Eagle Star Investments

Weekly News 4th August 2009

Global Overview

Equity markets extend the rally

Equity markets gained again last week after economic data released showed conditions worldwide continued to improve while, on top of this, numerous companies released expectation-beating earnings results.

US GDP data

Economies worldwide got a boost from the latest GDP data from the US which showed that the world's largest economy shrank at a better-than-forecast 1% annual rate in Q2. This improvement follows a 6.4% drop for Q1. This was mainly helped by a jump in government spending as recent stimulus programs began to kick in. Yesterday saw the announcement that the ISM Manufacturing Index and Construction Spending for July beat investors' expectations.

European consumer prices

European consumer prices fell in July, by the most in over 13 years, as energy prices declined and unemployment hit its highest rate in a decade. President of the ECB, Jean-Claude Trichet, believes inflation will remain negative for the time being, before turning positive, but well within the ECB's 2% limit, by the end of the year.

Oil and currencies

The oil price rose by almost 4% over the week after the improved GDP data and weakening dollar boosted the outlook for demand for most commodities. Oil finished the week just below $70 a barrel, and rose even further, to over $71 yesterday, after further encouraging economic data. The €/$ rate ended the week relatively unchanged at 1.42.

	Index	Year to Date Return 31.12.08 to 31.07.09		1 Week Return 24.07.09 to 31.07.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	9.3	7.1	0.8	0.7
US	NASDAQ	25.5	22.9	0.6	0.5
Europe	FT/S&P Europe Ex. U.K.	11.3	11.3	2.6	2.6
Ireland	ISEQ	19.1	19.1	-0.4	-0.4
UK	FTSE 100	3.9	16.6	0.7	2.2
Japan	Topix	10.6	3.9	3.2	3.3
Hong Kong	Hang Seng	43.0	40.1	3.0	2.8
Australia	S&P/ASX 200	14.0	31.9	3.8	5.5
Bonds	Merrill Lynch Euro over 5 year Govt.	2.9	2.9	2.2	2.2

Global Equities

United States

Overview

US equity markets reached their highest levels since last November after another week of upbeat earnings releases and improved economic data. Both of these helped the Dow record its best month since October 2002, in July.

Motorola – The mobile-phone maker posted a narrower Q2 loss than analysts projected, pushing its share price almost 9% higher. The improved conditions were helped by job cuts and a recovery in handset shipments.

MasterCard – The world's second-biggest credit card company reported earnings which well exceeded market expectations. This recovery was helped by MasterCard raising fees, slashing expenses and processing more transactions over the quarter.

Europe

Overview

European equities traded higher over the week, on the back of improving economic conditions worldwide and further companies beating earnings expectations. Financials, telecoms and chemicals led the way, while oils underperformed after poor results from BG, ENI and Total.

Alcatel-Lucent – The largest supplier of fixed-line phone networks posted its first profit in eleven quarters, aided by a gain from selling its stake in Thales. Its shares gained 10% over the week.

Barclays – Barclays saw its shares jump yesterday after it announced that earnings from its investment banking unit doubled in the first half of the year. Shares rose by almost 7% following this announcement.

Ireland

Overview

The Irish market traded in a range over the week, finishing the week marginally lower.

Banking sector – There was positive news for Bank of Ireland and AIB, after the publication of the draft legislation for NAMA provided no shocks. NAMA will be paying the banks for the loans, which they take off their books, in government-backed securities, paying a rate of interest based on the six-month rate at which banks lend to each other.

Asia Pacific

Overview

Asian markets provided the best returns of the week, as some of the largest export-led economies got a boost from the recovery in the US GDP rate. Further to this, the Chinese manufacturing index remained in expansionary territory for the fifth successive month, pointing to the emergence of renewed growth for many economies in the region.

Bonds

Eurozone bonds got a boost from the further drop in consumer prices and comments from the ECB President regarding low inflation for the next few months. On top of this, the International Monetary Fund has asked the European Central Bank to keep interest rates low, or cut them further. The Merrill Lynch over 5 year government bond index gained 2.2%.

Global Outlook

- Economic data has stabilised after being in freefall earlier this year and GDP forecasts are currently being revised higher. Leading indicators of future activity have improved considerably from their worst levels. Signs of less stress in the financial system have bolstered this process although, outside of China, bank lending is moribund and this remains a concern. China's positive growth story has been a considerable help to sentiment although its real impact on the rest of the world is limited.
- The scale and scope of policy initiatives to save the banking system and offset the collapse in private sector demand have been unprecedented. Because of the scale of the global crisis, the ultimate success of these efforts (or their unintended consequences) is still far from certain. Put another way, whether the outlook is inflationary or deflationary, and which comes first, remains an open question.
- Short rates have likely reached their cyclical lows in the major economies – at somewhere between 0% and 1%. The major central banks feel in a quandary, however, trying to keep policy easy while talking about exit strategies from their various initiatives, including their partially-successful QE policies. Currently, investors expect modest increases in most short rates early next year.
- Although many commentators continue to speculate on the long-term inflation risks from the current policy mix, inflation indicators are still pointing downwards. That may continue to provide some support to bonds, although the exit from emergency short rates – whenever that comes – is unlikely to leave bond markets unaffected. In the eurozone, peripheral bond markets, such as Ireland, have seen their spreads over Germany narrow aggressively. This has been helped by considerably improved funding positions, although the scope for further narrowing must be limited at this stage.
- Developed equity markets have embraced recent earnings data and the continued surge in China's equity indices, although it's noteworthy that China's equity market now has bubble characteristics. The caveat – that final demand in Europe and the US remains weak and that most of the earnings from those regions, outside of financials, have been boosted by cost control – is interesting in itself but secondary to the more bullish sentiment now evident. Technically, equity markets have broken out of recent ranges and this normally sets the stage for further gains, but markets are now in overbought territory and could easily see some consolidation. Investors will therefore watch near-term price action very carefully.
- Currently, the funds are neutral to overweight equities and overweight bonds, versus the manager average. Within equity sectors, the funds are overweight technology, and underweight industrials and utilities. Geographically, the funds have an underweight position in Ireland and the US, are closer to neutral in Japan and the UK, and are overweight in the Pacific Basin and Europe.

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