

iShares Europe ETF (IEU)

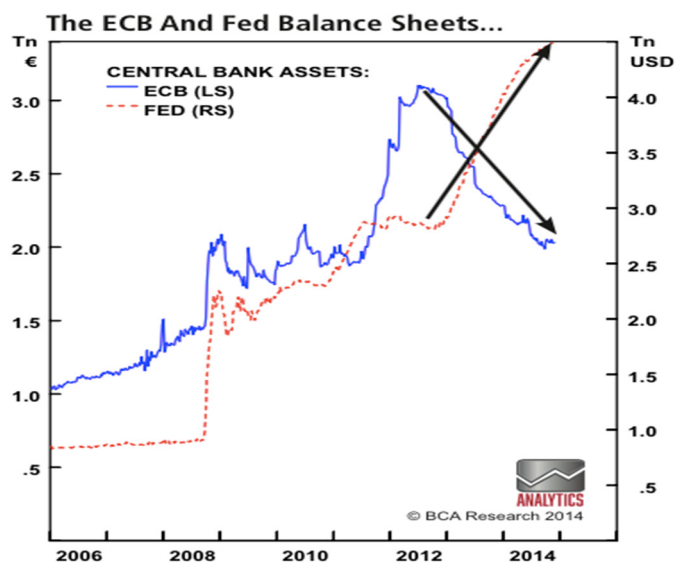
Over the last couple of months we have been looking for an opportunity to invest more directly into the European equity markets and we have now initiated on this view; implementing an allocation of between 1.2% and 8.6% depending on the appetite for risk.

The European economy, so long under pressure with austerity measures and economies not pulling in unison has now suffered a further set back with inflation declining precipitously and moving still lower. In contrast the US inflation rate, after years of declines has seen a modest uptick after the Federal Reserves aggressive Quantitative Easing (QE) programs.

As we discussed late last year, one of our reasons for turning more optimistic, the expectation that the ECB would embark on a QE strategy began to get more focus and led to a rise in European equities although over any longer term time frame, European Equities have significantly underperformed other developed markets. Whilst the path will be volatile, this will not be inconsistent with the lessons from the US QE journey but the ECB's balance sheet expansion should ultimately lead to a long-term rise in European stocks and close the underperformance gap.

The InvestSMART Diversified Portfolios currently hold their European Exposure inside the Vanguard All-World ex-US Shares ETF. This ETF has an exposure of circa 31% in Europe and the purchase of the iShares Europe ETF is in addition to this. To fund the purchase of Europe we have reduced our exposure to emerging markets via a reduction of iShares MSCI Emerging Markets and the Vanguard All-World ex-US Shares. With the purchase of the iShares ETF, the portfolios now have an exposure to Europe of between 2% and 14%.

The chart below shows the difference between the US Federal Reserves balance sheet and the ECB's.



The chart shows the different trajectories in both the US and the European central banks' respective balance sheets. With the European economy faltering, the ECB announced that it would embark on an aggressive policy of QE and expand its balance sheet by over \$1trillion (tr) towards \$3tr. Whilst these numbers are large, they are short of the US Federal Reserves strategies and may see additional bond repurchases.

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