Eagle Star Investments

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ZURICH

Global Overview

Global equity market volatility

Equity markets traded nervously as worries that China's latest move to rein in lending, combined with continuing uncertainty about Dubai and eurozone sovereign debt, increased market volatility. Despite this, hopes of an imminent solution to Greece's fiscal problems, along with encouraging corporate earnings results, lifted investor sentiment and most markets ended the week in positive territory.

US Federal Reserve "exit strategy"

In his testimony before the House Financial Services Committee, Fed Chairman Ben Bernanke provided further detail on the Fed's "exit strategy", noting that the US Federal Reserve may consider raising one of its secondary interest rates, the so-called discount rate.

US economic data

There were some positive signs from the Labour Department, which reported that the number of US workers filing new unemployment benefit claims dropped by 43,000 to a seasonally adjusted 440,000 last week. Also, on a positive note, sales at US retailers posted a healthy rebound of 0.5% in January, after dipping 0.1% the month before.

European economic data

Economic growth in the eurozone slowed to 0.1% in the fourth quarter of 2009 over the previous quarter, as weaker spending and investment in Germany unexpectedly brought growth in the region's largest economy to a halt. Elsewhere, the Bank of England's latest quarterly inflation report raised the prospect that UK interest rates might stay low for longer than expected.

Currencies and oil price

The euro remained under pressure for much of the week as eurozone debt fears drove investors out of euro-denominated assets and into the relative safety of the US dollar. The €/$ rate ended the period at 1.36. On commodity markets, despite intra-week volatility, the oil price climbed 3% over the week, due to adverse weather conditions in the US and supportive economic data, to end the week at $74 a barrel.

	Index	Year to Date Return 31.12.09 to 12.02.10		1 Week Return 05.02.10 to 12.02.10	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-3.6	1.4	0.9	0.9
US	NASDAQ	-3.8	1.2	2.0	2.0
Europe	FT/S&P Europe Ex. U.K.	-6.4	-6.4	1.3	1.3
Ireland	ISEQ	-2.4	-2.4	0.4	0.4
UK	FTSE 100	-5.0	-3.1	1.6	1.9
Japan	Topix	-1.7	7.0	0.0	-0.7
Hong Kong	Hang Seng	-7.3	-2.8	3.1	3.1
Australia	S&P/ASX 200	-6.3	-2.8	1.1	3.8
Bonds	Merrill Lynch Euro over 5 year Govt.	1.5	1.5	0.2	0.2

Global Equities

United States

Overview

US markets gained last week, despite experiencing choppy trading conditions due to fears that tighter lending in China could dampen the global economic recovery, along with concerns over eurozone sovereign debt.

Coca Cola – The world's largest soft drinks maker reported a quarterly profit of $1.54 billion, in line with analysts' estimates, as strong growth in China, India and Brazil offset a decline in North America. Elsewhere, its rival Pepsico announced that profits almost doubled to $1.4 billion, again led by strong growth in Asia.

Europe

Overview

The announcement of tighter monetary policy in China, combined with worries about the peripheral eurozone region, dominated headlines and caused markets to trade in a volatile range. However, a pledge by the European Union to support Greece and other peripheral economies went some way to calm investor nervousness and Europe ended the week in positive territory.

ArcelorMittal – The world's largest steelmaker reported a $1.07 billion fourth quarter profit due to strong demand in emerging countries, and signs of a resurgence of steel buying in Europe and the US. First quarter guidance disappointed though, sending stock lower on the day.

Ireland

Overview

Despite extremely volatile trading conditions, the Irish market managed to end the week in positive territory.

Élan – The drug company, which is partly owned by Johnson & Johnson, reported a loss of €79.5 million ($57.7 million) for the fourth quarter of 2009, but has forecast a 2010 rebound as sales of its multiple sclerosis-fighting drug, Tysabri, continue to grow.

Asia Pacific

Overview

For the second time in a month, China unexpectedly increased its bank reserve requirements, raising fears that the pace of policy tightening could be more aggressive than expected. Latest Chinese consumer inflation data showed a slowdown to +1.5%, and Hong Kong's Hang Seng index gained 3%, while the Topix finished the week unchanged. Elsewhere, Australia's unemployment rate defied market expectations, dropping to a one-year low of 5.3%, increasing expectations that the Reserve Bank of Australia may recommence raising interest rates next month.

Bonds

Government bond markets registered modest gains amid optimism that the European Union would provide a bail-out for Greece, and possibly other eurozone nations such as Spain and Portugal who face similar budgetary deficit challenges. The Merrill Lynch over 5 year government bond index gained 0.2% on the week.

Global Outlook

- The global economy is expected to be 3% stronger in 2010, following a fall of just over 2% last year. A key issue is whether private sector demand in Europe and the US is strong enough to allow governments and central banks to withdraw some of the massive stimulus they have been providing. It is also notable that bank lending is still quite constrained. Partly for this reason, policy makers remain somewhat cautious on the economic outlook and this remains a key factor to watch during the year.
- Policy makers and academics continue to grapple with the long-term implications of the credit burst and the unintended consequences of policy actions. However, market participants work with a shorter time horizon and such longer-term worries tend to be aired only periodically such as now, when equity market sentiment has deteriorated.
- Short rates remain between 0% and 1% in the major economies, although other economies such as Australia have already increased rates. Investors are nervous about the withdrawal of low interest rates. Central bankers in the US and Europe are keen to remove emergency policy settings but don't want to do so prematurely, a balancing act which continues to be difficult to communicate. It is notable that end-2010 rate expectations in the US, UK and eurozone are still more or less at their cycle lows. On balance, therefore, investors expect that low rates will persist for some considerable time.
- For bond markets, inflation data remains supportive. As was the case for much of last year, the "elephant in the room" remains the exit from emergency policy settings, which is bound to have some impact on bond markets, and these concerns continue to keep bond markets in a broad trading range. Bond markets have been helped somewhat by the recent weakness in equity markets but are probably closer to the top of their range (price wise) at the moment. However, the fiscal woes in Greece have been the dominant concern so far this year. This story is still playing out but it appears that some solution will be achieved that helps Greece and the credibility of the euro.
- Equity market optimism has been dented by an almost 10% correction from early 2010 highs. More worries over a hard landing in China, plus fiscal risks in the eurozone, have offset strong corporate earnings. The technical picture has certainly deteriorated; sentiment has swung negatively (perhaps to a short-term extreme) and investors are nervous. However, valuations are now reasonable, liquidity conditions should remain constructive and markets are somewhat oversold. Near-term, we need to see whether markets can stabilise before turning more positive again.
- Currently, the funds are closer to neutral in equities and overweight bonds, versus the manager average. Within equity sectors, the funds have gone much closer to neutral but are still overweight technology. Geographically, the funds are pretty neutral, although they remain underweight in Ireland and slightly overweight in Japan and the Pacific Basin.

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