Eagle Star Investments

Weekly News

20th October 2008

Global Overview

Week of extremes for equity markets

Equity markets rebounded early in the week after a series of co-ordinated moves to re-capitalise ailing banks assisted a recovery. However, in the middle of the week, markets declined steeply as investors switched their attention to deteriorating economic fundamentals and the prospect of a global recession. Most markets held around half of the earlier gains, registering the first positive week out of the last five.

US economic data

US retail sales dropped by 1.2% (-0.6% ex-auto) in September, the sharpest fall for three years, signalling that consumers were deterred from spending by the banking sector collapses throughout the month.

UK economic data

Investor fears were fuelled by poor economic data with UK unemployment rising by 0.5%, to 5.7%, in the three months to August, its biggest rise since 1991 with companies scaling back labour force numbers as their financial positions deteriorate.

Inter-bank lending

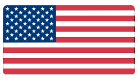
Short-term inter-bank rates for dollar, euro and sterling fell for four consecutive days, suggesting that central banks' liquidity provisions are beginning to thaw frozen money markets.

Commodities

Recession worries weighed heavily on commodities with oil prices falling below $70 per barrel for the first time since August 2007, reaching a low of just over $68 a barrel. However, oil prices later rebounded, on speculation that OPEC may soon announce production cuts to reduce stockpiles resulting from weakening demand. Elsewhere, the dollar maintained its strengthened position, with the €/$ finishing unchanged at 1.34.

	Index	Year to Date Return 31.12.07 to 17.10.08		1 Week Return 10.10.08 to 17.10.08	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-36.0	-30.5	4.6	4.7
US	NASDAQ	-35.5	-30.0	3.8	3.8
Europe	FT/S&P Europe Ex. U.K.	-41.4	-41.4	4.6	4.6
Ireland	ISEQ	-60.8	-60.8	-5.3	-5.3
UK	FTSE 100	-37.1	-40.5	3.3	5.4
Japan	Topix	-39.4	-27.7	6.4	4.4
Hong Kong	Hang Seng	-47.7	-42.9	-1.6	-1.6
Australia	S&P/ASX 200	-37.4	-46.2	0.3	6.8
Bonds	Merrill Lynch Euro over 5 year Govt.	3.7	3.7	-0.1	-0.1

Global Equities



United States

Overview

US markets finished the week higher despite the continuing slew of weak economic releases, mostly centred on deteriorating economic data and poor earning results.

Merrill Lynch – the US investment bank, which agreed to be bought by Bank of America last month, reported a third-quarter loss of $5.2bn, caused predominantly by write-downs and credit losses on complex debt securities.

Citigroup – Citigroup also warned of growing economic problems when it announced a third-quarter loss of $2.8bn, again mostly as a result of asset write-downs.

Europe

Overview

Despite an extremely volatile week, European markets finished higher as policymakers announced further measures to support markets. UK equities dropped to a five-and-a-half year intra-week low before rallying. Rising unemployment levels caused weakness within leisure, luxury brands and retail stocks.

Government guarantees – The week began with the UK Government announcing a Stg £37bn injection into the floundering UK banking system which resulted in RBS, HBOS and Lloyds TSB Bank possibly being partially nationalised. Various European governments also announced banking system support packages, including deposit guarantees and the creation of capital backstop funds that can be used if required. ING received €10bn from the Dutch government over the weekend.

Ireland

Overview

It was another volatile week on the ISEQ as banking stocks continued to slump with the market ending the week in negative territory.

Banking stocks – Allied Irish Bank and Bank of Ireland experienced the largest declines, falling by over 26% and 23% respectively, as the market worried that capital raising may be required.

Asia Pacific

Overview

The uncertainty in Wall Street was mirrored across Asian markets and intra-week, the Nikkei suffered its worst one-day decline since 1987, falling steeply by 11.4% as concerns for economic data and the financial sector continued. In Hong Kong, the Hang Seng Index recorded a record 10% intra-week gain, assisted by news of a record monthly trade gain surplus for China. Despite this record one-day gain, the Hang Seng finished the week down 1.6% while the Topix pared back some losses, ending the week up 6.4%.

Rio Tinto – Comments by Rio Tinto's chief executive of a slowdown in Chinese demand, resulting in the company revising down its expansion plans, caused a sharp sell-off in mining stocks.

Bonds

As equity markets recovered towards the end of the week, any earlier gains were quickly erased, resulting in bonds being largely unchanged for the week. The Merrill Lynch >5 year Government Bond retreated by 0.1% over the week.

Global Outlook

- Policymakers have now grasped the incredible risks facing the global economy and have taken a series of measures that should prevent a complete implosion of the global banking and economic system. It's now a given that US and European growth rates will be severely curtailed in the next year or so and that a global recession will have to be worked through. Policy action is intended to put a floor under economies and prevent a prolonged slump.
- Policy-makers have committed to taking all measures necessary to kick-start the money markets - the lifeblood of the banking system and the real economy. There has been some very modest progress in that regard in the past week; a huge amount of 'healing' has to take place however. As part of this process there will be further sharp falls in official short-term interest rates. At least a further 0.5% reduction is seen from the ECB by the end of the year, but this could happen much faster, given the pace of recent events. US rates are seen falling by around the same amount over that period also.
- With some markets priced for the deepest slump since the Great Depression, government bonds have received strong safe-haven flows. These may unwind somewhat over the next while as governments step-up their borrowings substantially and if investors' fear of equities and corporate bonds recedes somewhat. Overall, however, bonds should be supported by falling short rates and large drops in inflation rates.
- Equity markets are still characterised by enormous uncertainty with investors worrying about a prolonged economic slump. Co-ordinated policy action is intended to arrest that fear and set the stage for the return of some semblance of confidence into the banking system, the real economy and equity markets. While history suggests that powerful rallies can occur in the midst of severe bear markets, such as we are experiencing now, this notion appeared a distant possibility over the last couple of weeks. That may indicate just how weak sentiment had become and, ironically, this is often the time when rallies occur. The positive equity market performance of last week - in the midst of much weaker-than-expected economic data - was therefore interesting. At the moment the unfreezing of the money markets and the banking system is seen by equity investors as the acid test of whether policy action is working or not. Huge uncertainty will persist until those markets begin to return to normality.
- The funds are currently neutral to slightly overweight in equities and slightly underweight in bonds, versus the manager average. Within equity sectors the funds are overweight healthcare and underweight basic materials. Geographically the funds have an underweight position in Ireland, Japan and the Pacific Basin, are neutral in the UK, and are overweight in the US and Europe.

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