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Is Europe now ready to grow?

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On July 26th back in 2012 at a conference in London, Mario Draghi, President of the European Central Bank (the "ECB") made a speech in which he stated; "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro," adding; "believe me, it will be enough."

By happy coincidence, the following day marked the beginning of the Olympic Games in London. Investors enjoyed a strong financial market rally that summer while the British public enjoyed a sporting summer like no other. Eighteen months later and the happy dreams of London 2012 live long in the memory but the nightmare continues for those member countries of the Eurozone. Perhaps until today.

Following the financial crisis, the ECB remained the last of the four major developed markets' central banks to not engage in quantitative easing ("QE"), which permits a central bank to purchase government bonds. The net effect of which should lower interest rates, improve the flow of credit to an economy and provide some much needed confidence to both households and companies.

While the global financial elite congregate in Davos, Switzerland, this week many will have diverted their focus for an hour as all eyes turned to Frankfurt, Germany, at the ECB headquarters. President Draghi did not disappoint and confirmed what many commentators had expected, a programme of asset purchases equivalent to €60 billion per month that will begin in March and targeted to finish in September 2015. The asset purchases will include euro denominated investment grade corporate debt and Eurozone sovereign bonds. We use the term 'targeted' because the programme is potentially open-ended and the ECB won't actually stop buying assets until inflation is nearer the 2% target. Today the Eurozone is officially in deflation.

So will it actually work and how is this likely to impact portfolios?

QE on its own cannot work and President Draghi was quick to note this in his speech. Eurozone countries still need to implement extensive structural reforms if they are to return to longer term trend growth rates. In addition, many have questioned if the positive impact of QE in the US and UK can be replicated in Europe given the differences in the way their respective economies operate. However what most agree on is that QE does provide the foundations for growth which encourages corporate investment and instils confidence across an economy.

A liquidity injection of this magnitude is very likely to help improve financial markets and risk assets (e.g. equities) should be the main beneficiary. Bonds are also likely to perform well, not least because the ECB has agreed to start buying them for the next eighteen months. This is why we continue to believe that holding a diversified, multi asset portfolio can lead to potentially strong risk-adjusted returns in 2015.

Paula Eddery
Director
paula.eddery@thomasmiller.com

Jordan Sriharan
Senior Investment Analyst
jordan.sriharan@thomasmiller.com

Carly Seltzer
Investment Analyst
carly.seltzer@thomasmiller.com

Chris Ramsey
Investment Analyst
chris.ramsey@thomasmiller.com

Dan Smith
Investment Analyst
dan.smith@thomasmiller.com

THOMAS
MILLER
INVESTMENT

London
90 Fenchurch Street
London
EC3M 4ST
Tel +44 (0) 20 7204 2200

Edinburgh
46 Charlotte Square
Edinburgh
EH2 4HQ
Tel +44 (0) 13 1220 9310

Isle of Man
Level 2 Samuel Harris House
5-11 St Georges Street
Douglas
Isle of Man
IM1 1AJ
Tel +44 (0) 1624 645200

Birmingham
125 Colmore Row
Birmingham
B3 3SD
Tel +44 (0) 12 1265 7226

Southampton
Maritime Walk
Ocean Village
Southampton
S014 3TL
Tel +44 (0) 23 8088 1836

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