Eagle Star Investments

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ZURICH

Global Overview

Most equity markets fall further

Equity markets remained volatile over the week, as disappointing US jobs data, slowing growth in China along with the worsening government debt crisis in Europe, most recently Hungary, weighed on investor sentiment. The VIX index measuring stock market volatility ended the week 11% higher.

US economic data

Latest headline non-farm payroll numbers for May came in weaker-than-expected, due to weak growth in the private sector.

Latest Chinese PMI data

Chinese Premier Wen Jiabao commented that global growth remained vulnerable to the debt crisis after the country's official purchasing managers' index disappointed, falling to 53.9 in May from 55.7 in April.

Euro weakness continues

Fears that the eurozone's debt crisis could result in slower growth worldwide combined with rising tensions in the Middle-East, fuelled safe-haven demand for the dollar, causing the single currency to weaken further. Concerns that Hungary may default, sent the country's currency to an almost 15-month low against the dollar, dragging the €/$ rate below 1.20 for the first time since March 2006. The €/$ rate ended the week at 1.20, a weakening of 2.5%.

Commodities

The oil price finished at $71.5 a barrel, a fall of 3% over the week, based on fears that global economic recovery will be slower-than-expected.

	Index	Year to Date Return 31.12.09 to 04.06.10		1 Week Return 28.05.10 to 04.06.10	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	-4.2	9.3	-1.2	0.7
US	S&P 500	-4.5	13.9	-2.3	0.2
US	NASDAQ	-2.2	16.6	-1.7	0.8
Europe	FT/S&P Europe Ex. U.K.	-6.7	-6.7	-0.8	-0.8
Ireland	ISEQ	0.3	0.3	1.5	1.5
UK	FTSE 100	-5.3	1.4	-1.2	1.4
Japan	Topix	-1.9	18.7	1.3	2.8
Hong Kong	Hang Seng	-9.6	7.3	0.1	2.5
Australia	S&P/ASX 200	-8.6	0.2	-0.2	0.0
Bonds	Merrill Lynch Euro over 5 year Govt.	3.1	3.1	-1.0	-1.0

Global Equities

United States

Overview

The S&P 500 fell by 2.3% over the week, as Eurozone sovereign debt concerns along with disappointing employment data fuelled concern that Europe's debt crisis is spreading into the financial system.

Energy Sector – Coverage of the Gulf of Mexico oil spill dominated market news and energy companies lost ground. Anadarko Petroleum Corp., the Texas oil company that owns a stake in BP's leaking Gulf of Mexico well, declined by 14%.

Alcoa – Elsewhere, the largest US aluminium producer fell by almost 7%, to its lowest level since July 2009. Elsewhere, Home Depot and Caterpillar, the world's largest-maker of construction equipment, both declined by 5%.

Europe

Overview

European markets fell by 1% in response as credit-ratings downgrades in peripheral Europe triggered concern that European governments will struggle to fund deficits.

British Petroleum – Shares at the oil company sank a further 13% last week in response to concerns over the oil spill.

Prudential – The company terminated the agreement to buy AIG's Asian insurance unit, AIA, for $35.5 billion, after AIG directors rejected its last-minute attempt to have the price reduced.

Ireland

Overview

Despite increased volatility in global equity markets, the Irish market bucked the trend, gaining 1.5% over the week.

Ryanair – The airline company announced that a one-off dividend worth up to €500 million (£341 million) will be paid to in October, subject to shareholder approval.

Asia Pacific

Overview

Despite increased uncertainty experienced in global equity markets, Asian markets gained over the week.

Reliance Industries – The company announced that it has "in principle" approved a plan to sell as much as a 26% stake to a private equity investor.

Bonds

Despite investors' move away from risky equity markets towards safer assets, the Merrill Lynch over 5 year government bond index fell by 1% over the week. Growing worries over eurozone sovereign debt caused spreads between core and peripheral bond markets to widen further. Indeed, even semi-core countries like Austria and Belgium underperformed dramatically as the debt crisis continues.

Global Outlook

- Most forecasters anticipate that the global economy will expand by around 3.3% this year, although financial market volatility may jeopardise this somewhat. Inflation pressures globally should remain modest, reflecting weaker data in US, Europe and Japan and offsetting strength in emerging economies and Asia. A key issue is whether the private sector in Europe and the US can grow without continued massive government stimulus. Doubts about this plus constrained bank lending, make central banks still cautious on the economic outlook.
- Sovereign creditworthiness, concerns about the long-term consequences of the credit burst, and the unintended consequences of a myriad of policy actions, are once more centre stage after the Greek debt contagion.
- Short rates continue to be set at emergency levels in Europe and the US, although they have risen somewhat in some of the stronger economies such as Australia, India and China. It's now clear that developments in Greece will temper the timing of policy changes across the globe, not just in the eurozone. It is notable that end 2011 rate expectations are at new cycle lows in the US, UK and eurozone. Investors expect that low rates will persist for some time.
- Inflation data, short rates, liquidity conditions and risk aversion continue to be of general support to the major bond markets. German and US bond markets continue to benefit from a flight away from peripheral markets and discussions about "disinflation", with the collapse in the functioning of the Greek bond market refocusing minds on the many implications of highly-indebted countries. ECB bond purchases have had very limited success so far and the longer-term success of the euro project will need a more far reaching set of proposals than we have seen to date. Peripheral bond market spreads have been widening again; the situation is still very delicate, investor conviction is low and the message from the authorities is not yet coherent enough to be persuasive.
- The 6% decline in global equities so far this year masks very substantial volatility, three 8%+ falls and one 14% recovery. One result of the latest fall is that policy will remain easier for longer, especially in Europe, and this gives some forward support to risk markets. Equally, it is notable that after a 20% fall in Chinese equity prices this year, policymakers' rhetoric is becoming more moderate. However, in most markets nervousness is still the order of the day with investors focusing on downside risks to forward economic data and corporate earnings. Further volatility and falls are quite possible in the near-term, before opportunities emerge, because investors fear a lack of co-ordination at the global policy level. However poorly it is being done at the moment, we should not discount the determination of policymakers to offset risk aversion in equity and credit markets.
- Currently, the funds remain underweight equities and overweight bonds, versus the manager average. Within equity sectors, the funds are reasonably balanced, with a reduced, but still overweight, position in technology. Geographically, the funds are underweight in Ireland, the UK, the US and Europe, and are neutral in Japan and the Pacific Basin.

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