# Monthly outlook – June

## Ádám Halóka: Should we leave the equity market for oil?

The European debt crisis affecting the global economy, together with the series of measures recently taken in China aimed at preventing the overheating of its residential property market, may lie behind the unfavourable performance of equity markets in May. It is ironic that the drop in share prices has occurred precisely at a time of improving macroeconomic figures and favourable company reports. The MSCI World index decreased by 9.9% in May in US dollar terms, but scarcely changed in forint terms due to the favourable effects of the weakening forint.

On the first trading day in May, the S&P500 opened at 1189 points, before beginning a sharp correction and closing at 1089 on 28 May, a decline of exactly one hundred points, or 8.41%.

Although it is true that a drop in share prices of this magnitude in a capitalization-weighted index watched by professional investors will in itself not necessarily result in small investors selling their shares en masse, the hesitation of professional investors on the equity markets is nevertheless striking when one takes into account the oft-cited problems of national debt on the global – and particularly European – level.

OTP – one of the largest participants on the Hungarian equity market and a favourite stock of the small investor – has been hit by the unfavourable turn in international investor sentiment, and its share price has also been negatively affected by the recent public statements issued by the government. Consequently, the bank's shares lost more than 18.8% of their value over the above-mentioned period.

I believe that in light of the above, investors will rightly be asking how they might reduce the negative impact of unfavourable share price movements. In the case of the AEGON Smart Money Investment Fund of Funds, AEGON Hungary Investment Fund Management took the following decision this month regarding the strategic allocation of assets, with the aim of ensuring steady performance in the coming period:

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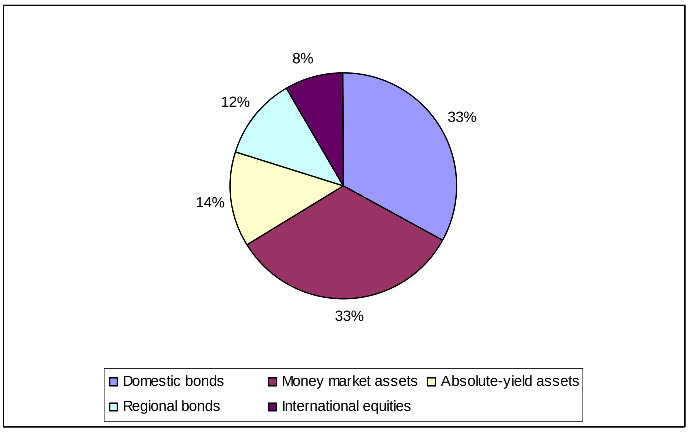
| Domestic bonds | 33,00% |
| Money market assets | 33,00% |
| Absolute-yield assets | 13,80% |
| Regional bonds | 12,00% |
| International equities | 8,20% |



We maintain a low level of exposure to equities, as the markets are very fragile, holding to our current neutral position and treating increases in equity market prices rather as an opportunity to sell within our overall investment strategy. We maintain a relatively high weighting for instruments with an absolute yield, as this is an investment strategy that may prove a winner in an uncertain market environment.

Thanks to their flexible investment policy, absolute-yield derivative funds offer savers investment flexibility combined with significant yield potential, by taking up intraday as well as longer-term positions. They are an ideal choice for those who regard the long-running rise in stock prices to have led to overheating in the equity markets, and who would like to invest, under conditions of medium risk, by exploiting the opportunities of leveraged speculative investments, which offer a close-to-equity-market profit potential.

There has already been much discussion of the possible positive effects of diversified portfolios based on the imperfect synchronization of yield movements on bonds and equities of varying maturities, but little has been said of the potential inherent in raw materials, and particularly oil. I believe it is important that small investors are made aware of the profit opportunities that lie in the broader investment universe, such as in traditional bonds and equity-type instruments or variously weighted mixtures of these. This is precisely the kind of opportunity that may be offered by the currently highly popular derivative collective investment products.

Given that the equity markets have been rising for some time now and are starting to look overheated, and that the rally that has significantly outstripped the pace of recovery of the real economy, perhaps now is the time for investors to leave the equity market and get into oil. It might prove expedient to turn to the profit potential inherent in finite, non-renewable resources such as oil.

The crude oil classifications often cited in the media are North Sea Brent Crude and West Texas Intermediate (WTI). Both are types of light crude, with a density lower than that of water and a low sulphur content, and are consequently also known as sweet crude. They are traded mainly on the New York commodities exchange (NYMEX), in units of 500 and 1,000 barrels, on the spot and futures markets.

As students of economics know, the price of oil is determined by the relationship between supply and demand, and influenced by the short-term expectations of speculative capital. The volume of production, accumulated reserves, trends in consumption and the pace of economic growth all have a significant effect on oil prices. Beyond the finite nature of raw materials, the recovery of the real economy and improving GDP prospects, together with the increased premiums that must be paid to insure oil platforms as a consequence of the ongoing catastrophe in the Gulf of Mexico (which producers will obviously end up passing on as a burden to end consumers), may prove the elements that will buoy oil prices in the long term.

According to the International Energy Agency (IEA), in the event of a rapid recovery from the crisis and significant growth in GDP, demand for oil will increase by an annual 2.6% until 2014, which supposes an expansion in demand of 1.1 million barrels per day at the annual level. The organization regards OPEC’s production capacity as sufficient to satisfy this increase in demand, and for this reason, even under such an optimistic scenario, it does not expect an oil price of more than USD 100 per barrel. At the same time, the main driver of oil consumption may prove to be the transport sector, whose consumption of the raw material will have a significant effect on the price. It is interesting to take a closer look at the need for oil on the part of motor vehicles, which is important in light of data concerning the rapidly developing population of China. The demand of the transport sector consists of a number of complex factors, but can be expressed in one simple equation. When assembling a fleet, the number, type and fuel consumption of the vehicles to be used is measured, as well as the average vehicle miles travelled (VMT), and this is divided by the average miles per gallon (AMG). The demand of the transport sector is thus: (fleet x VMT)/ AMG.

According to an example mentioned in one of the IEA's presentations, the total number of vehicles in the United States was 249 million in 2008, of which 55% were motor cars, and the remainder buses and other vehicles. The average consumption of American motor vehicles fell from 13.9 miles per gallon (5.91 km/l) in 1985, to 16.2 miles per gallon (6.89 km/l) in 1991, representing a 16.55% average increase in distance per gallon in the space of six years. The 2008 consumption figure was 17.1 miles per gallon (7.27 km/l), which means an improvement of just 5.55% over the ensuing 17 years. An important question is whether the expansion of the total number of vehicles in the Asian region will be able to influence global oil demand through a significant change in the global figures for consumption and vehicle distance travelled, in light of generally improving but not endlessly improvable motor performance. Given that the production capacity exists to satisfy global demand, it is the influence of news developments and speculative capital which might be expected to have the greatest impact on the prices of this raw material in the years to come.

Instead of making prognoses and price forecasts for 5–10-year investment horizons, AEGON Investment Fund Management takes the view that what investors need is medium-risk solutions (the AEGON Smart Money Fund of Funds, the AEGON Atticus Alfa Derivative Investment Fund), which can – among other things – help them ride out even the short-term price fluctuations of the raw materials market (both rises and price falls).

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