Eagle Star Investments
Weekly News
16th February 2009

Global Overview

Markets end lower as fear returns

After two weeks of gains on equity markets, investor sentiment turned negative last week, as poor economic data renewed worries that the US stimulus package may not be enough to stem the economic downturn.

US data

The University of Michigan preliminary index of consumer sentiment fell mid-month in February to 56.2, compared to 61.2 in January, as fears grow about recession and mounting job losses. On a positive note, retail sales in January actually surprised on the upside, rising by 1%, the first increase in seven months.

Eurozone data

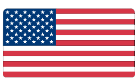
Industrial output in the region fell by a record 2.6% in December and by 12% for 2008, the largest fall since records began in 1990. The region also recorded its deepest contraction in the fourth quarter of 2008, with economic growth falling by 1.5%. Both data releases add pressure on the European Central Bank to cut rates again in March.

Currencies

In currency markets, the weak eurozone data pushed the single currency lower against the dollar, and the €/$ rate ended the period at just under 1.29. Sterling lost ground amid some concerns about the Bank of England's possible policy of quantitative easing, which would involve buying government bonds. The €/£ rate ended the period at 0.89. Oil prices retreated last week, finishing at just under $39 per barrel amid concerns about demand, following signs of deteriorating economic conditions.

	Index	Year to Date Return 31.12.08 to 13.02.09		1 Week Return 06.02.09 to 13.02.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-8.5	-0.8	-4.8	-4.7
US	NASDAQ	-2.7	5.4	-3.6	-3.5
Europe	FT/S&P Europe Ex. U.K.	-6.2	-6.2	-3.1	-3.1
Ireland	ISEQ	0.1	0.1	-4.8	-4.8
UK	FTSE 100	-5.5	1.0	-2.4	-4.9
Japan	Topix	-11.0	-4.0	-3.3	-2.9
Hong Kong	Hang Seng	-5.8	0.2	-0.7	-0.6
Australia	S&P/ASX 200	-4.4	-3.3	2.6	-0.1
Bonds	Merrill Lynch Euro over 5 year Govt.	-1.2	-1.2	1.1	1.1

Global Equities



United States

Overview

US equity markets moved into negative territory as consumer confidence approached its lowest level in decades, job losses mounted and the slide in home values deepened.

Coca Cola – The soft drinks company bucked the trend, reporting better-than-expected quarterly profits helped by double digit gains in China, India and Eastern Europe. The company reported a 4% rise in sales volumes in the fourth quarter of 2008, reiterating that it remains committed to its long-term growth targets in spite of the challenging environment.

Europe

Overview

Weak eurozone economic data, combined with poor performance from banking stocks, resulted in European markets finishing lower.

Lloyds Banking Group – Shares in Lloyds Banking Group fell sharply after Lloyds warned that the recently-acquired HBOS group suffered a worse-than-expected pre-tax loss of £10bn in 2008.

Ireland

Overview

It was a choppy week on the ISEQ as news of deposit transfers between two of the country's main banks overshadowed the Government's recapitalisation plan. The ISEQ ended the week almost 5% lower.

Anglo Irish Bank / Irish Life & Permanent – Markets responded negatively to news that IL&P had provided over €7bn in deposits to Anglo Irish Bank in the days leading up to the end of the bank's financial year on 30th September. The transaction was deemed "unacceptable" by the Government, leading to several resignations including Denis Casey, Chief Executive.

AIB / Bank of Ireland ratings – The rating agency, Standard & Poor's, announced it had cut its rating on AIB and Bank of Ireland from A+ to A due to an increase in bad debts in the deteriorating economy. The other main rating agency, Moody's, also downgraded both banks by one level, to Aa3.

Asia Pacific

Overview

Initial optimism about the potential US stimulus plan was offset by weak economic data showing economies worldwide are continuing to contract. Chinese exports fell by 17.5% and Chinese imports plunged by over 43% in the year to January signaling a deepening economic slump. Both the Topix and Hang Seng indices ended the week in negative territory.

Bonds

Eurozone bonds made healthy gains last week as equity markets fell sharply and investors opted for the perceived safety of government bonds. The Merrill Lynch >5 year Government bond index rose 1.1% last week.

Global Outlook

- Policymakers continue to work to prevent a deflationary slump through aggressive interest rate reductions, higher government spending and extraordinary interventions in the financial markets. With few exceptions, the current economic data is horrendous. At best there seems to be some stabilization in the forward indicators of economic activity. However, output and employment will likely 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. There has been a reduction in the money market funding costs of banks but, so far, little success in maintaining the flow of credit to the real economy. The current debate is centred on the creation of so-called "bad banks", the idea being to take poor-quality assets off banks' balance sheets and allow the resultant (more transparent and less risky) banks concentrate on mainstream lending to firms and households.
- Global short rates will remain exceptionally low for some time to come. The ECB will likely cut rates to 1.5% next month and to 1% thereafter; it has already allowed short-term money rates to fall below 1%, so these official announcements will not be any surprise. As with the Fed, investors are focused on what further unconventional policies will be put in place. Part of that policy may involve active purchases of government bonds. However the Fed has dithered on this front and lost valuable time since its first pronouncements on this subject in December and the ECB only seems to be in contemplation, rather than action mode.
- Prices of government bonds fell at the start of the year but have recovered since then. Sovereign ratings' downgrades and worries over the fiscal policies of countries like Ireland and Spain have taken their toll. There has even been talk of a bubble in bond markets after the surge in prices last year. 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 are likely at some stage and would also be a support to prices.
- So far equities have held last year's lows despite a slew of appalling economic and corporate data since then. However, sentiment and conviction remain very weak. What optimism there is tends to centre on new policy initiatives such as unconventional Fed interventions in bond markets, the Obama fiscal measures or the stimulative actions of other economies. However, policy division and delay have, so far, dented the efficacy of many of the policy announcements. While money market rates and risk measures have fallen significantly, the corporate bond markets remain a hostile environment for companies to fund capital. Markets will remain volatile and the direction uncertain for some time to come.
- Currently the funds are close to neutral equities and overweight bonds, versus the manager average. Within equity sectors the funds are overweight technology and healthcare and underweight consumer goods. Geographically the funds have an underweight position in Ireland, Japan and Europe, and are slightly overweight in the Pacific Basin, the US and the UK.

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