

Eagle Star Investments

Weekly News

22nd September 2008

Global Overview

Week of extremes for equity markets

Early last week, equity markets fell to lows not experienced for over five years as the ongoing credit crisis claimed its biggest casualties to-date. However, most markets managed to finish the week only slightly lower as details emerged on Friday about a government package to help financials, causing record one day gains on markets.

Banking concerns

With the US Treasury having only recently stepped-in to guarantee the survival of government sponsored entities, Fannie Mae and Freddie Mac, who are both crucial to the mortgage market in the US, last week saw the credit crunch claim its largest casualties. Firstly, Lehman Brothers filed for bankruptcy after a buyer could not be found for the struggling investment bank, then AIG had to be bailed out by the Fed as it failed to raise new cash and, finally, a takeover of Merrill Lynch was announced up by Bank of America, ending the near-100 year independence for the global financial services provider. As these developed, central banks around the world moved to inject \$180 billion into the financial system to try ease dollar liquidity concerns as banks ceased lending to each other. While this helped support markets, talk from the US Government about a financial package to take bad debts off banks' balance sheets sparked a major recovery in stocks worldwide towards the end of the week. It is hoped that this unprecedented \$700 billion bank bailout might prevent further financial market turmoil that risks hurting economies worldwide.

Short-selling

Mainly to protect financial stocks, regulators in the UK, Ireland and the US introduced temporary bans on short-selling. Short-selling is the practice of selling borrowed shares in the hope of repurchasing them later at a lower price. This is done in an attempt to profit from an expected decline in the price of the shares. Financial stocks have been subject to extreme falls in share-prices recently due to this.

Commodities

The oil price fell heavily at the start of the week as investors' fears for economies worldwide were shaken by concern of further banking problems. As details emerged about the possible rescue package from the US Treasury and the dollar weakened slightly, oil prices experienced strong gains, finishing the week at just over \$104 per barrel.

	Index	Year to Date Return 31.12.07 to 19.09.08		1 Week Return 12.09.08 to 19.09.08	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-14.5	-13.5	0.3	-1.2
US	NASDAQ	-14.3	-13.2	0.6	-1.0
Europe	FT/S&P Europe Ex. U.K.	-23.9	-23.9	-0.8	-0.8
Ireland	ISEQ	-40.4	-40.4	-4.8	-4.8
UK	FTSE 100	-17.7	-23.0	-2.0	-1.0
Japan	Topix	-22.1	-17.6	-2.4	-3.4
Hong Kong	Hang Seng	-30.5	-29.5	-0.1	-1.4
Australia	S&P/ASX 200	-24.2	-27.5	-2.0	-2.2
Bonds	Merrill Lynch Euro over 5 year Govt.	1.2	1.2	-0.7	-0.7

Global Equities



United States

Overview

US markets suffered losses similar to the aftermath of the September 11th attacks as financial turmoil gripped investors early in the week. It was to be a week of extremes though, as equities went on to rally and experience their biggest gains in years, to finish the week marginally higher.

Lehman Brothers – One of the largest investment banks filed for bankruptcy last Monday. Some parts of the business are being bought though, with Barclays Bank buying Lehman's core U.S. broker-dealer business in a \$1.8 billion deal.

Merrill Lynch – Another financial company badly affected by a lack of liquidity over the past few weeks was Merrill Lynch. The world's largest retail brokerage was subsequently bought by Bank of America for \$50 billion.



Europe

Overview

As credit concerns peaked, European markets experienced the same volatility as the rest of the world and finished the week slightly lower. The financial weighting in the UK market helped it to a massive 9% rise on Friday.

Halifax Bank of Scotland – The biggest story of the week was Lloyds TSB agreeing to merge with the troubled mortgage and retail bank, HBOS, for over £12 billion. This deal was encouraged by the government amid fears of financial turmoil and now creates one of the largest mortgage and savings banks in the UK.



Ireland

Overview

After hitting five-year lows during the week, the ISEQ soared by over 10% on Friday as financials experienced massive gains on renewed optimism for the sector and a ban on short-selling was imposed.

Bank of Ireland – Amid the financial turmoil which was developing worldwide, Bank of Ireland announced that it was to cut its dividend in half and post a drop in first-half profit as borrowers struggle to repay loans as economic growth slows.



Asia Pacific

Overview

After four straight days of big losses, Asian markets gained strongly on Friday, on hopes that the US Treasury's package to remove bad debts for banks balanced sheets will help ease liquidity concerns in the region. China and Hong Kong surged over 9% on Friday to substantially reduce the weeks' losses.

China – The Chinese government also announced a package to support the stock market. This would involve a sovereign wealth fund purchasing shares in companies, while also scrapping the 0.1% stamp duty on the purchase of equities.

Bonds

Having gained early in the week, bonds retreated to finish in negative territory as optimism grew that the proposed US package will see a reduction in risks to the financial system, renewing investors appetite for equities. The Merrill Lynch >5 year government bond index fell 0.7% on the week.

Global Outlook

- Global growth rates have moderated from a very high level, with the cumulative effect of previously high oil prices and the credit crisis adding downside risks to this picture. US data has been 'recession-like' while the eurozone economy has slowed abruptly in recent months. Asian (ex-Japan) economies are performing reasonably well, although a slower global economy is clearly impacting. Japan's lack of exposure to the credit crunch has been a positive, but its export dependence a clear negative. Weaker growth and the 30% fall from the high in oil prices have helped lower inflation expectations and taken some of the pressure off interest rates.
- US interest rates expectations have gyrated wildly in the past few weeks; currently investors expect the Fed to keep rates unchanged at 2% coming into the year end. Comments after the Fed's meeting last week only served to reinforce that expectation.
- While the ECB has been surprised by the recent slowdown in the eurozone economy, so far this has had little impact on its pre-occupation with inflation risks. Investors are currently anticipating that rates will remain unchanged at 4.25% for some months to come.
- A strong bond market was thrashed at the end of last week by the US rescue package as investors embraced risk assets, shunning the safe haven market of government bonds. It's too early to see to what extent bond-supportive factors reassert themselves in the coming weeks, although a continuation of low interest rates is probably essential to the global healing process.
- The announcement of the US rescue package last week should remove the 'Armageddon' risks for the US financial system and global equity markets. While the headwinds for equities are still strong, a more positive sentiment will be underpinned by this move. With a cyclical slowdown in global earnings most likely in the next year, the key now will be to keep interest rates low enough to support equity prices.
- The US dollar still has a lot of valuation support versus European currencies. However the funding implications of last week's rescue package may undermine sentiment over the next while and see some reversal in the recent dollar rally. A volatile period is the most likely pattern over the next few months.
- The funds covered in equity exposure last week and are currently neutral in equities and still slightly long bonds versus the manager average. Within equity sectors positions are reasonably balanced at the moment. Geographically the funds have an underweight position in Ireland, the Pacific Basin and Japan, an overweight in the US and Europe and are more neutral in the UK.

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.

Eagle Star Life Assurance Company of Ireland Limited

Eagle Star House, Frascati Road, Blackrock, Co. Dublin, Ireland.

Telephone: 01 283 1301 Fax: 01 283 1578 Website: www.zurich.ie

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