

Global Overview

Equity markets retreat further

Equity markets fell further last week with the main losses coming in the final part of the week, as mounting worries over the possibility of eurozone sovereign debt default, Chinese monetary policy tightening and mixed economic data releases cast further doubt over the strength of the global economic recovery.

US economic data

In contrast to last week's better-than-expected US fourth-quarter economic growth rate, the monthly jobs report for January suggested a loss of 20,000 jobs and, combined with disappointing weekly unemployment data, unnerved investors. On a positive note, US ISM manufacturing data for January surprised on the upside.

European economic data

As expected, the European Central Bank left interest rates unchanged at 1%, with ECB President Jean-Claude Trichet signalling that officials will wait for further signs of economic recovery before withdrawing emergency support.

Currencies and oil

Following the release of disappointing economic data, equities and commodities bore the brunt of the selling, as eurozone debt concerns drove investors out of euro-denominated assets and into the relative safety of the US dollar. The dollar gained almost 2% against the euro, the €/€ rate ending at 1.36. On commodity markets, the oil price peaked just above \$78 a barrel mid-week, before succumbing to sovereign debt worries to end the week at \$71 a barrel, while gold fell by almost 3%.

| | Index | Year to Date Return 31.12.09 to 05.02.10 | | 1 Week Return 29.01.10 to 05.02.10 | |
|-----------|--------------------------------------|---|-----------|---------------------------------------|-----------|
| | | Local Currency % | Euro % | Local Currency % | Euro % |
| US | S&P 500 | -4.4 | 0.5 | -0.7 | 1.2 |
| US | NASDAQ | -5.6 | -0.8 | -0.3 | 1.6 |
| Europe | FT/S&P Europe Ex. U.K. | -7.6 | -7.6 | -4.3 | -4.3 |
| Ireland | ISEQ | -2.9 | -2.9 | -2.9 | -2.9 |
| UK | FTSE 100 | -6.5 | -4.9 | -2.5 | -3.0 |
| Japan | Topix | -1.7 | 7.7 | -1.0 | 2.1 |
| Hong Kong | Hang Seng | -10.1 | -5.7 | -2.3 | -0.5 |
| Australia | S&P/ASX 200 | -7.3 | -6.4 | -1.2 | -2.3 |
| Bonds | Merrill Lynch Euro over 5 year Govt. | 1.3 | 1.3 | 0.6 | 0.6 |

Global Equities



United States

Overview

Despite the release of mostly better-than-expected corporate earnings results (Time Warner, Visa, Cisco, News Corp and Dow Chemical), US markets retreated last week as disappointing labour data added to investor worries regarding European sovereign debt.

Cisco – Sales and earnings at the equipment-maker outpaced analysts' forecasts as more customers resumed upgrading their networks. Profit rose to \$1.9 billion, from \$1.5 billion in the same quarter, a year earlier.

Pfizer – The drug-maker posted fourth-quarter earnings of \$767 million, from \$266 million, a year earlier. Despite this result failing to meet analysts' estimates, the company noted that acquisition and restructuring charges, along with higher costs, had weighed down on profit but that it remains committed to its long-term forecast.



Europe

Overview

Concerns over the ability of Greece, Spain and Portugal to finance their massive budget deficits prompted heavy selling across Europe, and resulted in European markets ending the week 4% lower.

Vodafone – The mobile phone operator raised its outlook, after posting a 10.3% rise in third-quarter revenue of £11.5 billion, well ahead of forecasts, largely due to cost-cutting and improved trading trends across Italy, Britain and Germany.



Ireland

Overview

The Irish market finished the week almost 3% lower, with the financial sector, Bank of Ireland (-11%), AIB (-15%) and Irish Life & Permanent (-11%), leading this decline.



Asia Pacific

Overview

Equity markets across the region fell with investors troubled by the prospect of Chinese monetary tightening taking some of the heat out of the global economic recovery. Hong Kong's Hang Seng index fell by over 2%, going below the 20,000 mark for the first time since September. Elsewhere, the Reserve Bank of Australia surprised markets by maintaining interest rates unchanged at 3.75%, citing China's efforts to reduce the degree of stimulus to its economy as the main reason behind this decision.

Bonds

Eurozone bonds recorded healthy gains last week as equity and commodity markets fell sharply and investors opted for the perceived safety of government bonds. German bonds continued to outperform peripheral markets, such as Greece, Spain and Portugal, as fears remain that their debt crises could trigger a default in the eurozone. The Merrill Lynch over 5 year government bond index gained 0.6% on the week.

Global Outlook

- The global economy is expected to be 3% stronger in 2010, following a fall of just over 2% last year. A key issue is whether private sector demand in Europe and the US is strong enough to allow governments and central banks to withdraw some of the massive stimulus they have been providing. Note that while strains within the financial system have eased considerably, bank lending is still impaired. Partly for this reason, policy makers remain somewhat cautious on the economic outlook and this remains a key variable to watch during the year.
- Policy makers and academics continue to grapple with the long-term implications of the credit burst and the unintended consequences of policy actions. However, market participants work with a shorter time horizon and such longer-term worries tend to be aired only periodically, such as now when equity market sentiment has deteriorated.
- Short rates remain between 0% and 1% in the major economies, although other developed economies such as Australia have already increased rates. Investors keep growing nervous about rate expectations in the US and Europe only for policy makers to make soothing comments. At the same time, the latter want to exit from emergency policy settings as quickly as conditions permit, a balancing act which continues to be difficult to communicate. It is notable that end-2010 rate expectations in the US, UK and eurozone are still more or less at their cycle lows. On balance, therefore, investors expect that low rates will persist for some considerable time.
- For bond markets, inflation data remains supportive. As was the case for much of last year, the "elephant in the room" remains the exit from emergency policy settings, which is bound to have some impact on bond markets, and these concerns continue to keep bond markets in a broad trading range. Following the recent equity sell-off, which has helped bond markets somewhat, we may be closer to the top of that price range at the moment. In the eurozone, the performance of peripheral bond markets, especially Greece, has become a significant issue beyond the bond markets themselves. It is also now a key test as to the efficacy of the eurozone as a single currency area.
- Equity market optimism has been dented by an almost 10% correction from early 2010 highs. Worries over a hard landing in China, plus fiscal risks in the eurozone, have offset strong corporate earnings. The technical picture has certainly deteriorated and investors are clearly nervous. However, valuations are now reasonable, liquidity conditions should remain constructive and markets are somewhat oversold. Near term, we need to see whether markets can stabilise before turning more positive again.
- Currently, the funds are closer to neutral in equities and overweight bonds, versus the manager average. Within equity sectors, the funds have gone much closer to neutral but are still overweight technology. Geographically, the funds are pretty neutral although they remain underweight in Ireland and slightly overweight in Japan.

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

