Eagle Star Investments

Weekly News 13th July 2009

Global Overview

Equity markets remain under pressure

Disappointing economic data, combined with uncertainty about the onset of the US second-quarter corporate earnings season, heightened investors' sense of unease about a global economic recovery. Cautious comments from the IMF and the G8 meeting in Italy, along with discussions about a second US stimulus package, resurrected fears, resulting in equity markets retreating for the fourth consecutive week.

US economic data/indicators

The University of Michigan index of consumer sentiment fell mid-month in July to 64.6, compared to 70.8 in June as fears grow about the recession and mounting job losses. Despite this, investors were encouraged by the latest labour report showing that initial jobless claims fell to a better-than-expected 565,000 – the lowest weekly level since early January.

European economic data

The Bank of England announced its decision to hold interest rates at 0.5%, for the fourth month in a row. However, the Monetary Policy Committee surprised markets by opting against creating more money to pump into the economy through its quantitative easing (QE) program. Elsewhere, German factory orders recorded their largest jump in two years.

Oil and currencies

Recession worries weighed heavily on commodities with oil prices falling 10%, to below $60 a barrel, on the back of bearish US supplies data and concerns about the global economy's recovery prospects. Elsewhere, the €/$ rate finished the week unchanged at 1.40.

	Index	Year to Date Return 31.12.08 to 10.07.09		1 Week Return 03.07.09 to 10.07.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-2.7	-2.7	-1.9	-1.7
US	NASDAQ	11.4	11.3	-2.3	-2.0
Europe	FT/S&P Europe Ex. U.K.	-3.3	-3.3	-3.6	-3.6
Ireland	ISEQ	9.8	9.8	-4.5	-4.5
UK	FTSE 100	-6.9	3.3	-2.6	-3.2
Japan	Topix	1.5	-0.2	-5.2	-1.3
Hong Kong	Hang Seng	23.1	23.1	-2.7	-2.5
Australia	S&P/ASX 200	1.9	12.4	-0.9	-3.2
Bonds	Merrill Lynch Euro over 5 year Govt.	1.0	1.0	0.3	0.3

Global Equities

United States

Overview

US equity markets finished the week lower due to a slew of weak economic releases, falling oil prices, and nervousness caused by the onset of the second-quarter corporate earnings season.

Alcoa Inc. – The aluminium giant kicked off second quarter earnings season in the US, announcing a smaller-than-expected net loss of $454 million. Despite being the third consecutive quarterly loss, this result beat estimates by a large margin due to cost cutting.

Oil sector – Oil prices fell more than 10% over the week, falling below $60 a barrel for the first time since mid-May, as weekly US inventories showed that stock levels rose to the highest level in nearly 25 years. Conoco-Phillips and ArcelorMittal were among the big names that retreated during the week, as investors fear weaker profits going forward.

Europe

Overview

European stocks ended the week almost 4% lower, with energy and banking stocks leading this decline, amid mounting uncertainty over the global economy and deteriorating financial conditions.

Aviva – The insurance company was the largest FTSE faller on speculation that the insurer would have to sell assets and cut its dividend to boost capital.

Ireland

Overview

The ISEQ finished the week down 4%, with the banking sector leading the decline on renewed concern on the profitability of the banks post NAMA.

CRH – The Company issued a weaker-than-expected trading statement due to poor European and US non-residential trading conditions. In spite of an 83% drop in pre-tax profits for the first-half of the year to €100m compared to €600m the previous year, the company will continue to pay an interim dividend.

Asia Pacific

Overview

Worries surrounding Asian economies and fears of a global recession persisting caused Asia to follow the rest of the world lower over the week. Hong Kong's Hang Seng Index and Japan's Topix fell by 3% and 5% respectively.

Bonds

Eurozone bonds gained last week as equity markets fell and investors opted for the perceived safety of government bonds. The Merrill Lynch over 5 year government bond index rose by 0.3%.

Global Outlook

- The general feeling amongst investors is that economic data has stabilised after being in freefall earlier this year. Signs of less stress in the financial system have bolstered these hopes, although, outside of China, bank lending is moribund. A lot of the 'green shoots' sentiment has its origin in China and Asia but that comes with some health warnings - China's growth is internally-focused and not really helping the rest of the world, while Asia's growth is still dependent on exports to a weakened US consumer sector.
- The scale and scope of policy initiatives to save the banking system and offset the collapse in private sector demand have been unprecedented. The ultimate success of these efforts - or their unintended consequences - is still far from certain, however, given the depth of the crisis faced by the global economic system. 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%. However, investors have recently scaled back thoughts of rates rising in the near term after comments from various central banks. This highlights the bind that major central banks feel they are in trying to keep policy easy, while talking about exit strategies from their various initiatives, including their partially successful QE policies. Witness the Bank of England's comments last week on the latter point, which feels that its buying of bonds has been highlighted by profligate government borrowing.
- In the short-term, bonds have rallied from support levels and seem to have entered a more constructive phase, helped by soggier equity markets. Some commentators continue to speculate on the long-term inflation risks from the current policy mix, but inflation expectations have started to fall back again in the past couple of weeks. In the eurozone, peripheral bond markets, such as Ireland, have been helped by "solidarity" expressions from the EU and ECB and somewhat improved funding positions. Periodic concerns about the budgetary positions could easily impact on these spreads again, although it seems that the political commitment to containing this issue has strengthened if anything.
- "Green shoots", oversold markets, large short positions and pessimistic sentiment combined to produce a powerful bear market rally in equity markets over the past three months. At this stage, however, the burden of proof may now lie with those who are bullish on the market. In the last few weeks, negative data seems to be gaining more traction than positive data, suggesting that improvements have been discounted and investors have "enough" risk assets on board at the moment. Whether this is a period of messy consolidation or something more corrective is not clear yet. In that context, the coming Q2 earnings' data will be closely watched for market reaction.
- Currently, the funds are close to neutral in equities and overweight bonds, versus the manager average. Within equity sectors, the funds are overweight technology, and underweight industrials and basic materials. Geographically, the funds have an underweight position in Ireland and the US, are closer to neutral in Japan, the UK and Europe and are overweight - but less so - in the Pacific Basin.

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