Eagle Star Investments

Weekly News

11th May 2009

Global Overview

Equity markets rise further

Global equity markets extended their recent run of form, with investors welcoming the US government's 'stress test' results and taking the view that both encouraging economic data and central bank action should lead to an earlier recovery in the global economy.

US economic data

The pending home sales index rose 3.2%, to 84.3 in March, pointing to an improvement in existing sales numbers for April and May. Elsewhere, US employment data revealed a fall of 539,000 for non-farm payrolls in April, below the consensus forecast for a drop of 600,000.

European Central Bank

The European Central Bank lowered its key interest rate by 25 basis points, to a record low of 1%. Furthermore, ECB President Jean-Claude Trichet announced the bank's pledge to purchase €60bn of covered bonds. Whilst these bonds are corporate bonds, Mr Trichet has not ruled out other purchases in the future.

Bank of England

In line with expectations, the Bank of England left interest rates unchanged at 0.5%. However, the Bank of England's Monetary Policy Committee reported that it is extending the size of its own operation to buy government and corporate bonds, from the initial £75bn target to a total of £125bn.

Currencies & Oil

In currency markets, the euro gained versus the dollar on speculation that the ECB's quantitative easing plan is not aggressive enough. On Friday, the euro climbed as high as 1.36 versus the dollar, as a report showing slower deterioration in the US labour market reduced demand for the relative safety of the currency. The €/$ rate ended the week over 1.35. Oil prices led the broad rally across commodity markets, rising by 9% a barrel, to finish the week at $58 a barrel.

	Index	Year to Date Return 31.12.08 to 08.05.09		1 Week Return 01.05.09 to 08.05.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	2.9	5.9	5.9	3.6
US	NASDAQ	10.3	13.5	1.2	-1.0
Europe	FT/S&P Europe Ex. U.K.	4.2	4.2	4.6	4.6
Ireland	ISEQ	14.2	14.2	2.1	2.1
UK	FTSE 100	0.6	7.4	5.2	4.5
Japan	Topix	4.2	-1.4	5.7	4.1
Hong Kong	Hang Seng	20.9	24.5	12.0	9.7
Australia	S&P/ASX 200	5.9	18.3	4.6	7.4
Bonds	Merrill Lynch Euro over 5 year Govt.	-0.2	-0.2	-0.9	-0.9

Global Equities

United States

Overview

US equity markets recorded another good week, amid growing confidence that the US economy is stabilising. The US government's 'stress tests', ordering ten of the largest US banks to raise almost $75bn in equity, was also broadly welcomed by investors.

Cisco – The technology company posted better-than-expected quarterly results, showing a smaller drop in profits, largely due to cost cutting. Net profit for the quarter ending April 25th, fell to $1.3bn, from $1.8bn a year ago.

Europe

Overview

European markets moved almost 5% higher following gains in the financial sector worldwide and improving sentiment.

Swiss Re – The Swiss reinsurance company delivered better-than-expected results and an improved outlook on its capital position. The stock rose by 40% on the week.

Royal Bank of Scotland – The part-nationalised lender announced a small first-quarter loss of £44 million, compared with a profit of almost £480 million a year ago. The bank also reported that it has taken another £2.1bn write-down on risky assets.

Ireland

Overview

The Irish market finished the week 2% higher, led by banking stocks.

CRH – The company issued an interim trading statement, indicating that poor weather conditions and the deteriorating economic environment impacted performance in the first four months of the year, but hoping that trading conditions would pick up in the latter part of 2009.

Asia Pacific

Overview

Asian markets followed the world higher, with gains in banking stocks more than offsetting losses in property stocks. China's Manufacturing Purchasing Managers' Index rose sharply to 50.1 in April, from 44.8 in March, signalling an expansion of the manufacturing sector for the first time in nine months. Hong Kong's Hang Seng Index surged 12% and Japan's Topix rose by almost 6%.

Bonds

Bond markets fell back last week as equity markets rallied. Eurozone government bonds sold off on disappointment that the quantitative easing measures announced by the ECB are not aggressive enough. The Merrill Lynch over 5 year Government bond index fell by 0.9%.

Global Outlook

- Amidst the worst global recession in decades, investors have latched onto some green shoots in the global economic data. 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.
- From fiscal expansion to rate cuts, to quantitative easing (QE) programs, to measures aimed at removing assets from the banking system, the scale of the initiatives to save the banking system and offset the collapse in private sector demand has been unprecedented. The ultimate success of these efforts is still far from assured, however, given the depth of the crisis faced by the global economic system.
- UK and US short rates have already reached their cyclical lows and euro rates have probably reached their lows, after the ECB's cut to 1% last week. The operation of the US and UK QE programs has been less than successful so far, and it remains to be seen how the ECB will deploy the corporate bond-buying initiative it announced last week. In any event, the major central banks are already talking about exit strategies from these initiatives, hoping that this will temper any longer-term inflation expectations.
- Bonds have performed poorly recently, as investors have re-embraced risk assets and authorities have disappointed with their QE policies. Many commentators have also speculated on the long-term inflation risks from the current policy mix, but these seem a little premature at this stage. 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. Of course, periodic concerns about the budgetary positions could easily arise and impact on these spreads once more.
- The economic green shoots, combined with large short positions and pessimistic sentiment, have produced a powerful bear-market rally in equity markets. The stress test of the US banks has been greeted enthusiastically so far, allowing a number of banks to raise new capital or announce their expectation of doing so. However, market sentiment seems to have swung from one extreme to another in this move, creating room for disappointment with policy initiatives and the possibility of setbacks in risk markets.
- Currently, the funds are slightly overweight equities and overweight bonds, versus the manager average. Within equity sectors, the funds are overweight technology and underweight utilities. Geographically, the funds have an underweight position in Ireland, are closer to neutral in Japan, the UK and Europe, and are overweight in the Pacific Basin and the US.

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