expected to have almost doubled, to above €4,000 per annum. This helped push Ireland's CPI inflation rate to a peak of 9.2% in October, falling only to 8.5% in February, and presenting a sharp squeeze on real incomes.

Thus far, Irish consumer spending has been relatively resilient, up 1% in Q4 2023, with core retail sales volumes rising 0.4% in the three months to February. Jobs growth, income tax cuts and government supports have helped. However, Irish households may still be adjusting to the sharp rise in their energy bills.

That said, Ireland's household savings ratio was still 20% at the end of 2022. This is a far healthier buffer for many households to use to sustain spending in 2023. In contrast, in both the UK and the US, household savings have already been cut back sharply, with many consumers turning to credit card debt. This is a worrying trend and not sustainable in the medium term.

Of course, one reason for the optimism is the recent collapse in wholesale energy prices, trading close to €40 per megawatt per hour in March. Depending on when these lower wholesale prices are passed through to retail prices, CPI (Consumer Price Index) inflation could fall rapidly.

In the UK, the direct regulation of retail energy prices by OfGEM (Office of Gas and Electricity Markets) means that the average household energy bill is expected to fall back to £2,150 in July. However, the timing for Irish households' energy bills is far less certain. Taoiseach Leo Varadkar has threatened windfall taxes on Irish energy companies if retail energy prices are not cut in the near future.

Jobs cuts amongst technology firms have attracted attention

Expectations for the Irish economy for 2023 had been relatively subdued. There has been no lack of headwinds; the Ukraine war, tightening monetary policy by Central Banks and of late, the uncertainty in the banking system.

However, as in previous downturns, Ireland's defensive export sector, with little exposure to highly cyclical sectors such as heavy engineering, capital goods or car production, should provide some protection should global demand deteriorate.

Perhaps what is different this time is the slowdown in the ICT sector, evident in high-profile job cuts in Facebook, Google and other technology firms. Many of these firms had hired very aggressively during the COVID-19 pandemic as the digitisation of advertising, communications and media accelerated, but they are now cutting back.

However, the quantum of announced job cuts in Ireland's ICT sector is still very small. There have been winners and losers in the sector. Some firms are still set on expansion. The American Chamber of Commerce recently reported that two-thirds of US companies operating in Ireland still expect to increase their staff numbers over the next twelve months.

Still struggling to address the problems of success

Irish residential property prices rose by 7.7% through 2022. However, asking prices have fallen back in recent quarters. This suggests a degree of froth built-up in the housing market, leading to stretched valuations which are now correcting. This was particularly the case in Dublin where house prices have already declined by 2% between September and January.

However, the housing market remains extremely tight with little let-up in demand. In addition, by its own estimates, the Central Bank's surprise decision to loosen the mortgage lending rules could eventually add 8% to house prices. This may be already evident in mortgage approvals data. The average first-time-buyer approval rose by 2.3% in February to a fresh record high of €281,350.

Of late, the Irish government is now considering fresh policy initiatives to address problems in the housing sector. Specifically, tax changes to help stem the exodus of buy-to-let landlords, but also measures to ease the acquisition of such properties by local authorities, with tenants in situ.

However, intransigent problems remain. Capacity problems in An Bord Pleanala and Irish Water are clearly holding back development. In January, Minister Darragh O'Brien published draft legislation intended to streamline the planning system. However, the Irish Planning Institute has already criticised the plans as 'unworkable'.

Generally, the Irish Fiscal Advisory Council (IFAC) has criticised the lack of clarity on spending for the National Development Plan, the rollout of the Slaintecare primary care system and Climate Action Plan. Notably, planned public capital spending in October's Budget for 2023 was left unchanged at €12.4bn, despite clear build cost inflation.

In short, the key threat to Ireland's fortunes may not be external, but the risk that public investment will fail to address the growing evidence of bottlenecks and cost pressures in the economy.

Warning: Forecasts are not a reliable indicator of future performance.

Conall MacCoille
Chief Economist

A bleak economic outlook for the UK

The current consensus forecast average indicates that the UK economy will suffer a 0.5% contraction in 2023, the clear underperformer amongst the G7 this year.

Why this bleak view? Firstly, UK CPI (Consumer Price Index) inflation was still in double-digit territory, at 10.4% in February, far higher than in other countries. This means that UK households will face an unusually sharp squeeze on real incomes, accentuated by the Chancellor of the Exchequer Jeremy Hunt's austerity measures, to bring public borrowing under control.

Indeed, the March budget provided little respite. True, the energy price guarantee was extended for another three months. This means that average household bills will stay at £2,500, rather than rising to £3,000. Crucially, however, there was no change to income tax bands and thresholds, which will stay frozen, despite rising wages – effectively a stealth tax on households struggling with rising prices.

The corporation tax rate will also rise as scheduled, to 25% from April 2023, up from 19% previously, undoubtedly hurting companies. This move had attracted heavy criticism from Conservative MPs, but is now seen as essential, following the disastrous 'mini-budget' last autumn. In short, with the borrowing of almost £152bn, 6% of GDP (Gross Domestic Product) expected this budget year 2022/2023, Jeremy Hunt had little room for manoeuvre.

For now, consumer spending and retail sales have proved surprisingly resilient. However, consumers may literally be living on borrowed time. Credit card lending grew by 13% in the year to February, the fastest seen growth since 2018. This is a worrying trend. The clear concern, is that households will eventually have to stop dipping into savings and take on debt to sustain spending.

How high will the Bank of England raise rates?

The second headwind facing the UK economy is that the Bank of England has now raised official interest rates to 4.25%. Markets are split on whether the Monetary Policy Committee (MPC) will raise rates further, to a peak of 4.5% by mid-2023. Of course, this all depends on whether the Bank of England will see any tentative evidence in the coming months, that CPI inflation is returning to 2%.

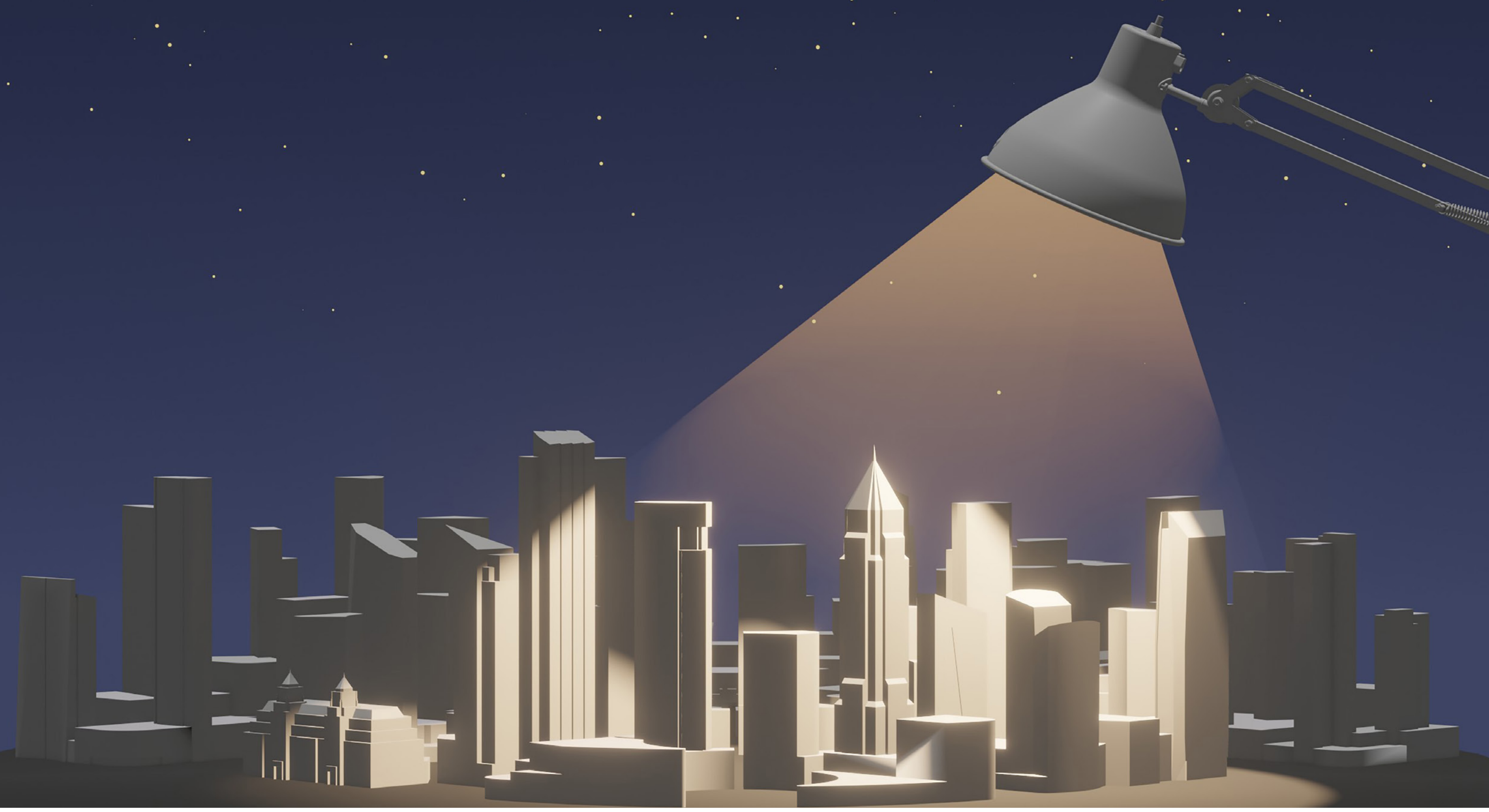
For now, the signs are at best, mixed. Thankfully, the decline in wholesale gas prices means household average energy bills will soon fall to £2,150. However, in February, services price inflation accelerated to 6.6%. This is a worrying sign that the acceleration in pay growth, to 6%, is being passed through to consumers, creating persistent inflationary pressures.

Lurking beneath the surface here, is Brexit. UK employment is still marginally below pre-pandemic levels, but the unemployment rate is still at a very low 3.7%. The decline in net migration, but also weak participation amongst older age groups has contributed to labour shortages, which won't be easily resolved.

Hence, in its February projections, the Bank of England forecasted that CPI inflation would likely fall below 2% in 2024 and 2025. However, at the same time, the MPC said the upside risks to its CPI inflation forecast had never been greater.

The housing market in the doldrums

Fixed rates on UK mortgage products have receded from the eye-watering levels above 6% late last year. However, in February the average quoted 2-year fixed mortgage rate was still 5.38%. At these levels of interest rates, affordability in the UK housing market is clearly stretched too far. Something has had to give – so sharp declines in both transactional activity and house prices are expected in 2023.



Mortgage approvals in February were 43,500, down 37% on the year. This is one of the weakest levels of lending activity since the mid-1980s. Approvals last fell to these levels during the COVID-19 pandemic and before that in 2009, following the global financial crisis when UK house prices declined by 15%.

The current median forecast is that UK house prices will see a 5% decline through 2023. This follows a 3-4% decline through September to December, according to the Halifax and Nationwide indices. So arguably, a circa 10% peak-to-trough decline is expected.

However, it is not only UK house prices that are at risk from higher interest rates. Close to an additional two million households will have to refinance their existing fixed rate mortgage deals by the end of 2023. Many will now face paying interest rates above 5%, rather than the 1-2% rates they are currently on.

In December, the Bank of England calculated that once they re-finance, 670,000 households might face spending 70% of their disposable incomes (after essential items such as food and energy) on their monthly mortgage payments. Since December, energy prices and mortgage rates have fallen back. However, many households will still face a very difficult period for their personal finances.

Some good news on Brexit

Brexit has no doubt created unwelcome uncertainty for investors. The standoff on the Northern Ireland protocol meant there was still a risk that the existing EU/UK trade deal, as part of the Withdrawal Agreement, might suddenly unravel. These fears were justified, given the European Commission had drawn up a list of retaliatory trade measures, should the UK refuse to implement the protocol.

However, Rishi Sunak has managed to see off any lingering opposition within the Conservative party to the new 'Windsor framework', despite his predecessors Boris Johnson and Liz Truss and the Democratic Unionist Party (DUP) voting against the deal.

The deal is clearly perceived in Britain to have been a success, securing unexpected concessions from the EU. There is little appetite to restart negotiations or extend political capital to support the DUP. While dysfunctional politics in Northern Ireland may continue, a breakdown in the EU/UK relations now seems unlikely.

However, it remains to be seen whether this progress will be sufficient to stimulate business investment in the UK. The existing trade deal is far from perfect, still implying much red tape and regulatory barriers for UK businesses.

An improved 'Swiss-type' deal had been mooted in the British press during the autumn but was met with opposition from Conservative MPs. Labour leader Keir Starmer is unlikely to press the issue ahead of the next general election, determined to win back Brexit voting 'red-wall' seats.

Aidan Donnelly
Head of Equities, Davy Private Clients

Global equities - Every landing faces turbulence

Those of a certain age will remember the original incarnation of the band, The Pet Shop Boys, and their first (and biggest) true hit single, West End Girls. Among some great lyrics in that song is the line "Which do you choose, a hard or soft option?" For most of the last nine months, investors have been asking the same question in relation to global economic growth – hard or soft landing? Of late, this choice was joined by another - and philosophically more difficult to understand option, known as the 'No Landing'. If this wasn't difficult enough for central banks to deal with, the 'shock waves' going through the banking sectors on both sides of the Atlantic have created an additional layer of hard or soft options when it comes to the fate of certain banks and any collateral damage to the broader financial system and global economy.

Most asset markets got off to a powerful start this year as the scent of 'immaculate disinflation' permeated the air, bringing with it the promise of lower interest rates in the back half of the year and a benign backdrop for the deployment of capital. That narrative started to come a cropper, first in the US, as buoyant economic indicators and sticky inflation spurred concerns about a hawkish response from the US Federal Reserve (Fed) trying to keep price growth in check, and second in Europe where the European Central Bank (ECB) stepped up their war of words (and actions) to bring inflation under control. And as a result, bond, interest rate, and foreign exchange markets began pricing in higher terminal rates for this cycle.

The interplay between interest rates and economic growth is a particularly interesting one at this juncture – and one that is creating a conundrum for central banks. Based on academic research, many would believe that the transmission mechanism of higher interest rates to slowing growth typically takes six to nine months from the commencement of a raising cycle. Therefore, spare a thought for central banks (particularly the Fed), which have stood over one of the steepest and fastest increases in rates only to see modest impacts on growth and inflation.

Some of the most dangerous words in investment are "it's different this time" and while using them as a general catch-all to explain the unusual is fraught with danger, that is not to say that some factors will change from one economic cycle to the next. Obviously, what sets this interest rate cycle apart from the last two (COVID-19 and Global Financial Crisis) is the absence of Quantitative Easing (QE) – although its reversal is an additional headwind to financial conditions this time around. However, expecting the economy to respond 'as normal' to interest rates – the last normal cycle was early this century – and the economy is very different to that now. Things never repeat themselves, but they do often rhyme.

Events of the last few weeks in the banking sector may pick at the scars of the 2007-2009 period and cause people to question if a repeat is about to hit our screens. While Silicon Valley Bank's collapse was clearly the result of a flawed business model that was poorly executed, the sudden flare-up of risk aversion in the global banking sector might be seen as a proximate cause of the demise of Credit Suisse. In and of itself, it should not have been fatal for a systemically important global institution. Recent years have seen an inordinate number of missteps by the Swiss bank, so in a sense, it has crumbled because the street has simply lost faith in it after years of cartoonish mistakes – again, not a systemic issue for the wider industry.

Yet all of this does create a conundrum for central banks. It could be argued that, for the first time in many years, the goals of financial market stability and price stability (fighting inflation) are at opposite

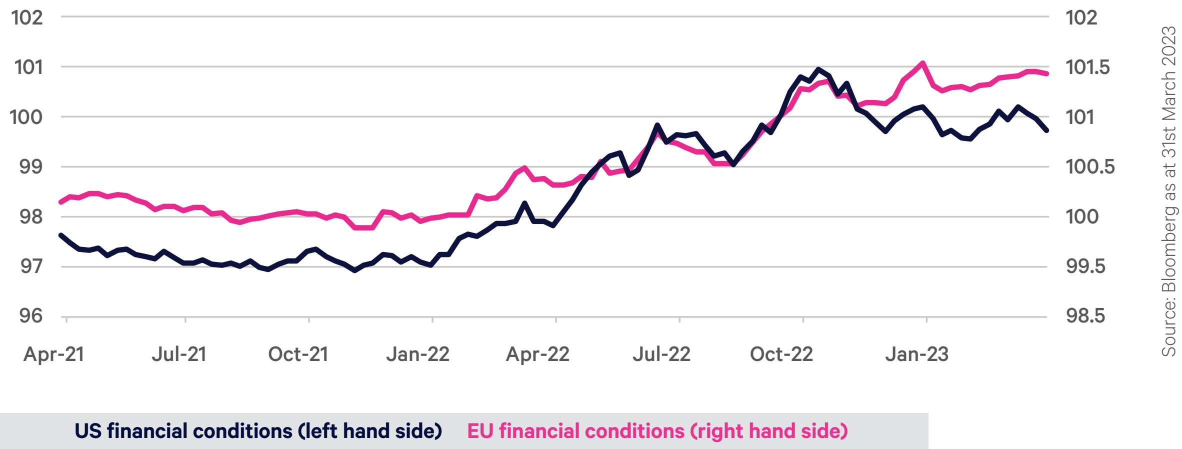
ends of the scales. If both the Fed and the ECB continue on their path of hiking rates - in line with the market expectations at the beginning of March - that could eventually be seen as a Trichet-esque policy error of ignoring financial stress by focusing on the single inflationary needle on their policy compass. If they hold, let alone cut, it could well suggest that they don't believe their own rhetoric on the strength of the banking system.

Financial stability has clearly become a more prominent risk and difficulty for banks will tend to make loans somewhat harder to come by, and therefore will tighten financial conditions - but the magnitude of the recent tightening of conditions can be difficult to quantify.

Of course, what matters most is how conditions evolve moving forward, and it certainly seems reasonable to posit that credit conditions are going to tighten no matter what, which would take the place of a rise in official interest rates for either central bank to achieve their price stability goals. One would think that investor risk aversion could accomplish the same goal, though the enthusiasm with which punters have bought tech stocks and crypto suggests that animal spirits (and thus the potential demand impetus for future inflation) remain all too alive.

Over the coming months, the central bankers in the cockpit may have to deal with course corrections, gusting winds, and more air pockets before the wheels touch down on this landing – please keep your seat belts fastened!

Figure 1: Financial conditions have been tightening



Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Marie Gillespie
Senior Equity Analyst

Irish markets: No time for boredom

Those who think that covering a small market like Ireland must be rather mundane in comparison to the bigger, more 'glamorous' global markets would be very wrong. If anything, I'd welcome an interlude now and again! Companies listed in Ireland are, by definition, global in nature, and whilst this quarters multiple topical issues are dominating Irish stocks, none of them are particularly Irish in origin. The phrase I used in our last edition of MarketWatch, 'no stock is an island' is certainly currently holding true.

Banking: this time it's different?

Let's begin with the current big topic – the banking sector. Others can discuss ad infinitum banks in a global context, but my role is as a purveyor of Irish Equities. Firstly, I'm always wary of those that claim that "this time it's different" when generally speaking about markets. In my experience, it's usually used to explain why markets or profits won't fall this time, when in reality cyclicality is an inherent part of investment markets – hence the warnings on every financial product.

However, in the particular instance of banks, in an Irish context at least, I do believe that this time, Irish banks are positioned well. That's not to say that global banking sentiment can't, and won't impact banking share prices – clearly, it can, and it has. However, there are several factors in relation to Irish banks that are different from the last credit cycle:

1. **European banking regulations are amongst the strictest globally**
   This impacts banks' liquidity coverage and capital ratios. In addition, the prioritisation of how bondholders are viewed versus equity holders (which has been an issue for Credit Suisse), is clearer in the EU.

2. **The average bond duration held at Irish banks is relatively short term (c. 3.5 years); mostly sovereign in nature; and the majority of liquidity is held with the ECB**
   There is limited exposure to longer-term, riskier debt such as that held by Silicon Valley Bank and others.

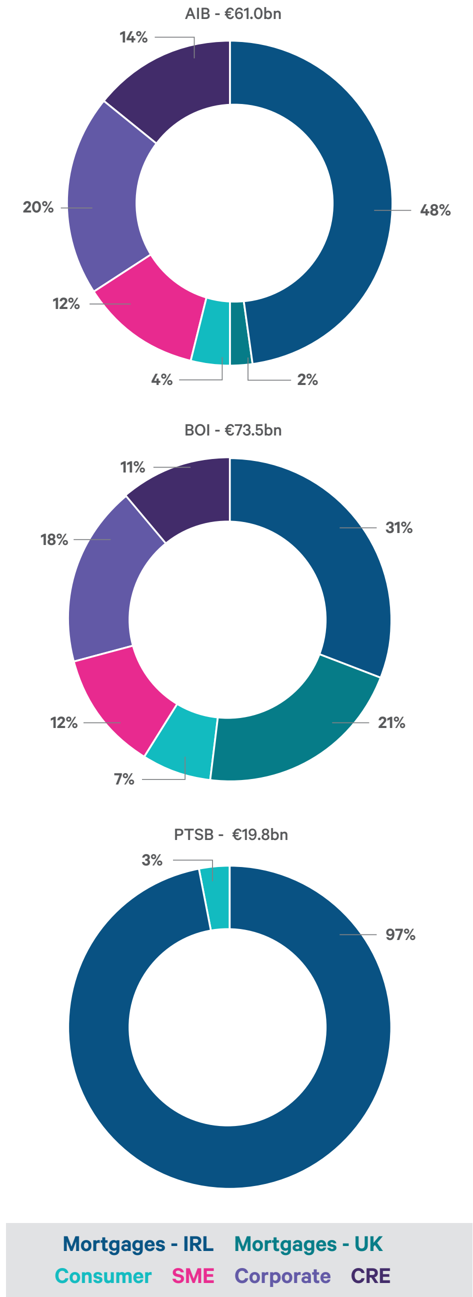
3. **The Irish banking market is concentrated**
   After the exit of KBC and Ulster bank from the market, only three banks remain in Ireland: Bank of Ireland, AIB and Permanent TSB.

4. **Irish banks are retail-oriented franchises with strong deposit ratios**
   With a minimum of 50% of deposits covered by the €100k European Central Bank guarantee.

5. **>50% of lending in Ireland is mortgage lending**
   This is strictly governed by the Central Bank Macro-Prudential rules in Ireland. In other words, even if Irish banks had wanted to get carried away with riskier mortgage lending, they would have been unable to do so.

Hence, whilst short-term market volatility cannot be ruled out for the Irish or indeed any other bank, structurally speaking, it does appear that Irish banks are well positioned to weather the storm.

Figure 1: Banks' balance sheet summary



Source: Davy research as of June 2022; CRE: Commercial real estate; SME: Small and medium-sized enterprises

Bills, Bills, Bills

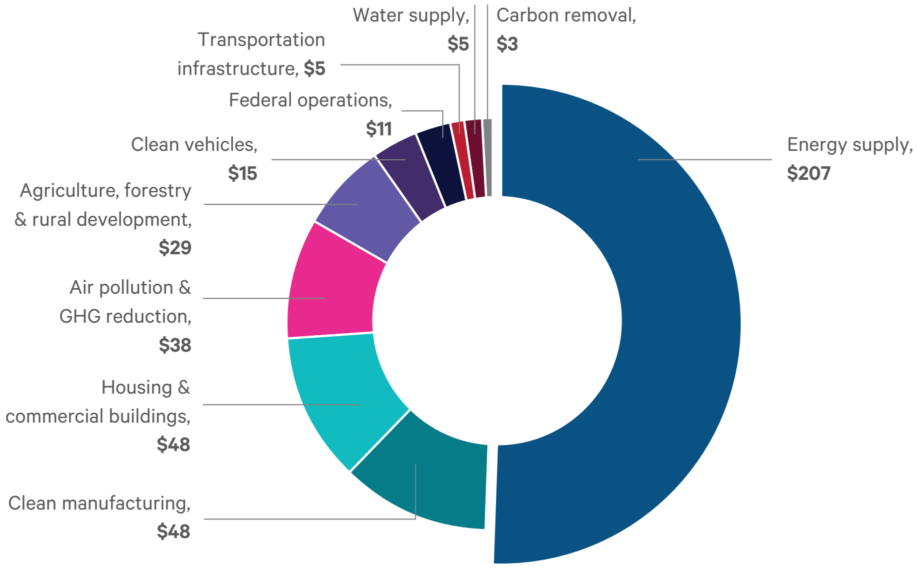
Having recently met numerous Irish corporates in succession following year-end results, there were, as always, several themes that cropped up repeatedly. It seems natural to assume these themes may be Irish or at least European in nature, but actually, the US was the region mentioned by many a corporate lip this quarter.

Why is this? Well, in some ways it should be no surprise that in the new global world order in which we find ourselves, investment in Asia or other regions may seem less attractive – at least in the short term. However, the US has made itself an increasingly attractive place to invest on a couple of fronts.

Firstly, the US has introduced several initiatives/bills that are attracting growth. The first bill is of course the US Infrastructure bill, which whilst in planning for some time, is really only beginning to come to fruition now. In addition, but less relevant in an Irish context, the US Chips act is encouraging the onshoring of semiconductors back to the US and hence further tech investment.

However, the third and arguably most relevant bill is the Inflation Reduction Act (somewhat worryingly also referred to as the 'IRA' by many US investors). In essence, this is an environmental policy that encourages investment in renewable energy, air pollution, clean water supply, improving green transport, etc. Whilst it's clear that the finer details of the act have not yet been fully worked out, it would seem there will be plenty of opportunity in many areas, including Food and Farming, Infrastructure, Energy, and so on. This plays into sectors that many of the Irish corporates are exposed to and see as good long-term opportunities (some details to follow)

Figure 2: Significant investments from the Inflation Reduction Act ($bn)



Source: C40 as at October 2022; GHG: Green House Gas

US: Go big or go home

Overall, it seems clear that several bills are encouraging investment in the US. Furthermore, it appears that geopolitically speaking, the US is currently seen as a safer region to invest in for growth, at least in the short term.

These are undoubtedly two of the factors in the recent announcements from no less than two large Irish corporates (CRH and Flutter) to consider moving from the ISEQ towards making their main share price listing the US.

What's the big attraction?

Strategically speaking, in the case of both CRH and Flutter, the main market for the underlying businesses is or is swiftly becoming the US. Additional factors include beneficial tax treatment in Merger and Acquisition (M&A) negotiations for US-listed companies; favourable considerations in the attraction and retention of US employees (who have a preference for an element of stock compensation); and likely additional liquidity considerations.

The bigger picture is hence emerging of many factors influencing companies with a large proportion of profitability and growth that are dependent on the US to move their listing there. Whilst this could result in disappointment from an ISEQ perspective, the companies in question seem likely to remain domiciled in Ireland, and of course, investors can continue to buy and sell shares regardless of the region. Finally, whilst the US is attractive, it is far from the sole source of growth for listed Irish companies, and new stories will always evolve – such is the nature of markets.

The global vs the local

2023 is demonstrating that markets are cyclical, and trends emerge over time. Those trends may be financial in nature, or influenced by policy, and some trends even appear to repeat if we wait long enough. Importantly, whilst global trends can and do influence local, companies can still differentiate themselves. Concerns around banks in a global context can bring us straight back to some scars of the past. However, thankfully in a local context, much has evolved to help prevent similar fates as some global counterparts.

When it comes to opportunity, companies will inevitably look globally for long-term growth. As an investor, whether investing globally or locally, one of the key things to look out for is quality of management, because a good management team will weather short-term storms successfully and seek out the best long-term opportunities wherever they present themselves.

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

David Finn
UK Multi Asset Portfolio Manager

UK equities: What makes a market?

Given all the negative headlines, investors may not have expected to see UK equities outperform global equities last year, returning 1.2% (in EUR terms) compared to global equities which fell -12.6% (in EUR terms). In fact, performance was so strong, the UK equity market performance was ahead of all major markets in 2022.

Bucking the trend

After underperforming global equities in fourteen of the last twenty years (including the last ten years in a row), this sudden change of fortunes may have come as a surprise, especially given the political turmoil experienced in 2022. The last year has seen three changes of prime minister and four different chancellors; not to mention the LDI (liability driven investment) crisis which shook bond markets, brought on by the government's calamitous mini-budget in September. Not exactly the political backdrop one would expect for an outperforming stock market.

Naturally, the poor recent run of UK equities has resulted in considerable underperformance over longer time periods, despite the recent turnaround. The resurgence has us asking two questions:

Why did things turn around for UK equities after such a long period of underperformance, and is it likely to continue?

Think sectors, not regions

Taking the first question on the lengthy underperformance of UK equities, it's important to remember the stock market is not the economy. While economic growth in the UK was positive, this has very little bearing on the performance of the stock market. The reason being, the UK stock market is mostly made up of large, global companies which generate revenues and profits all over the world. In fact, around 75% of the UK market's revenues come from abroad, meaning the fortunes of companies like HSBC and Unilever rely on more than domestic growth. While there are companies heavily dependent on the UK economy, they are typically smaller and therefore have much less impact on the index performance as a whole.

Figure 1: Global equity performance vs. UK equity performance (annual, 2003-2022)

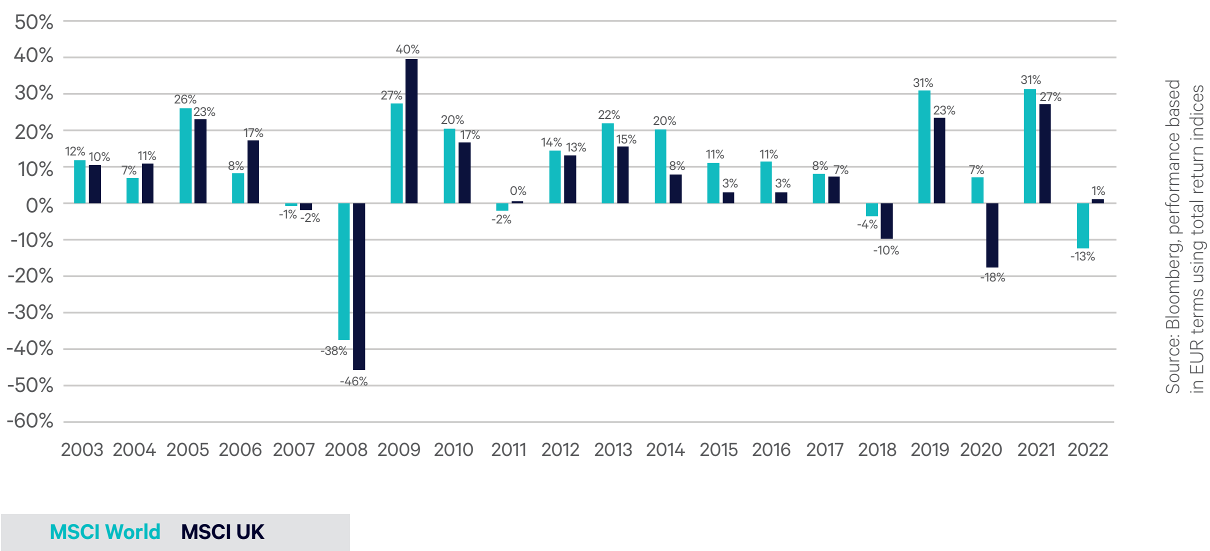
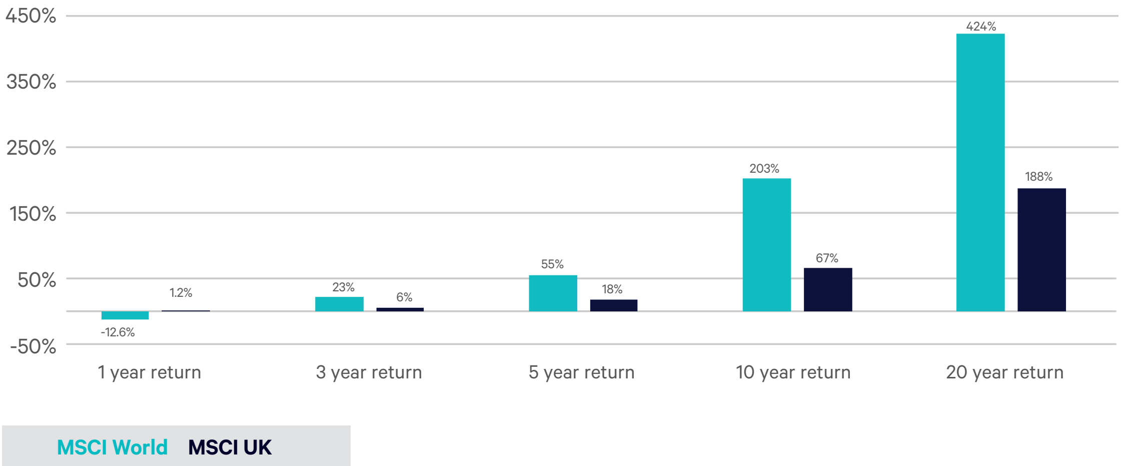


Figure 2: Global equity performance versus UK equity performance (rolling returns, 2003-2022)

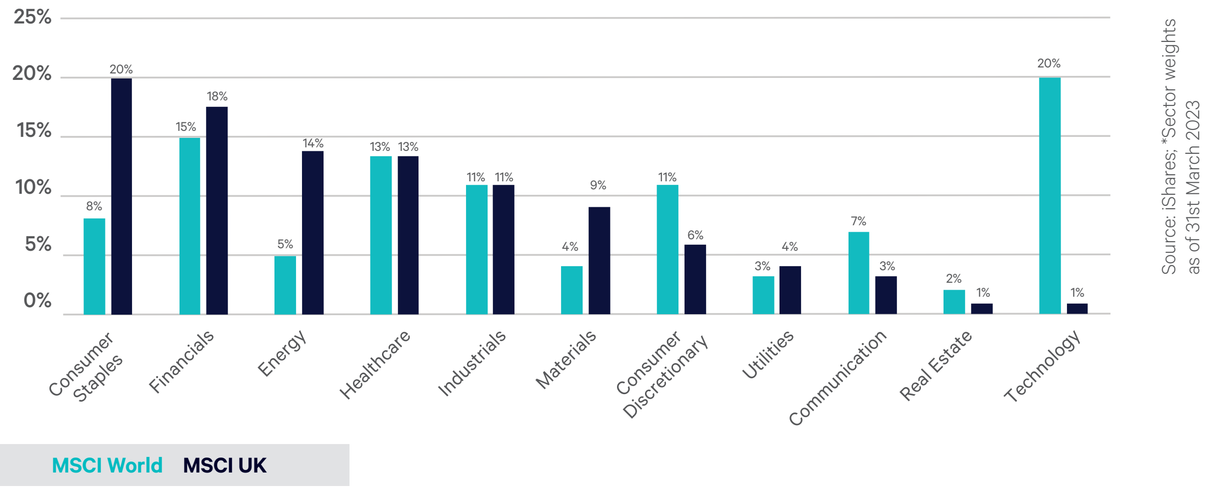


Source: Bloomberg, performance based in EUR terms using total return indices

That being said, other major stock markets are also dominated by large, global companies, so it doesn't explain the strong performance of the UK market. When discussing the lack of innovative and fast-growing companies listed in the UK, former Baillie Gifford fund manager James Anderson recently described UK equities as a "19th century and not even a 20th century index". However, the change in the market environment has meant this has now become a positive. The lack of exposure to high-growth sectors in UK equities meant it avoided the significant drop in technology stocks, and a corresponding increase to sectors like financials and energy, means the index benefitted from an environment of rising rates and increasing commodities prices.

We know from history that sectors will perform differently under different market conditions. This leads us to our second question: Is the current outperformance of UK equities likely to continue?

Figure 3: Sector weights* – UK versus global equities.



The UK market is shrinking

UK equities have become a much smaller share of global markets overall in recent years, and it's important for investors to consider that the UK is no longer a true reflection of the global economy. One of the reasons for this shrinking market share is the growing number of UK companies moving their stock market listing overseas, in particular to the US. The world's largest building materials company, CRH, is the latest corporation seeking to leave the UK index. This comes after Softbank announced their intention to list their Cambridge-based subsidiary arm in the US, while gambling company Flutter plans to establish a secondary listing in the US also.

Why is this pattern emerging? Company executives see the US as an environment that embraces higher growth and is drawn by a larger, more liquid market that places higher valuations on similar companies. One reason for the lack of depth in the UK market is that pension funds, traditionally some of the largest investors in UK stocks, have reduced their exposure to UK companies considerably over the past twenty years. Recent data indicates that UK holdings in British pension and insurance funds have fallen from about half to around 4%.

This significant shift in asset allocation was driven partly by accounting changes brought in at the turn of the century, which meant that companies would have to recognise pension fund deficits on their own balance sheets. This led to the development of the now infamous LDI strategies, which promised to match portfolios more closely to fund obligations. In simple terms, this meant selling equities to buy long-dated government bonds.

Where to from here?

Technology is a catch-all term for new innovative companies with industry-changing products, which encompasses a wide range of sub-sectors; increasing exposure to this sector may increase portfolio exposure to a more diversified range of return drivers. Furthermore, if the trend of investor preferences continues toward sustainability, demand for large energy companies that dominate the UK market may fall, further depressing valuations. So, while UK equities are currently experiencing a resurgence, it may prove difficult to sustain into the future.

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Stephen Grissing
Investment Strategist

The far-reaching US dollar

During 2022, the US dollar had its strongest run in two decades compared with other major currencies. This strength has prompted global investors to reassess both the impact and role of the US dollar in investment portfolios.

In this article, we discuss the merits of valuation metrics that aim to measure how under and over-valued a currency is, in comparison to another. We also discuss the investment implications of US dollar fluctuations over the short and long-term, and the options that are available to manage this risk. Former US Treasury Secretary, John Connally, captured the far-reaching nature of the US dollar nicely when he famously stated that “the dollar is our currency, but it is your problem”.

An over-valued US dollar?

What do we mean when we say the US dollar is over-valued? Firstly, we cannot state that a currency is under or over-valued on a standalone basis. Currencies are viewed through a relative lens i.e., the US dollar can be under or over-valued versus another currency. Commonly used currency valuation metrics that have stood the test of time include Purchasing Power Parity (PPP) and the Dynamic Equilibrium Exchange Rate (DEER).

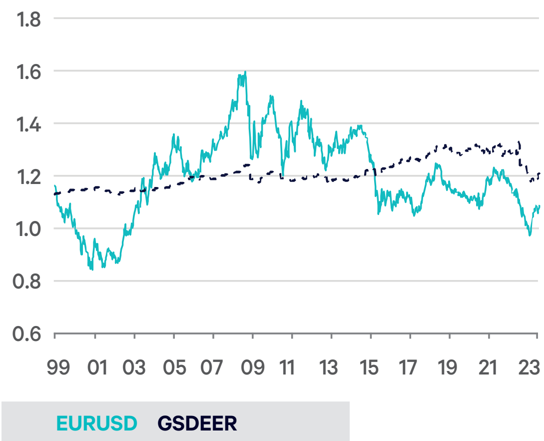
Purchasing Power Parity

Earning the title of the oldest theory of exchange rate determination, PPP assumes that the price level of goods in two regions should be equal when expressed in a common currency, and as a result, real exchange rates adjust for relative price levels. Critics of PPP argue that by not accounting for items like trade restrictions, transit costs and input costs, deviations from a currency pair’s fair value can persist for prolonged periods.

Dynamic Equilibrium Exchange Rate

In an attempt to enhance the PPP approach, DEER fair value models were introduced. They adjust for economic fundamentals like productivity differentials and terms of trade (relative prices of exports vs. imports).

Figure 1: EURUSD versus fair value determined by Goldman Sachs Dynamic Equilibrium Exchange Rate (GSDEER)



Source: Bloomberg, Goldman Sachs.
Updated as of 31st March 2023

The US dollar is currently over-valued versus the euro and sterling based on the PPP and DEER’s determination of fair value. It is worth noting that the fair value level determined by DEER has changed significantly over the past year. In Goldman Sach’s version of DEER, the fair value for EURUSD moved from \$1.31 in April 2022 to \$1.17 by the end of 2022.

DEER is sensitive to changes in a country’s relative terms of trade. In 2022, the euro area, which is a large net energy importer experienced a negative term of trade shock. The euro area’s current account shifted from a surplus of close to 3% of GDP (Gross

Domestic Product) in the third quarter of 2021 to a deficit of -0.3% by the end of 2022. The more recent dramatic decline in energy prices has resulted in the current account for the euro area bouncing back into surplus territory. This is likely to move the EURUSD fair value higher once again.

As Figure 1 shows, considerable deviations of a currency pair from its fair value can persist for a prolonged period – with deviations from PPP tending to be more persistent than from DEER. Although both approaches have limited predictive power in the short to medium-term, our analysis shows that significant deviations from fair value can be useful for predicting longer-term moves in currency pairs. For EURUSD, our analysis shows that PPP deviations explain 34% of 5-year forward returns of the currency pair, this increases to 57% for 7-year forward returns. For GSDEER, the equivalent figures improve to 55% and 76%.

Short to medium-term currency drivers

There are also several drivers that influence currency pairs in the short to medium-term causing oscillations away from a currency pair's longer-term fair value. In a previous version of MarketWatch, we discussed a number of these drivers and how the significance of each driver tends to change over time.

- Interest rate differentials: a currency tends to benefit in an environment where interest rates in a region, or expectations for future interest rates outpace that of its peers.
- Economic outlook: an economy that is outperforming or is expected to outperform its peers tends to provide support for its currency. The US dollar is considered a safe haven currency, so it also tends to outperform in times when global economic growth is deteriorating in tandem.

US dollar implications for global investors

By investing in overseas assets, you are also investing in a foreign currency. Simply investing in a diversified global equity index like the MSCI World ACWI, due to the size of the equity market in the United States (U.S.), means that over 60% of your investment will be in U.S. companies, denominated in US dollars. As a result, a European or UK investor is taking on significant unintended currency risk. The US dollar currency exposure for an investor of global government bonds is close to 50%.

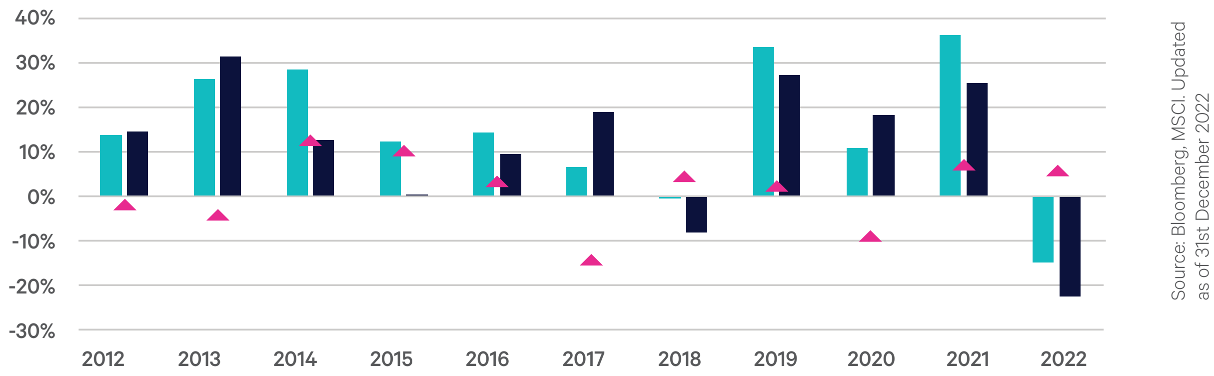
In addition to the currency that stocks are denominated in, beneath the surface a non-US listed stock might provide indirect exposure to the US dollar from the revenues that it generates overseas. The MSCI UK index is a standout example. In a year like 2022 when the US dollar strengthened, the significant overseas revenues of MSCI UK-listed companies benefitted from the currency move and the index outperformed many of its peers.

What is currency risk?

Currency risk is the impact of an exchange rate on the investment returns from an overseas investment. In the short term, currency moves can be volatile and are very difficult to predict. These moves can have a significant impact on returns from foreign investments from one year to the next.

Having said that, at Davy, we believe that currency hedging can play an important role in managing

Figure 2: Annual US dollar moves versus the euro and the impact on US equity returns for a euro-based investor, annual percentage change



MSCI USA Net Total Return EUR Index MSCI USA 100% hedged to EUR Net Total Return Index USDEUR

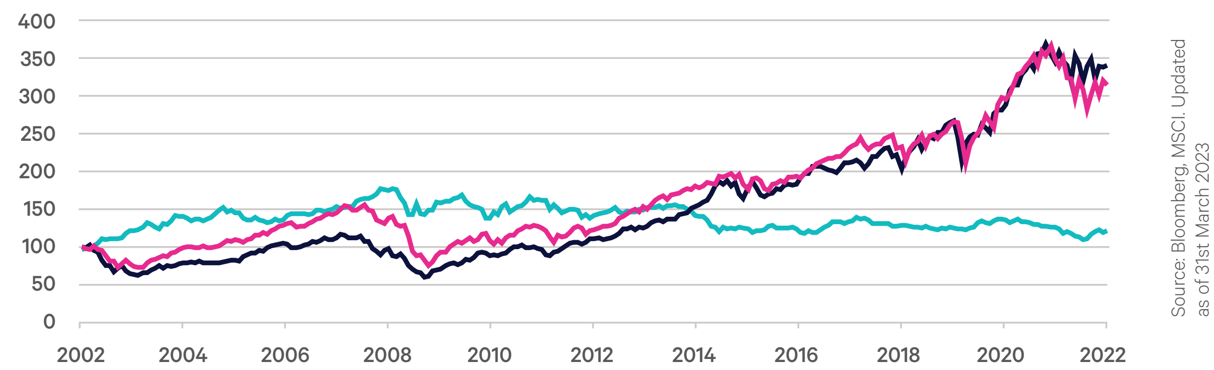
To hedge or not to hedge, that is the question

The answer to the currency hedging question is not a binary one. Instead, we believe that timeframe, asset class, and the proportion of hedging implemented are all important considerations.

Although currency pairs can be highly volatile in the short term, over the long term currency pairs tend to mean revert to fair value. Therefore, in theory, any returns from currency moves are minimal. This theory diminishes the argument for long-term hedging of currency risk within risk assets where the currency impact fades to a negligible level compared to the returns from the risk asset.

multi-asset portfolios. At this juncture, it is important to distinguish between equities and bonds. Global bonds generally produce lower returns than equities, while displaying a lower level of volatility than currencies. This means that bonds are more vulnerable to currency moves which have more potential to eliminate returns for bond investors. For this reason, we generally recommend hedging the foreign currency exposure within fixed income investments.

Figure 3: Impact of currency fluctuations on long-term global equity returns. Cumulative returns rebased to 100 on 31st December 2001



EURUSD MSCI World Net Total Return EUR Index MSCI World 100% hedged to EUR Net Total Return Index

Hedging currency risk within risk assets can also be beneficial, particularly at times when a currency pair has departed significantly from its fair value. This is currently the case with the US dollar versus a number of currencies. Implementing a partial currency hedge within risk assets, rather than a full hedge, may be more appropriate for the reasons outlined below. Taking account of the partial currency hedge that is currently in place within Davy discretionary portfolios, there is approximately 35% exposure to the USD within risk assets.

- **Diversification benefits:** the US dollar demonstrates a negative correlation to risk assets like global equities. Over the past ten years, the US dollar has exhibited a correlation to global equities of -0.53. At times when equities are depreciating, US dollar exposure in your portfolio can dampen the level of drawdown experienced. By fully hedging the US dollar exposure of your risk assets, you are also removing the diversification benefit that the US dollar provides.
- **Currency view:** when you decide to implement a short to medium-term currency hedge, you are taking a view on a currency pair. If your view is incorrect, and the US dollar appreciates for example, this can negatively impact returns.

An alternative approach for reducing currency risk in a portfolio is to implement a 'home bias'. The term home bias refers to an investor who tilts their portfolio in favour of domestic assets. This approach will achieve the objective of reducing currency risk, but also has drawbacks such as reducing regional diversification benefits and narrowing the scope of investment opportunities.

Our US dollar view

Given stretched US dollar valuations and a narrowing of the interest rate differential between the US and regions such as Europe and the UK, we expect US dollar strength to fade further in the medium term. For this reason, in Davy discretionary model portfolios we continue to hedge a portion of the US dollar exposure within our equity holdings. Over the longer term, the US dollar remains by far the most prominent global currency, so a dramatic fall from grace remains unlikely.

Figure 4: US dollar historical correlation with risk assets, January 2011 – December 2022

Global equities	-0.53
Commodities	-0.41
Global high-yield corporate bonds	-0.44
US equities	-0.41
Global investment-grade corporate bonds	-0.29

Source: Bloomberg, Davy. Updated as of 31st December 2022

Note: US dollar = DXY index. Global equities = MSCI ACWI Net Total Return USD Index. Commodities = Bloomberg Commodity Total Return Index. US equities =MSCI USA Net Total Return USD Index. Global high yield corporate bond = ICE Global High Yield Index. Global investment grade corporate bonds = ICE Global Investment Grade Index

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Danielle Flanagan
Investment Selection Analyst

The return of the money market fund

Money market funds have been around for over half a century, yet they've never caught the imagination of Irish investors who were content to earn interest income on their cash through a bank deposit. Currently, with European Central Bank deposit interest rates at 3% and Irish bank deposit interest rates stuck close to zero, the interest in money market funds has ticked up significantly.

What is a money market fund?

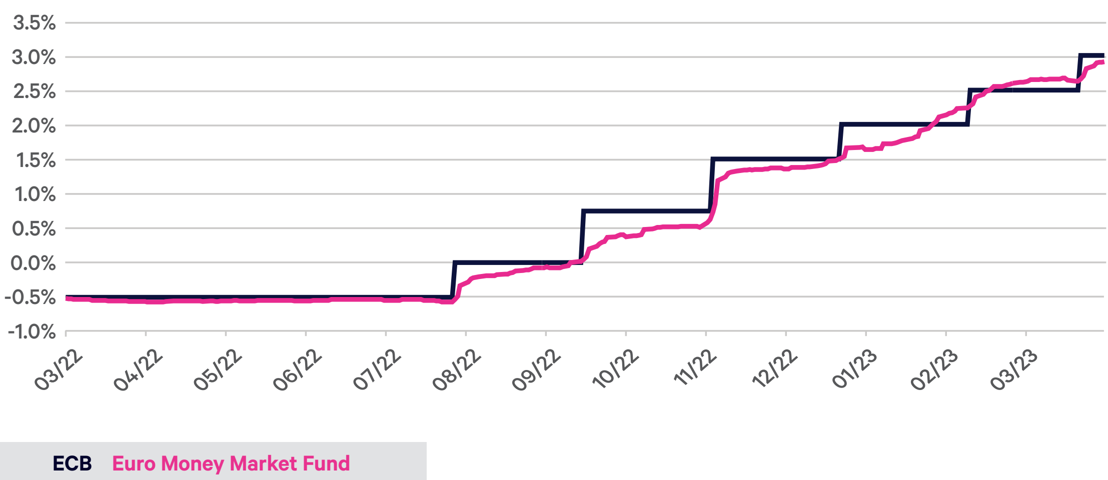
A money market fund is a fund that invests in very short-term, high-quality debt issued by governments, financial institutions, and highly rated corporates. These characteristics make money market funds a low-risk investment option to invest surplus cash for the short term. Money market funds are primarily used to preserve capital, with a high degree of liquidity, and aim to generate a return in line with Central Bank deposit rates. They are daily liquid, meaning that your capital is not locked up.

Is cash really king?

Although not quite as safe as cash, money market funds are considered very low on the risk spectrum. Money market funds invest in a highly diversified range of securities, issuers, and maturity profiles, whilst maintaining very high credit quality. Money market funds are particularly attractive when interest rates are rising. In a rising rate environment, as the short-term securities mature, they are reinvested at the higher prevailing rates. This means that increases in the Central Bank policy rates are passed on more quickly to investors in money market funds than they otherwise would be holding cash deposits in a bank. Thus, broadly speaking, the yield on money market funds should track the Central Bank base rates, albeit with a slight lag.

Bank deposits, on the other hand, are cash deposits with a single counterparty. The deposit rate is entirely dictated by the individual bank and the yield is influenced by the banks' funding needs and balance sheet. As we have seen in recent months, the rates offered by many Irish banks have not yet risen in line with European Central Bank policy rates. For this reason, investors who are looking to capitalise on the increases in Central Bank interest rates could consider money market funds as a means to invest their cash over the short term.

Figure 1: ECB deposit rate vs euro money market fund yield



Source: Bloomberg and European Central Bank Euro System. Data correct as of 31st March 2023.

What are the risks?

Money market funds, like most investments, are not risk-free. They may expose an investor to counterparty risk, liquidity risk, and credit risk, to name a few. The diversification benefits of money market funds enable the investor to mitigate many of these inherent investment and market risks. Money market funds can spread counterparty risk across many underlying issuers, which reduces the risk of capital loss. Bank deposits, on the other hand, expose the investor to a single counterparty. The events of 2008, while unlikely to happen again, highlight the importance of diversification and the risks of the concentration of deposits with a single institution.

The credit ratings of money market funds are typically very high and range between AA to AAA rated on average. This means that the creditworthiness of the underlying government or corporate debt securities is of very high quality. To many investors' surprise, the credit rating of a typical Irish bank, where many of us hold our cash deposits, is BBB-rated on average. Money market funds are arguably of higher credit quality than bank deposits.

Can money market funds lose money?

Given the short-term, high-quality nature of the underlying securities, money market funds are considered very low risk. But the risk of loss is not zero. The value of these securities can change day to day. As seen in the past, in the event of a highly stressed scenario, there is a small chance that the underlying assets can default. However, money market funds have become increasingly regulated over the past fifteen years which has led to greater confidence and stability in the asset class. For example, at the height of the COVID-19 crisis in March 2020, the worst-performing UK money market fund lost just -0.2% before recovering, according to Charles Stanley, December 2022.

The evolving regulatory landscape

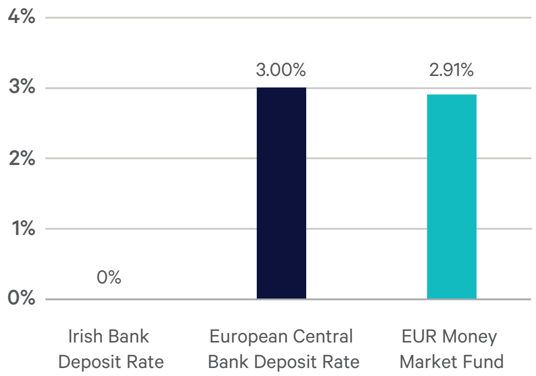
Since the volatility caused by the Global Financial Crisis (GFC) in 2008, global financial regulators have since strengthened the rules and guidelines surrounding money market funds. The enhanced guidelines now require higher levels of diversification within the fund and require increased levels of liquidity. Further regulation in the asset class has raised standards in money market fund investing and ultimately aims to reduce the risk of capital loss. This makes, what is considered to be a safe asset class, even safer.

It no longer makes sense to keep your money under your mattress

Post the GFC in 2008, Central Banks reduced interest rates to record lows and they even dropped to negative in the Eurozone. Interest rates remained close to zero for almost a decade and the hunt for yield became practically impossible in short-term, high-quality debt. As a result, money market funds became irrelevant to investors searching for positive yield.

With inflation in the Eurozone reaching levels that we have not seen in decades, the old practice of keeping your money under your mattress no longer makes sense. The real, or inflation-adjusted value of your cash is being quickly eroded by the power of inflation. Money market funds may be one tool that investors consider if they have surplus cash to invest, to take advantage of higher Central Bank interest rates. The European Central Bank base rate now stands at 3% and the yield on Euro money market funds is now at, or outpacing this return. Although money market funds won't outpace the rate of inflation in the long term, the short-term benefits of money market funds are clear. In the search for yield over the past decade, investors had to extend their risk appetite beyond what they would normally be comfortable with. There's no need to reach for yield anymore. Relatively attractive yields on low-risk assets are back.

Figure 2: Yield on deposits



Source: Europa & JPMorgan

Disclaimer: The graph is for illustrative purposes only. Data is correct as of 17th March 2023. The yield on the Euro money market fund is the current yield on an example product as of 17th March 2023. Yields fluctuate with market conditions such as an investor's annualised return may be more or less than the yields reported.

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Gary Connolly
Head of Advisory and Execution Only

How Nixon changed history

On Sunday, August 15th, 1971, Richard Nixon changed the course of history. Before that weekend, all national currencies were pegged to the U.S. dollar, which was convertible to gold at a fixed rate of $35 an ounce. By the 1970's there were far more dollars in overseas hands than the United States had gold to redeem at that price.

In a televised address to the nation on that Sunday night, against a backdrop of dwindling US gold reserves, Nixon ordered that nations could no longer exchange their dollars for gold. Thus ending the bedrock of the Bretton Woods system of mostly fixed exchange rates that had been in place since 1944.

Since then, the world's monetary system has consisted of (mostly) freely floating currencies. Nixon essentially set money free — free to be printed without the limits imposed by a gold standard.

This article is about money — how we define it, think about it, and why we are most often wrong in our assessment — with very expensive implications.

You'll often read that since the break with the gold standard, the US Dollar has declined by over 90%. In 1971 the official price of an ounce of gold was $35. Today, an ounce of gold buys approximately $1,800. That is an increase in the price of gold of some 5,000% or seen another way, the value of the dollar versus gold has fallen 98%. This is an extraordinary collapse in purchasing power in the last fifty years.

Uninvested money should simply be referred to as currency

Beware of gold bugs (investors that are bullish on gold) — those numbers are meaningless. The analysis is a misrepresentation of real investment and output denominated in the dollar over that period. People generally don't leave their dollars under the mattress. They invest dollars in instruments that earn cash flows from real investments. A household that simply held short-term government bonds maintained its purchasing power. Longer-dated bondholders did better again in real terms. The winners of the real return contest were of course equity investors with a 6% per annum return (US equities) over inflation over the last half-century.

There is a critical difference here between uninvested money – what I prefer to term as currency – and money as we traditionally think of it.

Money is a means to an end. That 'end' is usually funding our lifestyles. If the price of that lifestyle is inflating at 5% per annum, your 'money' loses 40% of its purchasing power every decade. Money, unless it's invested in productive assets, will likely experience a decline in purchasing power, as befell the US dollar in the last half-century. It is in this sense, that uninvested money should more appropriately be referred to as 'currency'. You should avoid holding much of it.

The financial world has returned to normality
We've had almost a decade of so-called 'return-free risk'. Since mid-2022, the financial world has returned to some semblance of normality, as interest rates have gone back above zero and now reside at 3% in Europe, with expectations of further rate hikes to come before the Summer.

Unfortunately in Ireland, there's no difference between sticking your currency under the mattress, or in a deposit in one of the main banks; Irish banks are so well-funded that deposit interest rates are zero.

Fret not, money market funds and direct government bonds can potentially offer plenty of low-risk options for money that haven't existed for several years.

However, before making any decisions in relation to uninvested cash, it's important to return to an earlier point about money; how we think about it and how we define it will have implications for how we use and invest it.

We tend to think about money in nominal terms – euros and cents in our bank account. In the long run, the only rational definition of money is purchasing power. If my living costs double and my capital and interest thereon remain the same, I have effectively lost half my 'money'. As argued throughout. This is not money. It is simply currency. You only need enough of this to fund your day-to-day expenses.

We have all grown up with the misguided idea that the primary risk of investing is the loss of capital over short time horizons. Defined as such, we are doomed to making poor financial decisions. This measure of risk is only relevant to our currency.

If money is purchasing power, the risk becomes that which threatens it and security, that which preserves or enhances it. This is the critical issue. What preserves or enhances purchasing power over time? Real productive assets, like businesses for one. This is where financial security is to be found.

Uninvested money is simply currency. Treat it as such and accept a fate similar to that of the dollar if you are going to hold it over long periods. With your money, you need to think differently.

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Market data

Total Return (%) in local currency	2018	2019	2020	2021	2022	YTD
Equities						
MSCI All Country Local	-7.7	26.2	14.2	20.9	-16.0	7.0
MSCI World Local	-7.4	27.3	13.5	24.2	-16.0	7.4
MSCI Emerging Markets Local	-10.1	18.0	19.1	-0.2	-15.5	3.8
S&P 500	-4.4	31.5	18.4	28.7	-18.1	7.5
MSCI USA	-5.0	30.9	20.7	26.5	-19.8	7.6
MSCI Eurozone	-12.2	25.1	-2.2	23.6	-11.8	13.6
MSCI UK	-8.8	16.4	-13.2	19.6	7.1	3.2
MSCI Ireland	-21.5	40.0	5.6	16.7	-21.4	19.3
MSCI Japan	-15.1	18.5	8.8	13.4	-4.5	7.1
MSCI Germany	-18.2	23.0	2.3	13.3	-17.3	12.7
NASDAQ Composite Index	-3.6	37.8	44.9	22.2	-32.5	17.0
MSCI Hong Kong	-8.5	10.8	5.3	-3.4	-4.6	-1.9
MSCI China A Share	-29.3	39.5	31.5	0.9	-20.2	4.9
MSCI USA Small Cap	-10.4	26.7	18.3	19.1	-17.6	3.8
MSCI UK Small Cap	-15.0	30.0	-4.9	14.5	-22.4	1.7
Equity Indices (in EUR)						
MSCI All Country Local	-4.8	28.9	6.7	27.5	-13.0	5.4
MSCI World Local	-4.1	30.0	6.3	31.1	-12.8	5.8
MSCI Emerging Markets Local	-10.3	20.6	8.5	4.9	-14.9	2.1
S&P 500	0.4	34.1	8.8	38.2	-13.0	5.9
MSCI USA	-0.6	33.8	10.8	35.9	-14.9	6.3
MSCI Eurozone	-12.2	25.1	-2.2	23.6	-11.8	13.6
MSCI UK	-9.9	23.7	-17.9	27.2	1.8	4.0
MSCI Ireland	-21.5	40.0	5.6	16.7	-21.4	19.3
MSCI Japan	-8.8	22.4	5.0	9.4	-11.0	4.4
MSCI Germany	-18.2	23.0	2.3	13.3	-17.3	12.7
NASDAQ Composite Index	2.0	39.4	33.1	31.2	-28.3	15.3
MSCI Hong Kong	-3.2	12.5	-2.8	3.2	1.3	-3.8
MSCI China A Share	-29.8	40.6	28.5	11.8	-22.7	4.8
MSCI USA Small Cap	-6.2	29.6	8.6	28.0	-12.4	2.5
MSCI UK Small Cap	-16.1	38.2	-10.0	21.8	-26.3	2.4
Global Equity Sectors						
MSCI World Energy	-13.4	10.3	-32.9	42.0	51.5	-3.8
MSCI World Materials	-14.1	22.7	15.2	19.8	-6.4	5.7
MSCI World Industrials	-13.5	27.6	8.2	20.5	-9.4	6.7
MSCI World Consumer Disc	-4.9	26.4	33.8	20.9	-31.7	16.1
MSCI World Consumer Staples	-8.4	22.3	4.6	15.6	-3.0	2.9
MSCI World Health Care	3.6	22.9	11.0	21.9	-3.5	-1.9
MSCI World Financials	-14.9	24.9	-5.4	30.4	-7.1	-1.9
MSCI World Info Tech	-2.4	47.5	42.4	31.2	-30.1	21.0
MSCI World Comms Services	-8.2	27.2	21.6	15.8	-35.9	17.9
MSCI World Utilities	3.8	22.5	1.9	12.3	-2.2	0.0

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. If you invest in this product you may lost some or all of the money you invest. These products may be affected by changes in currency exchange rates.

Total Return (%) in local currency	2018	2019	2020	2021	2022	YTD
Government Bond Yields						
US 10 Year	2.68	1.92	0.91	1.51	3.87	3.47
US 2 Year	2.49	1.57	0.12	0.73	4.43	4.03
German 10 Year	0.24	-0.19	-0.57	-0.18	2.57	2.29
German 2 Year	-0.61	-0.60	-0.70	-0.62	2.76	2.68
UK 10 Year	1.28	0.82	0.20	0.97	3.67	3.49
UK 2 Year	0.75	0.55	-0.16	0.69	3.58	3.44
Ireland 10 Year	0.90	0.12	-0.30	0.25	3.13	2.75
Italy 10 Year	2.74	1.41	0.54	1.17	4.72	4.10
Spain 10 Year	1.42	0.47	0.05	0.57	3.66	3.30
France 10 Year	0.71	0.12	-0.34	0.20	3.12	2.79
Portugal 10 Year	1.72	0.44	0.03	0.47	3.59	3.1
Bond Indices						
EUR Government Bonds	0.9	6.3	4.7	-3.4	-18.2	2.4
EUR Corporate Bonds	-1.3	6.2	2.8	-1.0	-13.6	1.8
UK Government Bonds	0.5	7.1	8.9	-5.2	-25.1	2.2
UK Corporate Bonds	-2.7	10.9	7.5	-1.5	-15.4	2.7
US Treasury Bonds	0.9	6.9	8.0	-2.3	-12.5	3.0
US Corporate Bonds	-2.5	14.5	9.9	-1.0	-15.8	3.5
Central Bank Rates						
European Central Bank	-0.40	-0.50	-0.50	-0.50	2.00	3.00
Bank of England	0.75	0.75	0.10	0.25	3.50	4.25
US Federal Reserve	2.50	1.75	0.25	0.25	4.50	5.00
Interest Rates						
EURIBOR 3 Month	-0.31	-0.38	-0.55	-0.57	2.13	3.04
LIBOR GBP 3 Month	0.91	0.79	0.03	0.26	3.87	4.42
LIBOR USD 3 Month	2.80	1.91	0.24	0.21	4.77	5.19
Currency Exchange Rates						
EUR-USD	1.15	1.12	1.22	1.14	1.07	1.08
EUR-GBP	0.90	0.85	0.89	0.84	0.89	0.88
GBP-USD	1.28	1.33	1.37	1.35	1.21	1.23
GBP-EUR	1.11	1.18	1.12	1.19	1.13	1.1
EUR-JPY	125.8	121.8	126.2	130.9	140.4	144.1
EUR-CHF	1.13	1.09	1.08	1.04	0.99	0.99
EUR-NOK	9.90	9.84	10.48	10.02	10.50	11.36
DXY Index	4.40	0.22	-6.69	6.37	8.21	-0.98
Commodities						
Bloomberg Commodity Index	-11.2	7.7	-3.1	27.1	16.1	-5.4
Gold	-2.8	18.0	20.9	-4.3	-0.7	8.1
Silver	-10.2	13.9	42.5	-12.3	2.6	0.8
Platinum	-14.8	21.6	8.5	-11.4	14.0	-6.7
Brent Crude Oil	-15.3	37.7	-35.1	63.0	36.5	-5.1
WTI Oil	-20.5	34.1	-60.3	62.2	27.6	-5.3

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. If you invest in this product you may lost some or all of the money you invest. These products may be affected by changes in currency exchange rates.

Total Return (%) in local currency	2018	2019	2020	2021	2022	YTD
Natural Gas	4.8	-32.3	-45.9	35.1	19.8	-49.8
Copper	-16.8	4.7	25.3	26.0	-11.2	8.5
Wheat	3.5	9.4	10.3	14.1	-2.7	-12.7
Corn	-4.1	-5.5	13.8	40.4	24.9	-2.9
Soybeans	-9.9	0.1	33.5	13.9	28.1	-1.1
Crypto						
Bloomberg Galaxy Crypto Index	-81.1	7.1	276.7	153.4	-70.2	59.7
Bitcoin	-74.3	94.8	305.1	59.8	-64.2	71.3

Source: Data is sourced from Bloomberg as at market close 31st March 2023 and returns are based on price indices in local currency terms, unless otherwise stated.

Change to: Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. If you invest in this product you may lost some or all of the money you invest. These products may be affected by changes in currency exchange rates.

Davy. Since 1926.
The Davy Group is Ireland's leading provider of wealth management, capital markets and financial advisory services. We work with private clients, small businesses, corporations and institutional investors.

Dublin Office
Davy House
49 Dawson Street
Dublin 2
D02 PY05
Ireland
+353 1 679 7788
dublin@davy.ie

Belfast Office
Donegall House
7 Donegall Square North
Belfast BT1 5GB
Northern Ireland
+44 28 90 310 655
belfast@davy.ie

Cork Office
Hibernian House
80A South Mall
Cork
T12 ACR7
Ireland
+353 21 425 1420
cork@davy.ie

Galway Office
1 Dockgate
Dock Road
Galway
H91 K205
Ireland
+353 91 530 520
galway@davy.ie

London Office
Dashwood House
69 Old Broad Street
London EC2M 1QS
United Kingdom
+44 207 448 8870
london@davy.ie

www.davy.ie

FSC
www.fsc.org
MIX
Paper from responsible sources
FSC® C153054

103_605537/03/22