Eagle Star Investments
Weekly News
18th May 2009

Global Overview

Equity markets retreat as fear returns
After two months of steady gains on equity markets, investor sentiment turned negative as poor economic data worldwide resurrected concerns over the strength of the global recovery.

US economic data
US retail sales unexpectedly fell by 0.4% in April after a downwardly revised 1.3% decline in March. The April decrease was sharply below the market forecast for a 0.1% increase, confirming that consumers remain hesitant about spending. Elsewhere, news that US jobless claims continue to increase, reinforced poor economic releases.

European economic data
The German economy suffered its largest contraction since reunification in the first three months of 2009. GDP shrank by a bigger-than-expected 3.8%, led by sharp falls in exports and investments. Over the same period, the eurozone region also declined by 2.5%, the largest quarterly decline since records began in 1970.

Currencies & Oil
In currency markets, economic data offered some support to the dollar as it benefited from safe-haven buying from investors, nervous about the global outlook. The €/$ rate ended the week at just over 1.35. Earlier in the week, oil prices briefly touched the $60 a barrel mark. However, the announcement by the International Energy Agency that global oil demand would record its sharpest annual decline this year since 1981, led to renewed pessimism amongst dealers about the outlook for global energy demand. The oil price finished the week at just over $56 a barrel, a fall of 4%.

	Index	Year to Date Return 31.12.08 to 15.05.09		1 Week Return 08.05.09 to 15.05.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-2.3	0.7	-5.0	-4.9
US	NASDAQ	6.5	9.8	-3.4	-3.3
Europe	FT/S&P Europe Ex. U.K.	0.4	0.4	-3.7	-3.7
Ireland	ISEQ	12.3	12.3	-1.6	-1.6
UK	FTSE 100	-1.9	5.3	-2.6	-2.0
Japan	Topix	2.6	1.2	-1.5	2.6
Hong Kong	Hang Seng	16.7	20.3	-3.4	-3.4
Australia	S&P/ASX 200	1.4	11.5	-4.3	-5.7
Bonds	Merrill Lynch Euro over 5 year Govt.	-0.4	-0.4	-0.1	-0.1

Global Equities

United States

Overview

Disappointing retail sales, labour market and retail earnings data undermined recent optimism about the economy, resulting in US equity markets retreating over the week.

Retail earnings – Further worries about consumer spending came after two leading US clothing retailers announced weaker-than-expected results. JC Penney's first-quarter earnings were in line with expectations however, the company lowered its full-year estimates amid concern over weak consumer spending. Elsewhere, the designer retailer Abercrombie & Fitch also reported a larger-than-expected first-quarter loss.

Europe

Overview

Fears for the global economy along with weak eurozone economic data, caused European markets to finish the week almost 4% lower.

British Telecom – One of the world's largest communication companies reported a pre-tax loss of £134m for 2008-09 compared to a profit of £2bn in 2007-08. The company slashed its full-year dividend by 59% to 6.5p. In an effort to reduce operating costs and capital expenditure by more than £1bn, the company plans to achieve this, partly by cutting 15,000 jobs.

Ireland

Overview

The ISEQ followed the rest of the world markets, ending the week 2% lower.

Elan – The pharmaceutical company gave back some of its recent gains, after speculation of an offer from the Danish pharmaceutical company, Lundback, resulted in Lundback's Chief Financial Officer announcing that given current market conditions, the company had no acquisition plans. Elan's share price fell by almost 4% over the week.

Asia Pacific

Overview

Asian markets finished the week lower as renewed concerns over the strength of the global economic recovery reduced investors' risk appetite. On the eve of the country's election, India's market bucked the trend, with analysts' expecting the economy to recover from late 2009.

Bonds

Bond markets fell back last week amid eurozone policymakers sending mixed signals over whether the European Central Bank would extend its plans to purchase covered bonds to other assets. The Merrill Lynch over 5 year Government Bond index fell by 0.1%.

Global Outlook

- Amidst the deepest global recession in decades, investors have latched onto some green shoots in the global economic data. The hope is that the worst of the data is behind us and 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 rates 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 are close to the lows, with an outside chance that we get another official rate. The success of the US and UK QE programs has been quite mixed so far, and it remains to be seen how the ECB will deploy its corporate bond buying program. While the premium which companies are paying for debt has fallen, the overall rate that companies are paying remains very high. In any event, the major central banks are already talking about exit strategies from these initiatives, suggesting a tepid level of commitment to their implementation.
- 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. 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 in recent weeks.
- Economic green shoots, combined with large short positions and pessimistic sentiment, produced a powerful bear market rally in equity markets over the past few weeks. The stress test of the US banks was choreographed very well, 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 large rally, creating room for disappointment with policy initiatives and the possibility of setbacks in risk markets.
- Currently, the funds are close to neutral in equities and overweight bonds, versus the manager average. Within equity sectors, the funds are overweight technology and underweight healthcare. Geographically, the funds have an underweight position in Ireland, are closer to neutral in Japan, the US, UK and Europe, and are overweight in the Pacific Basin.

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