Eagle Star Investments

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ZURICH

Global Overview

Mixed week for equities

Most equity markets struggled to extend their September gains into the new month, after the release of mixed economic data caused investors to question the pace of the global economic recovery. Most equity markets ended the week marginally negative to flat.

US economic data

US manufacturing growth slowed last month and inflation remained subdued in August, leaving the door open for the Federal Reserve to launch a fresh round of monetary policy easing (QE2). Elsewhere, the second-quarter US GDP figure was revised up incrementally, from 1.6% to 1.7%, helped by a stronger consumption component.

German retail sales

Retail sales in Germany fell unexpectedly in August, casting doubt on the strong recovery in the country's private consumption.

Spanish sovereign debt

In a widely anticipated move, credit-rating agency Moody's joined its peers in depriving Spanish government's debt of its assigned AAA credit-rating.

Commodities & dollar

The euro currency rose to a six-month high against the dollar as prospects of further quantitative easing in the US caused further dollar weakness. The €/$ rate ended the week at 1.37. Crude oil reached the top of its trading range, rising to almost $82 a barrel for the first time since August, as positive Chinese manufacturing data spurred hopes of strengthening global energy demand. Elsewhere, the gold price rallied strongly into a new all-time high of $1,320 per troy ounce, on Friday.

	Index	Year to Date Return 31.12.09 to 01.10.10		1 Week Return 24.09.10 to 01.10.10	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	2.6	8.5	-0.1	-1.4
US	S&P 500	2.8	7.2	-0.2	-2.2
US	NASDAQ	4.5	9.0	-0.4	-2.4
Europe	FT/S&P Europe Ex. U.K.	0.0	0.0	-1.6	-1.6
Ireland	ISEQ	-10.5	-10.5	-1.4	-1.4
UK	FTSE 100	3.3	5.6	-0.1	-2.1
Japan	Topix	-8.6	6.5	-1.0	-1.8
Hong Kong	Hang Seng	2.2	6.5	1.1	-0.9
Australia	S&P/ASX 200	-6.0	5.9	-0.5	-1.2
Bonds	Merrill Lynch Euro over 5 year Govt.	7.2	7.2	0.7	0.7

Global Equities

United States

Overview

The S&P 500 Index ended the month 8.8% higher, making it the best September for the benchmark since 1939. Despite this, however, the US stock market had a sluggish week, ending the week marginally down as the release of economic data such as ISM manufacturing and consumer confidence numbers disappointed investors.

Nike – The company reported better-than-expected first-quarter earnings results (by 9% from one year earlier) citing growing demand in North America, China and emerging markets.

Family Dollar Stores – The retailer posted better-than-expected quarterly profit as cash-strapped consumers continue to seek low prices on every day items.

Europe

Overview

European markets ended the week over 1% lower, with mixed economic data releases, along with Irish banking woes, dominating market headlines.

Sanofi-Aventis – The French pharmaceutical company launched a hostile $18.5 billion bid for Genzyme, after its original offer was rejected in late August.

Ireland

Overview

The Irish market fell over 1% on the week, with the banking sector suffering the most, as markets continue to fret over Irish sovereign debt levels.

Irish Banks – The Irish Central Bank and the Minister for Finance released statements detailing the further capital requirements for Anglo, Irish Nationwide and AIB. In AIB's case, a € 5.4 billion equity capital raising plan will be launched in November. It is expected that on completion of the capital raising, the National Pensions Reserve Fund will own a significant majority stake in AIB.

Asia Pacific

Overview

Better-than-expected Chinese manufacturing data lifted sentiment in what was otherwise a volatile week, and Hong Kong's Hang Seng Index ended the week 1% higher. In corporate news, China Petrochemical Corp (Sinopec) is paying a premium to take a stake in the Repsol Brazilian oil reserves unit.

Bonds

Eurozone bonds gained as equities struggled during most of the week. Fears for the Irish banking system pushed Irish 10-year bonds to their widest spread against German bunds earlier in the week. The Irish government announced that two bond auctions scheduled for October and November have been cancelled. This, plus the banking announcements, resulted in the later tightening of spreads. The Merrill Lynch over 5 year government bond index rose by 0.7% over the week.

Global Outlook

- Global growth forecasts are still quite healthy enough for this year and next (3.6% and 3.3%). However, weak bank lending and financial market volatility add to downside risks to both forecasts and there have been some concerns over a double-dip in the US economy. Inflation pressures globally remain modest, reflecting weaker data in developed economies and stronger readings in emerging economies and Asia. Indeed, further disinflation is a greater near-term concern than inflation. Exports are very strong from some European economies but domestic demand remains subdued and the global economy is still very lopsided. The underlying weakness of private sector demand in Europe and the US is a key concern.
- 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 are close to or have reached new cycle lows in the US, UK and eurozone, which underlines the risks facing the global economy. Worryingly, ECB rhetoric suggests anxiety about normalising short-term interest rates which seems premature at this stage. Thus, the chances of a policy error have risen, albeit remaining quite low still.
- Low short-term interest rates and disinflation concerns have been a support to major bond markets such as Germany, the US and Japan and long-term interest rates have recently fallen to record or near-record levels in the US and Germany. Irish bond spreads versus Germany had widened by 2.5% since mid-year but narrowed 0.5% after last week's banking announcements and the cancelling of debt auctions. However, it remains to be seen whether the latter will have the desired market impact. Ireland has certainly funded well this year and has a large cash buffer. However, the risk remains that investors continue to probe the credibility of the rescue mechanism in place for eurozone countries and, if so, a rocky road still lies ahead for Irish bonds.
- While global equities are only up 2.5% this year, it has been a period of very high volatility with several large gains and falls over the first nine months. Partly because of this, investors' convictions are very low and holding periods quite short. Low interest rates certainly provide some forward support to risk markets. Additionally, investors seem to believe that the Fed will ride to the rescue with further quantitative easing policy ("QE2"), although the Fed's recent comments suggest a division on the scale and timing of additional actions. After the latest rally it is possible that equities push on further. However, sentiment has already rebounded, meaning that the fuel for further gains may be limited. On balance, we remain cautious at the moment because we have seen plenty of false dawns this year; additionally, the fact that bond yields continue to fall or remain very low in major markets suggests that the macro disinflation risks are still high.
- Currently, the funds are slightly underweight equities and overweight bonds versus the manager average. Within equity sectors, the funds are now reasonably balanced. Geographically, the funds are underweight in Ireland and the UK, overweight Europe and the Pacific Basin and closer to neutral in other markets.

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