Practice Group Estate Planning, Trusts & Private Equity

# Our view on the Euro and investment risks

**By Prof. Robert Anthony**

*This article focuses on an extremely controversial subject. Whilst there is general agreement that the euro is most likely to remain, the view in France differs from that of other countries. The international community, the Swiss and British in particular, are highly critical of certain eurozone members, which are critical of them in return. This is a major confidence issue within the banking system. Our article below tries to highlight the current issues.*

Last year, the general and financial press inundated us with apocalyptic reports and other doomsday prognoses. We heard about the return of inflation, the riots in United Kingdom, the Greek crisis, the demise of the euro, the loss of France's AAA rating, which was reported at least twenty times, and the consequences of this downgrade... This has become a common theme. Time spans and reactions have become shorter and shorter. The result is a wild pack of wolves edging away from the rock face of certainty.

The reasons for inflation are quite simple to explain. Inflation reflects the rise in prices and increases are fundamentally connected to demand exceeding supply. At global level, the production capacity is not fully exploited, and we think that is all there is to it.

As for the British riots, we have sporadically observed such phenomena in Los Angeles and Paris, as well as many passive demonstrations elsewhere (e.g. "Los Indignados" in Spain). They seem to surface randomly, like a volcanic eruption. These events are really too dispersed to have any lasting impact.

At the end of 2011, the captivation of the international press with the demise of the euro was astounding. Many articles extended beyond one's imagination, advocating the dismal end of the financial institutions!!! It seemed to be forgotten that the euro today has better standing against the dollar than when it was first issued. Headlines did not highlight that short interest rates have fallen. Furthermore, there is a paradoxical sign of mistrust. Below we try to understand why.

Reporting on the loss of France's AAA is greatly exaggerating the potential upshot. The United States was already downgraded to AA+, like France, without any significant impact.

One could put forward other ridiculous ideas that are just as destructive and suggest there is no smoke without fire. Will the world really end in December 2012 as the Mayan prophecy of doom 2012 predicts? The next episode could perhaps be the collapse of China or the loss of the America's AA rating. Are you inclined to believe such conjecture?

All this would be ironic if there were no real damage caused, but these doomsday predictions result in collective anxiety and have a tangible effect. The media buzz slows down economic activity, making the crisis more acute and resulting in unemployment.

For our part, as professionals, we have the necessary experience and training. Our role is to separate us and our clients from this stream of meaningless statements and to provide simple and relevant answers. We saw the first signs of the financial crisis in 2006. Click **here** to read our articles published in March and May 2006, in "Investissement Conseils" and with responsible advice, we have since recommended extreme prudence. Assuming they paid heed, our clients will not have forgotten this advice, as every day they notice the consequences

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within their portfolios, by way of their assets values, which are still higher than many other professional fund managers and banks providing discretionary management.

Today, our position is simple: we think that there is little transparency in the equity markets and, even if the values seem attractive, the market is going through a period of extreme volatility. Our advice at the moment is to reflect on an investment in the euro fund with guaranteed capital. Obviously this is subject to an exchange risk for international clients and could form part of a portfolio.

If you want to read more fiction about this just read the press!

Euro funds with guaranteed capital are emitted and managed by insurance companies. The sums paid on these euro funds are guaranteed by the insurers: they cannot fall and are revalued every year with a minimal guaranteed and protected return (the technical rate), as well as a participation in profits. At present the technical rate is around 2.5% on average, whereas the profit-sharing represents approximately 1%. The total return is around 3.5% per year. These rates are net returns after charges.

Life insurance companies have the obligation to establish reserves (for sustainable depreciation of the general assets of the fund).

These funds are mainly constituted by corporate or government bonds/gilts (around 90% of the total) with an average duration about 6 years. The remaining 10% of the portfolio is generally invested in shares and in real estate yielding revenue.

To illustrate the Greek risk, at the moment the euro fund with capital protected from a life insurance company is invested in Greek gilts at the level of 0.22% of the total of the fund. By imagining the very improbable scenario of a total write off of Greece debt, the impact on the fund would be just 0.22%. This means that the return would fall by 0.22%. In reality, the insurance company would have the legal possibility of mobilizing its reserves for depreciation. The final end result is that there would be no customer impact as the deficit would be paid from its reserves.

Not such a bad choice in a confusing investment environment. We would be happy to provide further explanation of these issues on request.

*This article was published on 16 January 2012. This is only an overview of the situation; it should not in any way be taken as advice, only an analysis of individual personal circumstances will ensure proper financial planning.*

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