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The Angle

January 2007

Welcome to the first 2007 edition of our newsletter, which we have given a name, **The Angle**. In this edition I will be looking at some of the investment highs and lows of 2006, with focus on some of the star performers. We will also look at the year ahead to see where investment growth or indeed troubled waters can be expected.

2006 Year of the dog - Far from being a pup year, 2006 was another excellent year of growth across all asset classes, apart from bonds. 2006 has seen many asset values reach record levels, however there is expected to be lower growth rates ahead and more volatility in equities.

Equities – Most of the world equity markets returned double digit growth, with the MSCI world equity index increasing at 16% in € terms . There was a short period of market volatility in May but this was shortly reversed with gains in June. There has now been three years of strong equity market growth and an absence of market volatility.

European – Overall market index was up 19.1% with many countries showing impressive growth. The Irish index [ISEQ] returned 27.8% (on the back of a 18.5% return in 2005), German [DAX] 22% and Spanish [IBEX] 34%.

USA – Not as impressive as other markets at 13.6% growth (in USD). With the USD depreciating over 10% against the EURO only a 1.9% return on 2006 for anyone investing unhedged in the US S&P 500 index. This demonstrates the continued importance of looking at currency volatility when investing in non euro denominated assets.

ASIA – Japan disappointed and I expect it will again trail it's Asian neighbours in 2007, as there does not appear to be the political focus to grow the economy. China [SCI] Shanghai Composite Index was up 130% LC (Local Currency), Hong Kong [Hang Seng] up 34% LC and India [Sensex] up 46% LC. Other Asian markets did very well, with South Korea, Philippines and Singapore all ending on record highs. There are concerns that specific stocks are now overvalued, Chinese Financials specifically.

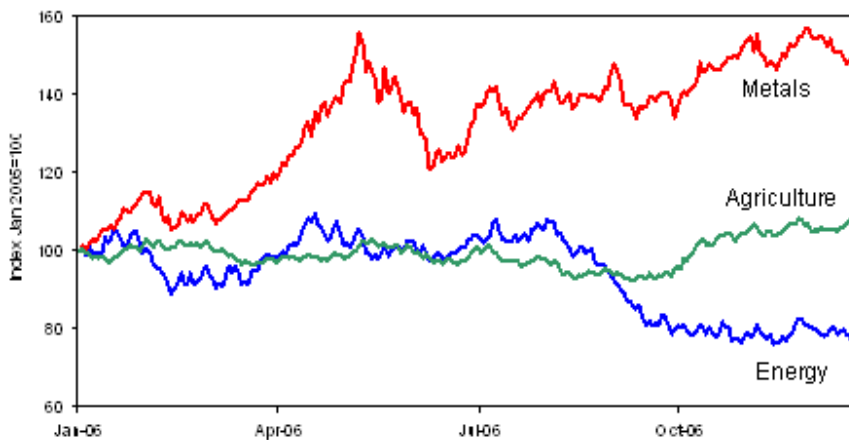
World Stock Market Performance
31st December 2005 to 31st December 2006

Market	Index	Local Currency (% Return)	Euro (% Return)
Ireland	ISEQ	27.8	27.8
Europe	FT/S&P Europe Ex. U.K.	19.1	19.1
U.K.	FTSE 100	10.7	13.1
U.S.	S&P 500	13.6	1.9
Japan	Topix	1.9	-9.4
Hong Kong	Hang Seng	34.2	20.0
Australia	S&P/ASX 200	19.0	14.8
Euro Bonds	Merrill Lynch Euro over 5 year	-1.8	-1.8



Commodities - Most people have a narrow view of what is traded on commodity markets. The chart below shows the three main sectors of the commodity markets and it also shows the volatility that can be experienced in commodity prices. The Roger's all commodity index shows the annual return for 2006 was only 1% in USD terms, however the metals index returned 51% (in USD) for the year.

**Rogers Commodity Sector Indices
Jan - Dec 2006**



Metals – The table below shows the price growth % in metals in 2006. Nickel and Zinc have more than doubled in value. Uranium, although not listed below, grew by 98% in USD terms. Interesting Oil was down 4% on the 2006 opening price, but at one stage was traded at a high of €77.05 a barrel in mid year.

Metal Price Trends 2006

	Latest Price	2006 Range		Latest : % change since	
		Low	High	3rd Jan	Peak
Nickel \$/t	34,595	13,505	35,450	156	-2
Zinc \$/t	4,310	1,912	4,620	125	-7
Tin \$/t	11,775	6,595	11,345	79	0
Lead \$/t	1,709	915	1,808	55	-5
Silver \$/oz	12.82	8.83	14.94	42	-14
Copper \$/t	6,340	4,537	8,788	40	-28
Aluminium \$/t	2,857	2,267	3,275	26	-13
Palladium \$/oz	323	265	404	22	-20
Gold \$/oz	634	525	725	20	-13
Platinum \$/oz	1,112	982	1,355	13	-18
Oil \$/bbl	60.53	55.9	77.05	-4	-21



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Bonds – Disappointing returns from bonds, which is understandable given the improving returns now available on cash deposits. Traditionally bonds have been used to diversify investment portfolio risk and many fund managers swapped out of equities to bonds in the May 2006 downturn (seen below). But now cash deposits are providing similar, if not better short term returns, with less risk.

Bonds were one of the few asset classes with positive returns during the equity market corrections in May-June '06

	Total Returns (%) May 10-June 12
Investment-grade bonds	0.8
U.S. Large Caps	-6.4
Foreign Large Caps	-11.8
U.S. Small Caps	-11.9
Foreign Small Caps	-15.4
Energy Services	-18.7
Emerging Markets	-20.7
Gold	-26.0

Property –

Ireland – **Residential** property inflation will probably end up at 12% for 2006 (final figures out later this month). There was a sharp tailing off in growth rates during the 2nd half of the year. The monthly increase in Nov was 0.1%. This is in sharp contrast to the monthly rises in the first half of the year where monthly price increases were up to 1.6% per month.

Full year returns on Irish **commercial** property for 2006 will not be known for some weeks yet, but it is likely returns will be in the region of 30%, the best returns since 1998. The market is still relatively small when compared to the UK and remains buoyant in line with the Irish economy.

UK – **Residential** – 2006 saw annual price rise of 9% and this can be seen as a positive growth rate, which should be sustainable over the medium term. This is a decent return from a medium risk asset, especially for leveraged property investments.

UK – **Commercial** – Returns will probably be at 20% for the full year, with retail proving the leading segment. Returns have been strong from UK commercial property for 10 years now. Returns from commercial property are not correlated with equity markets, so you can diversify investment portfolio risk and make returns on both equities & property over the same period.



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2007 – Year of the pig

Equities – History tells us that there has never been more than three years of a bull market, so expect to see a return to normal levels of volatility in the markets. But there continues to be strong growth in corporate earnings, strong growth in emerging markets and high levels of mergers & acquisitions.

Europe – With high M & A activity European markets should see high single digit growth rates. I think the UK market will perform better in 2007, as compared to its 2006 performance relative to other European markets. The ISEQ should continue to be a strong performer as the Irish economy looks like having another good year, but returns will more likely to be closer to the annualised 15 year return of 14%.

USA – The US markets will probably perform better in 2007 than 2006, but with the dollar continuing to depreciate against the EURO, not a place to invest unless hedging for a downward FX movement.

Asia – China and India continue to be attracting most focus. It appears that China may be the strongest grower of the two in the medium term, as the Indian economy struggles to invest in infrastructure required for sustained economic growth. As an emerging Chinese middle class starts to spend new wealth on consumer goods, the continuing growth in China may rely less on export growth and more on consumer growth. Over the last 6 to 12 months large flows of institutional funds have started to flow into Chinese equities, a sure sign that fund managers are starting to look at China with a longer term view.

China Life has just floated on the SSE (Shanghai Stock Exchange) and is now the 2nd largest insurance company in the World (behind AIG) by valuation. The only worrying sign is that the shares doubled when launched, indicating over exuberance on this particular stock and Chinese Financials in general. Expect growing Chinese companies to go on the global acquisition trail, further increasing the growth of the Chinese equity markets.

Commodities –

The two commodities with the best stories are Oil and Uranium.

Oil - Is a finite resource, we all know how important it is to the World economy. There are huge demands from growing economies such as China. Oil is expected to break \$80 a barrel during the year with some commentators looking for the \$100 a barrel mark to be the price level for the future. It is currently trading at \$55 a barrel, the lowest price since mid 2005. In 1999 Brent crude traded at \$10 a barrel, it has steadily increased to a high of €77 a barrel in April '06 (a 670% increase from low to high in 7 years). Long term it can go nowhere but up!



Uranium - Has been identified as the fuel of the future, as it is argued that other alternative fuel sources could never replace oil. The price of uranium has increased 700% in the last 5 years. It is interesting to note, that China has 35 nuclear power reactors under planning or construction at present.

Water – It may be hard to believe, but there are a number of funds which are including water as part of their alternative investment basket. When it takes steam (pardon the pun!) it will probably be included as a traded commodity of the future. This one is definitely for the longer term.



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Property – For the medium term UK commercial property is my choice. Expect capital returns in the mid teens which will probably outperform UK equities yet again. UK residential property forecast returns are 7% for 2007. If investing in the Irish market, commercial property should still provide decent returns. I believe Irish residential growth rates have peaked and 2007 will see growth rates of mid single digits at best.



My ideal 2007 investment asset split (not necessarily yours)

Equities –	50%	10% Ire, 15% UK, 10% Europe (ex. UK & Ire) 15% Asia
Property –	40%	UK commercial
Commodities –	10%	Uranium (through listed stocks)

*"I will take no responsibility for getting it wrong, but I will take all the glory for getting it right!
All the best for 2007."*

By Morton Rennick - QFA ACMA

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