ZURICH®

5th October 2015

The week gone by

Global **equities** (in euro terms) saw further weakness on Monday and Tuesday but managed to rally towards the end of the week as markets appeared to be oversold on a technical basis. Investors continue to focus on China as well as the timing of US interest rate rises. There is now only a 30% chance of lift-off of US rates in December 2015 with a 50% chance in March 2016. Equities remain well valued on a yield basis compared to cash and bonds whilst price/earnings multiples have contracted somewhat.

The global index (in euro terms) rose marginally last week and has given a total return year-to-date of plus 2.1%. Technically, the Index remains well below the critical 200-day moving average but is over 4% higher than the recent low on 24th August. There was a mixed bag of returns from the major equity **markets** in local currency terms last week ranging from plus 1.5% in Hong Kong to minus 3.4% in Ireland. The influential US market was up 1.0% on the week.

Eurozone **bond** prices were up by 1.4% on the week, reacting to changing expectations as to the timing of US rate rises. Overall, eurozone bonds have given a return of plus 2.4% year-to-date although prices remain well-off their mid-April peaks. The German 10-year bond yield fell from 0.65% to 0.51% last week; it had hit an all-time-low of 0.06% in April. Equivalent US yields fell from 2.16% to 1.99%. **Commodity** prices in general were down by 0.8% (in dollar terms) last week and are down by 15.6% so far in 2015.

	Index	1 Week Return 25.09.15 to 02.10.15		Year to Date Return 31.12.14 to 02.10.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	0.1	0.1	2.1	2.1
US	S&P 500	1.0	0.5	-5.2	2.0
Europe	FT/S&P Europe Ex. U.K.	-0.5	-0.5	1.4	1.4
Ireland	ISEQ	-3.4	-3.4	16.6	16.6
UK	FTSE 100	0.3	0.0	-6.6	-2.0
Japan	Topix	-0.6	-0.3	2.7	10.6
Hong Kong	Hang Seng	1.5	1.0	-8.9	-1.9
Australia	S&P/ASX 200	0.2	-0.3	-6.3	-13.5
Bonds	Merrill Lynch Euro over 5 year	1.4	1.4	2.4	2.4

The week ahead

- The Federal Reserve FOMC minutes (Thursday) will provide some insight into the decision not to raise interest rates in September and the context of the statement concerning the risks from 'global economic and financial developments'.
- At the Eurogroup meeting (Monday), finance ministers will discuss programme reviews in Greece and Cyprus. At the ECOFIN meeting (Tuesday), ministers will review the tax treatment for companies involved in cross-border business.
- In the UK, at the Bank of England MPC meeting (Thursday), it is expected that the Bank rate and asset purchases to remain unchanged at 0.5% and £375bn respectively.
- In Japan, at the BoJ September monetary policy meeting (Wednesday), it is likely that policy will remain unchanged.

Global Outlook

The existing gap between emerging and developed market growth appears to be getting wider. US and Western Europe data remains solid; with upward revisions to 1H 2015 GDP figures. News from emerging markets (EM) depicts a challenging environment, with GDP growth running below 4%; following a stream of downward revisions. The hope is that developed market strength can weather emerging market weakness. However, Global manufacturing data would give cause for concern as it has not improved so the outlook for emerging markets poses some downside risk. Volatility in the US and Europe remains elevated and risk assets are still being sold, with the major US and European indices all down last week once again.

United States

- Non-farm payroll numbers coming in behind expectations caused the market to push out expectations on timing of rate rises, and the S&P 500 rallied on Friday with sectors such as Energy and Materials getting a bid and outperforming on the day and for the week overall, following persistent underperformance over the past 2 years. Healthcare had a strong rebound on the week and Consumer Discretionary stocks held up well.

- Following the late August "waterfall" decline in the index, a rebound of approx. 7% off the low of 1867 was seen but the index failed to get through the key 2000 level and had a weak retest of the 1867 low and is now rallying back into high 1900's territory. Whether it can make new monthly highs remains to be seen.

- When reconciling the economic data with the volatility of US equity indices of late, the movement appears to represent an index price correction and does not reflect expectations for an economic recession in the US. However, fears remain over the risk of contagion from slowing growth in emerging markets. Domestically macro data doesn't show any material sign of deterioration, with unemployment remaining low and expectations for this Friday's non-Farm payroll not overly pessimistic. The housing market is recovering steadily and consumers are benefitting from low gas prices coupled with some wage inflation as labor force slack erodes. A housing recovery is vital to continued economic strength and demand, supply, affordability & credit figures all point towards a rejuvenation of the housing cycle. Residential investment still languishes at 3% of GDP vs. the longer term average near ~5%.

Euro Area, Europe & UK

- The EuroStoxx 600 Index is following a similar pattern to the S&P 500, having retested the August Lows and re-bounded. Similarly, the character of the market is somewhat different on the rebound with Energy stocks rebounding from lows.

- The ECB recently revised their outlook for real GDP growth for 2015, 16 and 17; primarily due to lower external demand owing to weaker growth in emerging markets. The Eurozone is one of the most exposed DM regions to EM's, given its export-driven growth mode and the ECB is therefore more sensitive to inflation and currency dynamics. With this in mind the ECB highlighted that risks to Euro Area growth remain on the downside. Although exports up to June 2015 have been robust, the recent devaluation of the Chinese Renminbi (CNY) and strengthening of the Euro is a meaningful headwind. Commodity prices, the emerging market slowdown and exchange rate developments will shape the inflation outlook for the region.

- Given continued high structural unemployment and low potential output growth in the euro area, the ongoing cyclical recovery must be supported by effective structural policy reform in key member states, including product and labor market reforms and supportive enhancements of the business environment. Loan growth has shown some improvement but the dynamics of loans to non-financial corporations remains subdued. The auto industry accounts for an important share of activity in Europe. In Germany, the auto industry holds a 4% share of total value added, almost 6% of capital spending, and nearly 20% of goods exports. Therefore, the recent auto industry "scandal" has heightened concern over growth slightly.

UK

- Robust private domestic demand is expected; despite the continuing fiscal consolidation and modest global growth. The near term outlook for inflation is muted as a consequence of falling energy prices. The continued strength of the GBP is a drag on import prices and continues to push down inflation; posing further downside risk. Some wage growth is expected and this should counterbalance the drag to inflation from Oil and GBP appreciation.

- Monetary conditions have tightened in the last two years due to the strengthening currency and higher real interest rates (as inflation remained low; exacerbated by oil price weakness). Whilst the MPC have been focused on domestic data (wage growth, inflation) they are also drawn towards external risks which include currency movements and real interest rate levels.

Emerging Markets

- Emerging market growth fears have been central to the turbulence that was seen in markets during August. China's flash Sept PMI reading fell to its lowest level since the financial crisis and signaled a buildup in inventories. This has added to skepticism that policy stimulus is not actually having the desired supportive effect on GDP growth. Emerging market currencies have depreciated substantially against G4 counterparts as global oil prices and the G4 bond yields have been falling. Confidence in global growth is low as sub-par emerging market growth remains a drag despite recovering developed markets.

- Emerging market private-sector debt levels remain high (JPM estimate levels at around 130% of GDP). The risk of disruptive de-leveraging combined with FX headwinds, reduced growth expectations, reduced pricing power for goods and commodities leaves emerging markets in a difficult position.

- In China, increased fiscal and monetary easing measures are being instigated by policy makers but risk remains to the downside. China may look to support its Casino industry through government intervention, which would provide some incremental good news.

Central Bank Watch:

- It appears that the G4 Central Bank policies are being affected by EM growth concerns and financial market developments.
- In the US, timing of rate rises remains the focus. The Median Fed forecasts still indicate a move prior to year end. However, the trajectory of hikes is more important than the timing of the first move and the path of hikes will be gradual.
- Earlier in 2014, ECB announced an open ended Quantitative Easing program. The ECB commenced buying €60bn of private and public sector securities every month from March to end-September 2016 at least. The ECB may increase the size of the program or bring forward some buying depending on economic data, including inflation.
- When the BoE does raise rates, they are expected to do so gradually and to a lower level than in recent cycles, given the likely persistence of the headwinds weighing on the economy.
- Japanese monetary policy is expected to remain loose for some time to come. Inflation still remains well below 2% target at present.

Positioning

- Zurich Life funds are overweight in equities and underweight bonds versus the manager average.
- In equities, we are
  - Underweight UK and marginally underweight Europe
  - Neutral Asia ex Japan and North America
  - Overweight Ireland and small overweight Japan

  (All the above are relative to the manager average)
- Sector weights (at aggregate level) are: underweight energy and utilities, and overweight consumer goods and industrials.

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

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