

# Eagle Star Investments

Weekly News 6th July 2009

## Global Overview

### Equity markets retreat further

Equity markets declined for the third week in a row following more signs that a sustained economic recovery may be further off than investors expected. Investors fear that markets may have recovered too far, too quickly and will be anxiously awaiting the earnings releases over the coming weeks for indications of the path to recovery.

### US economic data

Last week saw more disappointing economic figures in the US. Employment data released showed that numbers employed in June fell by a worse-than-expected 467k, pushing the unemployment rate to 9.5%, which also contributed to a fall in consumer confidence levels. This has increased concerns that stocks may be less attractive on a valuation basis following the recent rally.

### ECB rate decision

At its monthly meeting, the ECB kept interest rates unchanged at 1% in an effort to revive the worst economic slowdown in six decades. ECB President Jean-Claude Trichet feels "the current rates are appropriate", but also refused to rule out the possibility of further cuts. The ECB is expecting a 4.6% contraction in GDP in 2009, before seeing a modest recovery in 2010, while unemployment is predicted to reach 11.5% during 2010.

### Worries surrounding US\$

India became the latest country to join Russia and China in questioning the use of the US dollar as the world's main reserve currency. Despite this, the dollar gained against most major currencies over the week, as speculation mounted that the economic recovery is faltering, boosting the demand for the safety of the US currency. The €/€ rate finished the week just above 1.39.

	Index	Year to Date Return 31.12.08 to 03.07.09		1 Week Return 26.06.09 to 03.07.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-0.8	-1.0	-2.4	-1.7
US	NASDAQ	13.9	13.6	-2.3	-1.5
Europe	FT/S&P Europe Ex. U.K.	0.4	0.4	0.0	0.0
Ireland	ISEQ	14.9	14.9	0.1	0.1
UK	FTSE 100	-4.5	6.7	-0.1	-0.7
Japan	Topix	7.1	1.1	-0.7	-0.8
Hong Kong	Hang Seng	26.5	26.2	-2.1	-1.4
Australia	S&P/ASX 200	2.8	16.1	-1.9	-2.5
Bonds	Merrill Lynch Euro over 5 year Govt.	0.7	0.7	0.9	0.9

## Global Equities



### United States

#### Overview

Disappointing economic data covering unemployment rates, consumer confidence and house sales pushed markets back into negative territory for 2009. Investors will be looking for a new stimulus to move prices higher when earnings releases begin on July 7th, with Alcoa.

**Auto sector** – A recovery in the auto sector still seems a way off if the most recent sales are anything to go by, as once again they came in below expectations, although this could partly be due to the imminent car scrappage scheme. Chrysler reported sales plunged by 44%, while Toyota, Honda and General Motors logged declines of roughly 30%.

**AIG** – The insurer bailed out by the Federal Reserve said that valuation declines on credit-default swaps sold to European banks could have a "material adverse effect" on the company's upcoming results. AIG fell the most in the S&P 500, slumping by 38%.



## Europe

### Overview

European markets finished the week relatively flat, despite interest rates being kept unchanged, as unemployment continued to rise across the region.

**British Airways** – Europe’s third-largest airline, British Airways, announced it will extend capacity reductions, ground planes and delay deliveries of its super jumbo aircraft as demand for air travel shows little signs of rebounding amid the recession.



## Ireland

**Elan** – Shares in Elan soared on the news that Johnson & Johnson is pumping \$1bn into the company, plus a \$500m investment for the firm’s share of drug development costs on a range of Alzheimer’s treatments, including bapineuzumab. This investment reduces forecast 2009 net-debt by 64%.



## Asia Pacific

### Overview

Asian markets finished the week lower, as economic data across the region undershot expectations and commodities retreated from their recent highs. One of the few countries to experience growth in GDP in Q1, Australia, is now feeling the effects of a sharp downturn. Reports showed exports dropped to a 14-month low, bank lending fell and home-building approvals declined by the most since 2002, as the effect of a boost in spending following the recent stimulus package begins to fade.

## Bonds

Eurozone bonds gained further last week, as investors fear that the economic recovery is faltering. The ECB also boosted the prospect for bonds after refusing to rule out more cuts in the key interest rate. The Merrill Lynch over 5 year government bond index rose by 0.9%.

## 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, although, outside of China, bank lending is moribund. A lot of the ‘green shoots’ sentiment has its origin in China and Asia but that comes with some health warnings. This is because China’s growth is internally focused and not really helping the rest of the world, while Asia’s growth is still dependent on exports to a weakened US consumer sector.
- 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%. Investors have scaled back thoughts of rates rising in the near term after comments from various central banks. The success of the quantitative easing (QE) programs around the globe has been mixed, however. The manner in which US mortgage rates were “allowed” to rise in the past couple of months seemed premature. In any event, the major central banks still feel in somewhat of a bind, trying to keep policy easy while talking about exit strategies from these initiatives.
- Bonds had 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, if anything. At least in the short-term, bond markets in general have rallied from support levels and have entered a more constructive phase.
- “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 had been that we would get a period of consolidation followed by further gains, at this stage the thinking is probably changing somewhat and the burden of proof may be moving more towards the bulls. Recent events have shown that 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, more neutral financials and underweight industrials. 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.