

Global Overview

Equity markets drop sharply

Global equity markets moved sharply downwards last week as fears mounted for the strength of the economic recovery, particularly following Tuesday's downgrading of the outlook for the US economy by the Federal Reserve. Volatility jumped sharply, with the Vix equity volatility index up about 20% over the week.

US economic data & Fed policy

The Federal Reserve said on Tuesday that it would begin funnelling proceeds from maturing mortgage bonds into longer-term Treasuries in an effort to support the economic recovery. This came hand-in-hand with a downgrade of the economy and marked a significant turn-around in the Fed's thinking from the situation only a few months ago when it was tilting towards monetary tightening.

German economic recovery

Europe's largest economy announced second-quarter growth in GDP of 2.2%, well ahead of analysts' expectations and a record for reunified Germany. Elsewhere in the eurozone, growth was more modest, underlining the two-tier nature of the recovery so far.

Chinese economy

The latest batch of economic figures from China appeared to confirm the picture of slowing domestic demand after tightening measures were taken to cool down parts of the property market. While exports were strong, imports were significantly weaker and industrial production growth slowed.

Currencies

The euro tumbled against the dollar last week, as concerns over eurozone government debt resurfaced and fears over global growth fuelled safe-haven demand for the US currency. The €/£ rate ended the week at 1.28. The Japanese yen was also particularly strong, hitting a 15-year high against the dollar.

Oil

Oil prices fell approximately 6% on the week after Opec and the International Energy Agency both highlighted their worries about global demand.

	Index	Year to Date Return 31.12.09 to 13.08.10		1 Week Return 06.08.10 to 13.08.10	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	-2.5	8.1	-2.9	-0.1
US	S&P 500	-3.2	8.4	-3.8	-0.2
US	NASDAQ	-4.2	7.3	-5.0	-1.5
Europe	FT/S&P Europe Ex. U.K.	-2.2	-2.2	-2.1	-2.1
Ireland	ISEQ	-5.1	-5.1	-3.7	-3.7
UK	FTSE 100	-2.5	5.5	-1.1	0.3
Japan	Topix	-8.4	10.9	-3.5	-1.0
Hong Kong	Hang Seng	-3.7	7.7	-2.8	0.7
Australia	S&P/ASX 200	-8.4	2.4	-2.3	-0.7
Bonds	Merrill Lynch Euro over 5 year Govt.	6.3	6.3	-0.1	-0.1

Global Equities



United States

Overview

De-risking was the name of the game on equity markets on the back of growing fears about the health of the economic recovery. Pretty much all sectors fell in the US, with technology stocks leading the way.

Cisco – The technology bellwether fell sharply, despite better-than-expected earnings and a jump in net income. A downbeat assessment of economic conditions by the CEO, who repeated the Fed wording of 'unusually uncertain', spooked the market.



Europe

Overview

European markets could not escape the general downturn, though they fell slightly less than most other areas. Financials were the worst-performing sector.

Aviva/RSA – RSA, the UK's biggest non-life insurer, is said to have had a £5 billion offer rejected for Aviva's general insurance unit. Both companies beat analysts' expectations and raised their dividends when they reported first-half results recently.



Ireland

Overview

The Irish market followed the rest of the world downward. Much adverse publicity surrounding the ever-escalating cost of the Anglo Irish Bank bail-out played badly in the market, with the remaining quoted banks down sharply.



Asia Pacific

Overview

Markets in the Far East fell also, focussing on indications of slower growth in China. Japan underperformed other markets in the region, with economic indicators coming in on the weaker side, with only the more defensive areas of the market holding up reasonably well.

Bonds

The Merrill Lynch >5 year government bond index was flat on the week, but this disguised a return to the situation of core markets being in strong demand, while spreads between peripheral markets and Germany widened significantly as worries about sovereign debts in the eurozone resurfaced.

Global Outlook

- Most forecasters expect the global economy to expand by around 3.5% this year; however, weak bank lending and financial market volatility add to downside risks and we have begun to see some forecasts being pared back for the US. Inflation pressures globally remain modest, reflecting weaker data in the US, Europe and Japan and stronger readings in emerging economies and Asia. Exports are very strong from some European economies but domestic demand remains subdued. The key concern is whether the private sector in Europe and the US can grow without continued government support.
- The eurozone debt crisis had reawakened worries about sovereign creditworthiness, the long-term consequences of the credit burst and the unintended consequences of a myriad of policy actions – factors which periodically increase the risk concerns of equity investors. Some concern is again evident in markets, especially about peripheral Europe, post the bank stress tests.
- Central banks continue to set interest rates at emergency levels in Europe and the US, although they have risen somewhat in some of the stronger economies such as Canada, India and China. By extension, 2011 rate expectations have reached new cycle lows in the US, UK and eurozone. Investors, therefore, expect that low rates will persist for some time.
- These low short-term interest rates, combined with disinflation concerns, continue to be of support to the major bond markets such as Germany, the US and Japan, with long-term interest rates falling to levels that will unnerve many risk investors and policymakers. Peripheral bond spreads in the eurozone have widened again of late, with spreads between Ireland and Germany back to their widest point. Some of this is due to illiquid summer trading conditions, with a sense that Ireland's fiscal measures have been swamped by its banking woes. It is likely that the rescue mechanism in place for eurozone countries will be tested at some stage.
- Global equities are down a couple of percent so far this year but this masks very large gyrations: we have had four 7%+ falls, one 9% rise and one 14% rally. One impact of this is that investors' convictions are very low and holding periods very short. Low interest rates certainly provide some forward support to risk markets and investors seem to believe that the Fed will ride to the rescue with further quantitative easing policy ("QE2"). Having been positive, sentiment and market action have turned mixed again and caution is warranted still.
- Currently, the funds remain underweight equities and overweight bonds, versus the manager average. Within equity sectors the funds are now reasonably balanced, albeit with an underweight in financials. Geographically the funds are underweight in Ireland, Europe and the US and are neutral in Japan, the UK and the Pacific Basin.

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