# MV Capital Management Weekly Market Flash

## Currency Conundrums

### *March 13, 2015*

#### Paris, Je T'Aime

There seems to be no end to the euro's woes. The Old Continent's currency has fallen 25% against the dollar from its high mark last summer, and is closing in on parity. That's good news for tourists dreaming of springtime in Paris; somewhat more surprisingly, it has also been a boon for Eurozone equities. The MSCI Euro Index, which tracks the home equity markets of the single currency region, is up 2.6% for the year to date as of the 3/12 close, versus 0.8% for the S&P 500. That's 2.6% in US dollar terms, mind you. In home currency terms the Euro Index is up a whopping 17.0%. The combination of Euro-style QE (launched this week) and somewhat better-than-expected headline economic news appears capable of more than offsetting the drag caused by the plummeting currency.

#### Rising Sun, Rising Stocks

Japanese shares are also enjoying a season of growth. The yen is down 18% from its twelve month high, but the MSCI Japan Index is up 8.5% for the year to date (again, as measured in dollar terms). This despite an economy where retail sales tanked in the wake of last year's consumption tax hike and where stagnation has been the default mode for the better part of the last two decades. Prime Minister Shinzo Abe's "three arrows" of economic stimulus have yet to offer definitive proof that they're working, but investors appear disinclined to wait around.

#### Diversification Is Your Friend Again

The go-go performance of Eurozone and Japanese equities contrasts starkly with the moribund performance of US stocks year to date. For the past three years US large caps have been dominant. Asset managers who – in keeping with prudent practices for long term investing – have managed diversified portfolios have been punished for nearly every dollar of non-US exposure during this time. The MSCI EAFE Index, a composite of developed markets in Europe, Australasia and the Far East, gained a scant 5.8% on an average annual basis over the past three years. For the same period the S&P 500 index of large cap US stocks boasted a 17.2% average annual gain. So in addition to the underlying currency and economic factors, this year's relative performance would serve as a useful reminder that mean reversion lives. Every dog has its day, and every day has its dog.

#### Earnings and FX Headwinds

Weak currencies can be good for shares because, all else being equal, they make companies' exports more competitive on the world markets. Both the Eurozone and Japan are traditionally high value-added exporters. Companies as diverse as Toyota and Moncler (an Italian producer of high-end luxury winter coats) have benefitted mightily from the respective plights of their home currencies. One imagines an uptick in the number of Italian and French luxury coats spotted in the *New York Times* Style section. Conversely, Europe's and Japan's tailwind is a daunting headwind for large US companies which derive a significant portion of their sales from overseas.

While we see continued opportunities for tactical positioning in European and Japanese equities, we are far from convinced of any sustainable outperformance over time. Both regions continue to face profound economic challenges, ones not likely to be resolved simply by waves of the QE magic wand. The year is far from over.

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