

Eagle Star Investments

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Global Overview

Equity markets end lower as risk aversion returns

Global equity markets came under pressure as uncertainty about the economic recovery and the financial system prompted investors to fear that recent optimism about a recovery might be overdone. Despite experiencing mixed economic releases and some intra-day gains, many equity markets registered weekly declines, their first since mid-May.

US economic data

Despite US labour and housing market data releases confirming some sign of stabilisation, industrial production fell significantly in May, dropping by 1.1%, following a 0.7% fall in April. Elsewhere, investors digested details of the Obama administration's plans to overhaul the regulatory framework, and this nervous mood was further heightened as the ratings agency, Standard & Poor's, lowered its ratings and revised its outlook on 22 US banks.

European economic data

On a positive note, the ZEW German investor confidence index jumped to a three-year high of 44.8 points in June, on hopes that Europe's largest economy will recover later this year. However, earlier in the week, the European Central Bank warned that eurozone banks may face another \$283bn in write-downs on bad loans and securities over the next two years.

Commodities & Currencies

On commodity markets, the oil price briefly advanced to an eight-month high at \$73 a barrel, boosted by suggestions that the Chinese economy was recovering faster than expected. However, the oil price dropped below the \$70 a barrel mark shortly afterwards, as fears grew that the recent gains in commodity prices may have been overdone. The oil price finished the week at just over \$69 a barrel. In currency markets, despite some volatility intra-week, the €/ \$ rate finished the week unchanged at just over 1.39.

	Index	Year to Date Return 31.12.08 to 19.06.09		1 Week Return 12.06.09 to 19.06.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	2.0	1.9	-2.6	-2.2
US	NASDAQ	15.9	15.8	-1.7	-1.3
Europe	FT/S&P Europe Ex. U.K.	1.9	1.9	-3.5	-3.5
Ireland	ISEQ	20.1	20.1	-5.2	-5.2
UK	FTSE 100	-2.0	10.7	-2.2	-1.8
Japan	Topix	7.0	0.9	-3.3	-0.8
Hong Kong	Hang Seng	24.6	24.5	-5.1	-4.7
Australia	S&P/ASX 200	4.8	19.8	-4.0	-4.3
Bonds	Merrill Lynch Euro over 5 year Govt.	-1.1	-1.1	0.7	0.7

Global Equities



United States

Overview

US equity markets ended the week in negative territory, as disappointing economic data and earnings reports cast doubt over economic recovery.

Fedex – The package delivery company reported a larger-than-expected quarterly loss of \$876 million, for the fourth quarter ending 31st May. The company cited factors such as, the recession's impact on package volumes and rising fuel costs as reasons for its poor performance. This result compares to a loss of \$241 million for the same quarter, a year earlier.



Europe

Overview

Amid renewed concerns over the recovery prospects for the global economy, and warnings from the European Central Bank that banks could face further write-downs on bad loans by the end of next year, European markets fell by over 3%.

GlaxoSmithKline – The pharmaceutical company announced a strategic agreement with Indian generic drug maker, Dr. Reddy's, to develop and market selected products across an extensive number of emerging markets. This move will provide GlaxoSmithKline exclusive access to Dr. Reddy's portfolio and future pipeline of more than 100 products.



Ireland

Overview

The ISEQ followed the rest of the world lower, ending the week almost 5% down, with the banking and resources sectors leading this decline.

Allied Irish Banks plc – The bank announced that in a debt swap exercise with its bond holders, it has raised approximately €1bn, adding to its capital base. This strengthens the bank's position to absorb bad debts arising from impaired property loans.



Asia Pacific

Overview

Asian stocks finished the week in the red, as fears of a global recession persist. Both the Topix and Hang Seng indices staged a sharp retreat, ending the week down, by 3% and 5% respectively. Elsewhere, citing an improvement in exports and production, the Bank of Japan upgraded its economic assessment, suggesting that the economy's recession may be easing. Chinese financials outperformed on talk of further strong loan data in June, while materials slumped on global growth worries.

Bonds

Bonds gained over the week, as investors responded to equity losses and benign inflation figures. The Merrill Lynch over 5 year government bond index rose by 0.7%.

Global Outlook

- The general feeling amongst investors is that economic data has stabilised after being in freefall earlier this year. The hope is that an inventory rebound will help growth in the short-term, and that policy action will put a more lasting floor under activity in the medium-term. Signs of less stress in the financial system have bolstered these hopes. However, a lot of the 'green shoots' sentiment has its origin in China and Asia. This is a concern, given that the region is export-oriented and highly dependent on the US consumer.
- 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.
- Short rates have likely reached their cyclical lows in the major economies – at somewhere between 0% and 1% – and the question is for how long short rates can stay at these levels. The success of the quantitative easing (QE) programs around the globe has been mixed. The way in which US mortgage rates have been "allowed" to rise in recent weeks is a concern. In any event, the major central banks are already talking about exit strategies from these initiatives.
- Bonds performed quite badly, while investors re-embraced risk assets and authorities disappointed with their QE policies; many commentators have also speculated on the long-term inflation risks from the current policy mix. Peripheral bond markets, such as Spain and Ireland, have been helped by "solidarity" expressions from the EU and ECB and a more positive attitude towards risk assets. 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 in recent weeks. At least in the short-term, bond markets in general have probably reached support levels and a more constructive period may lie ahead.
- Economic 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. The stress test of the US banks was choreographed very well, and corporate debt markets have also been more supportive. While the general feeling in the equity markets is that we may get a period of consolidation followed by further gains, at this stage the burden of proof may be moving more towards the bulls; there could easily be some disappointment with policy initiatives or the pace of improvement in real economic data.
- Currently, the funds are close to neutral in equities and overweight bonds, versus the manager average. Within equity sectors, the funds are overweight technology & financials and underweight healthcare & consumer staples. 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 in the Pacific Basin.

This outlook does not constitute an offer and should not be taken as a recommendation from Eagle Star/Zurich. Advice should always be sought from an appropriately qualified professional.

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