

Eagle Star Investments

Weekly News

26th January 2009

Global Overview

Equity and bond markets fall

A deluge of poor economic data, combined with ongoing concerns about bond issuance and sovereign ratings, sent both bonds and equities down last week. The 'Obama bounce' was notable for its absence.

UK economic data

Figures confirmed that the UK economy is officially in recession for the first time since 1991. It contracted 1.5% in the last quarter of 2008, the biggest quarterly fall in 28 years.

Far Eastern data

China reported the slowest rate of growth in 7 years in Q4 of 2008, while Korea's GDP contracted by 5.6% in the same quarter. In Japan, exports fell a record 35% year-on-year in December, cutting the country's trade surplus for 2008 to its lowest level since 1982.

Credit Ratings

Portugal and Spain became the latest eurozone economies to have their credit ratings downgraded by Standard & Poor's, following Greece.

Currencies

Sterling fell sharply on currency exchanges last week, falling to record lows against the yen and a 23-year low against the dollar. It also fell against the euro, which in turn lost further ground against the dollar. The €/£ rate finished the week at 1.29, while €/€ was 94.25, a 4.5% rise on the week.

Index		Year to Date Return 31.12.08 to 23.01.09		1 Week Return 16.01.09 to 23.01.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-7.9	-0.5	-2.1	0.3
US	NASDAQ	-6.3	1.2	-3.4	-1.0
Europe	FT/S&P Europe Ex. U.K.	-9.5	-9.5	-4.9	-4.9
Ireland	ISEQ	-2.8	-2.8	-7.3	-7.3
UK	FTSE 100	-8.6	-7.2	-2.3	-6.4
Japan	Topix	-10.0	-0.6	-5.4	-1.4
Hong Kong	Hang Seng	-12.6	-5.7	-5.1	-2.7
Australia	S&P/ASX 200	-10.2	-10.0	-5.9	-5.4
Bonds	Merrill Lynch Euro over 5 year Govt.	-4.5	-4.5	-3.0	-3.0

Global Equities



United States

Overview

US equities ended the week down just over 2%, having fallen 5.3% on Tuesday, the largest-ever fall on a Presidential inauguration day.

General Electric – GE attempted to reassure the market about its triple-A rating and reaffirmed its dividend, but reported a 44% drop in quarterly profit on Friday. The stock finished down 10.8%.

Technology Shares – Microsoft surprised investors with worse-than-expected results. It also warned that it was unable to provide sales and earnings forecasts for the rest of the year and announced plans to cut 5,000 jobs. Apple and Google both revealed relatively upbeat results.

M&A – In a rare piece of M&A news, Pfizer appears to be on the point of acquiring Wyeth, for \$68 billion.



Europe

Overview

European markets fell every day last week, with banking stocks sinking to their lowest level in 16 years on Tuesday.

UK banks – It was another week of turmoil for the UK banks as the week began with a slew of new measures from the UK Treasury to support the industry, including insurance against further losses on toxic assets. The market was not reassured that further capital injections would not be required, resulting in further nationalization of UK banks. RBS fell 65% on the week, Barclays was down 48% and Lloyds Banking Group was down 50%.

Fiat – The Italian carmaker announced that it had taken a 35% stake in troubled US auto manufacturer, Chrysler.



Ireland

Overview

The banks continued to dominate the headlines in the aftermath of the nationalization of Anglo Irish Bank and the further part-nationalization of RBS in the UK. Shares in Bank of Ireland and AIB traded dangerously low in mid-week, before recovering some ground by Friday's close. AIB closed at 75c, while Bank of Ireland finished the week at 42c.

Ryanair – The airline conceded defeat in its latest attempt to take over rival, Aer Lingus, as the Irish government, the largest shareholder in Aer Lingus after Ryanair itself, said it would not support the takeover.



Asia Pacific

Overview

Asian stocks were among the worst performers last week with Japan, Hong Kong and Australia all down over 5% against a background of steadily worsening economic data. Shanghai bucked the trend, rising nearly 2% on the week.

Bonds

Eurozone bonds, particularly those of the more peripheral economies, continued under pressure as Standard & Poors downgraded Spain and Portugal's sovereign debt. This story, combined with the ongoing worries about issuance levels, has led eurozone bonds to fall 4.5% in the year to date and the Merrill Lynch >5 year government bond index fell 3% last week alone.

Global Outlook

- The global economic situation remains fragile with policymakers working to prevent a deflationary slump through aggressive interest rate reductions, governing spending and extraordinary interventions in the financial markets. So far there has been little improvement in the leading indicators of future economic activity; at best, there are some tentative signs of stability. Output and employment are likely to remain under pressure for some months yet.
- The crisis of confidence in the global banking system and resultant credit-crunch have meant that much of the effort of policymakers has been directed at trying to support the banking system, with the aim of reducing the funding costs of banks and getting credit flowing back to the real economy. There has been some success in this area, with money market funding costs falling significantly. More initiatives are likely, such as the creation of "bad-banks", which would take poor quality assets off banks' balance sheets.
- Global short rates will remain low or fall further over the coming weeks and months. After cutting rates to 2%, the ECB has yet again tried to downplay expectations of more rate cuts. Investors remain unconvinced and have continued to anticipate lower rates, expecting the cycle low to be close to 1%. With short rates close to zero in the US, the Fed is focused on driving down other interest rates, such as the level of mortgage rates and the rates that companies pay to raise debt financing. Further unconventional policy responses are likely over coming months.
- After surging last year, Government bond prices have fallen this year for several reasons - profit taking, concerns over rising Government supply, sovereign ratings' concerns and even talk of a bubble in bond markets. While the current level of short and long-term rates may be seen as "emergency" levels and hence not sustainable, it remains the case that the economic backdrop should be bond-supportive for a while to come. Possible direct or indirect purchases of Government bonds by central banks are also a very live issue.
- Equity markets have weathered an onslaught of dreadful economic news and employment data, giving some support to the idea that markets have already discounted a very weak economic picture going forward. However, the ease with which early new year gains were erased confirms that sentiment and conviction remain weak. There is still some optimism surrounding the new unconventional policies of the Fed, the Obama fiscal measures and the stimulative actions of other economies. As before, the key to any sustainable rally remains the unfreezing of the money markets and the re-opening of the corporate bond markets. Markets will remain volatile and the direction uncertain until those markets begin to return to normality.
- Currently the funds are close to neutral in equities and bonds versus the manager average. Within equity sectors, the funds are overweight healthcare and technology and underweight basic materials and financials. Geographically the funds have an underweight position in Ireland and Japan, are neutral in the Pacific Basin and Europe and slightly overweight in the US and the UK.

This outlook does not constitute an offer and should not be taken as a recommendation from Eagle Star/Zurich. Advice should always be sought from an appropriately qualified professional.

