## Press Release

London, 9 February 2006

# Currency strength not an indicator for long-term equity returns, says ABN AMRO / London Business School study

The paradigm that equity markets supported by strong currencies provide superior returns compared to equities in weak-currency markets has been rejected by the authors of the 2006 ABN AMRO Global Investment Returns Yearbook.

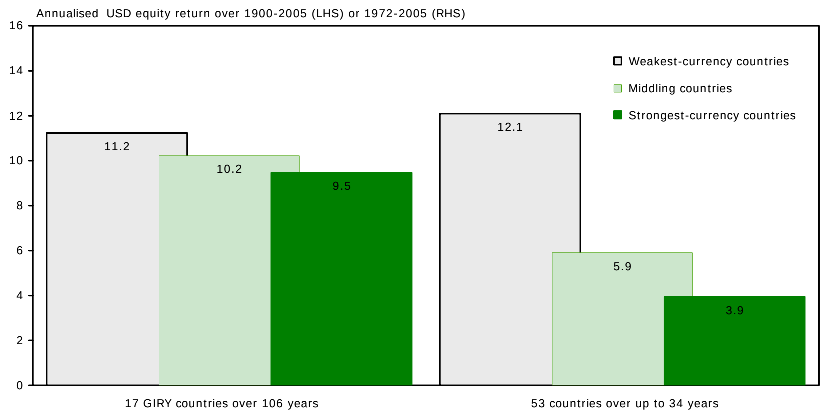
The Yearbook, published annually in partnership with Professors Dimson, Marsh, and Staunton of London Business School, is the most comprehensive and authoritative work of its kind and examines total returns since 1900 for stocks, bonds, cash and foreign exchange in 17 major markets, covering North America, Asia, Europe and Africa.

This year's study takes a close look at the role of currency exposure in portfolio management and challenges the widely held view that equity markets supported by strong currencies will produce favourable returns.

Using data since 1900 for all 17 countries and also for a broader sample of 53 countries, the authors show that instead, equity markets experiencing currency weakness are more likely to outperform.

Chart 1 ranks countries by their exchange-rate change over the preceding 5 years, assigning each country to quintile portfolios. The portfolio comprising the weakest-currency markets performed best over 106 years and (using a larger sample of countries) over the last 34 years.

**Chart 1: Performance of equity markets ranked by prior change in the exchange-rate**




Source: Elroy Dimson, Paul Marsh and Mike Staunton, *Global Investment Returns Yearbook 2006*, ABN AMRO (Chart 33)


Press Relations Department
Head Office: Gustav Mahlerlaan 10 (HQ 1190), 1082 PP Amsterdam, tel. +31 (0)20 6288900, fax +31 (0)20 6295486
London Office: 250 Bishopsgate, London EC2M 4AA, tel. +44 207 6788244, fax +44 207 6788245
Outside office hours please call +31 (0)20 6298000 for the press officer on duty

Professors Elroy Dimson, Paul Marsh and Mike Staunton of London Business School, said: "Our preliminary long-term evidence shows that over the long haul, equity returns have not been bolstered by currency strength. Historically, avoiding weak currencies might have been justifiable to control risk, but not to enhance performance".

The Yearbook also shows that while currency fluctuations, such as the dollar's strength in 2005 or its substantial fall over 2000−02, can seriously impact short-run equity performance, exchange rate movements have mattered much less to long-term investors.

This is because, over the long haul, parity changes have largely tracked relative inflation rates. Over more than a century, real exchange rates, after adjusting for differences in inflation rates, have changed at most by a mere fraction of one percent per year.

The Yearbook also shows the impact of currency volatility on the total risk of investing in overseas equities, and quantifies the gains from hedging.

Professors Dimson, Marsh and Staunton explain:
"A key strategic issue for global investors is whether to hedge their foreign-exchange exposure. Our analysis shows that while hedging reduces risk, the gains from risk reduction have declined over time and are now modest compared with the gains available from diversifying equity portfolios internationally".

The Yearbook also looks more broadly at investment returns in 2005 as well as long-term trends. Findings include:

- 2005 proved an excellent year for equities, with positive returns in all countries except China. The US disappointed with a mere 6.3% return, compared to the majority of markets that exceeded 20% returns

- UK and Japanese equities posted their best performance since 1999 with respective returns of 21.3% and 45%. Germany's recovery is starting to translate into equity performance, returning 28% in 2005

- Mid-cap stocks outperformed their large and small counterparts in 2005. The mid-cap FTSE 250 index posted a 30.2% return, versus 20.8% for the FTSE 100 and 28.6% for the Hoare Govett Smaller Companies Index. In the US, the S&P 400 Mid-cap index returned 12.6% compared to 4.9% for the large-cap S&P 500 and 7.7% for the S&P 600 small-cap.

- Since 2000, small-cap stocks and value stocks have outperformed large-caps and growth stocks by a substantial margin in most countries.

- Despite strong equity returns in 2005, and cumulatively, since the bottom of the 2000-03 bear market in March 2003, world equities still show the scars from the bear market. The annualised equity returns over the 21$^{st}$ century to date (2000-05) remain negative in 7 out of the 17 Yearbook countries, including the UK (-1.3%), the US (-2.7%), Germany (-4.1%), the Netherlands (-5.4%), France (-1.6%) and Sweden (-0.7%). The return on the world index was -1.2% p.a.

- Equities have outperformed government bonds and Treasury bills in all 17 stock markets, over the long term (chart 2).

ABN AMRO's Head of European Equity Strategy, Rolf Elgeti, discusses the practical implications of the Yearbook's findings for equity investors in a forward-looking chapter. He sees two opposing forces when analysing the effect currencies have on equity markets.

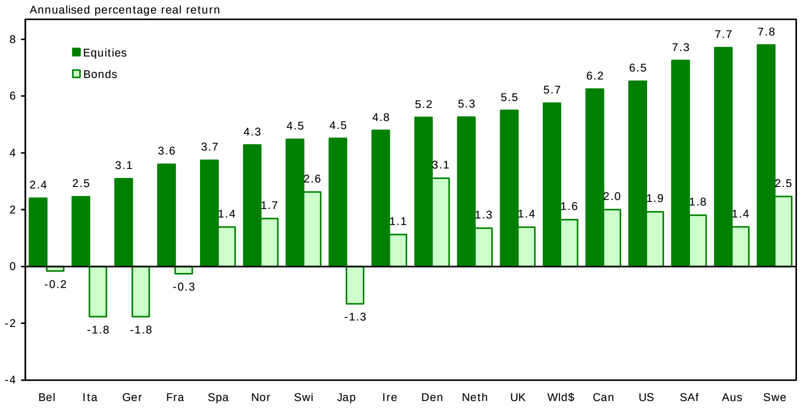
First, a weak domestic currency is generally assumed to increase corporate earnings in that country as export opportunities improve as a result of increased competitiveness. However, this effect has been much weaker than many people believe. Export-driven German equities for example have experienced good returns, despite the strength of the Euro, returning 28% in 2005.

Second, a depreciating currency tends to increase inflation and, more importantly, inflation expectations. This can translate into negative effects on a company's stock-market rating, however the lower PE multiples that tend to follow weaker domestic currencies have historically been more than compensated for by higher earnings generated by currency depreciation.

Rather than taking a macro approach toward equity market investment, Mr Elgeti believes the best opportunities lie at the stock and sector level.

"While a weak currency tends to lead to higher domestic earnings for export-sensitive equity markets, the effect on earnings for closed economies, such as the US, is more muted. The negative effect of a weak currency on overall market valuation and the positive effect on earnings may also broadly cancel each other out. We therefore believe that investors concerned about earnings should look at currencies as a factor for particular sectors and stocks, but not when looking at the whole market," he said.

**Chart 2: Real returns on equities and bonds around the world, 1900–2005**




Source: Elroy Dimson, Paul Marsh and Mike Staunton, *Global Investment Returns Yearbook 2006*, ABN AMRO (Chart12)

**ABN AMRO can provide complimentary copies of the *Global Investment Returns Yearbook 2006* to journalists on request.**

- - -

Media Enquiries:

ABN AMRO
Mark Bennewith +44 20 7678 8270 (24 hours per day)

London Business School
Kerry Taylor +44 20 7706 6972

Notes to Editors:

ABN AMRO
Netherlands-based ABN AMRO is a leading international bank with total assets of EUR 880.8 bln (as at 31 December 2005). It has over 3,000 branches in more than 60 countries and territories, and has a staff of over 96,000 full-time equivalents worldwide. ABN AMRO is listed on Euronext and the New York Stock Exchange.

London Business School
London Business School's vision is to be the pre-eminent global business school, nurturing talent and advancing knowledge in a multi-national, multi-cultural environment. Founded in 1965, the School graduated over 800 MBAs, Masters in Finance, Sloan Fellows and PhDs from over 70 countries last year. The School's executive education department serves 5,000 executives and 60 corporate clients on its programmes every year. London Business School is based in the most accessible and international city in the world.

The Global Investment Returns Yearbook
The Global Investment Returns Yearbook was launched in 2000. London Business School experts, Elroy Dimson, Paul Marsh and Mike Staunton, have produced it in conjunction with ABN AMRO since then. The study covers 105 years of investment in all the main asset categories in Australia, Belgium, Canada, Denmark, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, South Africa, Spain, Sweden, Switzerland, the United Kingdom, and the United States. ABN AMRO distributes the Yearbook to investment professionals and London Business School makes it available to other users.