Eagle Star Investments

Weekly News

2nd February 2009

Global Overview

Equity markets gain

For the first time in 2009, last week saw most equity markets finish the week higher. However, some of the week's early gains were given back following a further batch of poor economic data; notably though, not as bad as investors had feared.

European inflation figure

Data compiled by the European Union's statistics office estimated that inflation has retreated further. Consumer prices rose 1.1% year-on-year in January, following 1.6% in December and 2.1% in November. Worryingly, though, unemployment was reported at roughly 8%, its highest since November 2006.

US GDP data

GDP data confirmed that the US economy experienced its sharpest contraction in almost 27 years after it shrank by 3.8% in Quarter 4. It is hoped that this figure can be helped over coming quarters by President Obama's stimulus package, which is currently gathering momentum, and rumours of the setting up of a 'bad-bank' to absorb troubled assets.

Credit ratings

Credit rating agency, Moody's, warned that Ireland is in danger of losing its AAA sovereign debt rating, as it cut its outlook from 'stable' to 'negative'.

Currencies

As investors' appetite for risk waned following signs of deteriorating economic conditions, both the US dollar and Japanese yen gained due to their safe haven status. This helped the €/$ rate finish the week at 1.28. Sterling also gained versus the euro as fears about the UK banking system were soothed, causing the €/£ to end at 0.88, a 6% drop on the week.

Index		Year to Date Return 31.12.08 to 30.01.09		1 Week Return 23.01.09 to 30.01.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-8.6	-0.5	-0.7	0.0
US	NASDAQ	-6.4	1.9	-0.1	0.7
Europe	FT/S&P Europe Ex. U.K.	-6.4	-6.4	3.4	3.4
Ireland	ISEQ	-1.4	-1.4	1.5	1.5
UK	FTSE 100	-6.4	1.0	2.4	8.9
Japan	Topix	-7.6	1.5	2.7	2.1
Hong Kong	Hang Seng	-7.7	0.3	5.6	6.3
Australia	S&P/ASX 200	-4.9	-6.3	5.9	4.1
Bonds	Merrill Lynch Euro over 5 year Govt.	-2.6	-2.6	1.9	1.9

Global Equities

United States

Overview

US equities finished the week marginally lower as efforts to stimulate the economy and stabilise the banking system were overshadowed by further poor economic data and disappointing corporate earnings.

Procter & Gamble – Consumer stocks were hit by a sell-off after quarterly figures from Procter & Gamble were weaker than expected, while the company also lowered its annual forecast. The biggest consumer product company reported the stronger dollar as hurting its overseas sales, something that may hit many other consumer stocks.

Alcoa – JP Morgan increased its 2009 loss estimate for the largest U.S. aluminium producer, Alcoa, and said the metal's price may not rebound as much as expected. There was a 7% decrease in the shares over the week.

Europe

Overview

European stocks rose last week, led by the biggest weekly rally in banks in two months, after Barclays said it will not need Government funding and the U.S. prepared a plan to absorb toxic bank assets.

Barclays Bank – Barclays soared by a massive 107%, having fallen over 90% in the previous two weeks, after it said its investment bank and the Lehman Brothers Holdings North American assets acquired last year were driving profits. While Barclays wrote down £8bn in credit assets in 2008, it said it still exceeds the regulators' capital requirement by £17bn.

Ireland

Overview

The Irish market finished the week higher with banking and resource stocks leading the way.

Banks – AIB and Bank of Ireland were the leaders on the ISEQ last week, rising 63% and 55% respectively. Expectations are that the Irish Government is close to finalising a bank recapitalisation plan, involving a combined €7-8bn capital injection into both banks and the establishment of an insurance scheme to protect the banks against potential bad debts on loans.

Asia Pacific

Overview

Despite the background of steadily worsening economic data, most Asian markets gained over the week amid hopes for the US stimulus package and a continued recovery in banking stocks.

Bonds

Eurozone bonds recovered from the previous week's 3% sell-off after data confirmed that inflation is continuing to cool. Investors' expectations that the ECB may cut rates below the 2% level this month are increasing, despite the already aggressive cuts seen over the past few months. The Merrill Lynch >5 year Government bond index rose 1.9% last week.

Global Outlook

- The global economic situation remains fragile with policymakers working to prevent a deflationary slump through aggressive interest rate reductions, higher Government spending and extraordinary interventions in the financial markets. So far, there seems to be some stabilization in the forward indicators of economic activity and current economic data is no longer coming in as bad as analysts have been expecting. Output and employment is likely to remain very weak for some months yet.
- Much of the effort of policymakers has been directed at trying to address the crisis within the banking system, with the aim of reducing the funding costs of banks and getting credit flowing back to the real economy. There has been some success in this area, with money market funding costs falling significantly. Currently, the creation of "bad-banks" - which would take poor quality assets off banks' balance sheets - is firmly on the agenda in a number of countries.
- Global short rates will remain low or fall further over the coming weeks and months. Although the ECB has said it will not lower rates this week, investors remain convinced that rates will fall closer to 1% in the next few months from the current level of 2%. With short rates close to zero in the US, the Fed is focused on unconventional policies such as driving down mortgage rates and the rates that companies pay to raise debt financing. Part of that policy may involve active purchases of Government bonds.
- The prices of Government bonds have fallen this year for several reasons - profit taking, concerns over rising Government supply, sovereign ratings' concerns and even talk of a bubble in bond markets. While the current level of short and long-term rates may be seen as "emergency" levels and hence not sustainable, it remains the case that the economic backdrop should be bond-supportive for a while to come. Direct or indirect purchases of Government bonds by central banks would also be a support.
- Equity markets have weathered an onslaught of dreadful economic news and employment data, giving some support to the idea that markets have already discounted a very weak economic picture going forward. However, the ease with which early new year gains were erased confirms that sentiment and conviction remain weak. There is still some optimism surrounding the new unconventional policies of the Fed, the Obama fiscal measures and the stimulative actions of other economies. As before, the key to any sustainable rally remains the unfreezing of the money markets and the re-opening of the corporate bond markets. Markets will remain volatile and the direction uncertain for some time to come.
- Currently the funds are slightly overweight in both equities and bonds versus the manager average. Within equity sectors, the funds are overweight healthcare and technology and underweight basic materials and utilities. Geographically the funds have an underweight position in Ireland and Europe, are neutral in Japan and slightly overweight in the Pacific Basin, the US and the UK.

Print Ref: CSA63

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

ZURICH®