Eagle Star Investments

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ZURICH

Global Overview

Equity markets move higher

Despite the release of disappointing macroeconomic data, the prospect of further asset purchases by the Federal Reserve, along with better-than-expected US and European third-quarter earning releases resulted in most equity markets ending the week in positive territory.

US Federal Reserve minutes

The minutes of the US Federal Reserve's September policy meeting appeared to point to a growing view among policymakers that a new round of monetary easing in the form of quantitative easing (QE2) will soon be necessary to boost the stalling US economy.

US economic data

US inflation unexpectedly slowed in September despite a pick-up in retail sales. Elsewhere, a recent survey showed US consumer sentiment unexpectedly dipped in early October.

German economic growth

The German economic institutes revised up their German GDP growth forecasts for 2010 and 2011, to 3.5% and 2% respectively.

Dollar

The dollar came under further pressure last week, hitting its lowest level this year amid the prospect of further quantitative easing from the Federal Reserve. The €/$ rate ended the week at 1.40.

Commodities

Investors remain optimistic that the Fed's stimulus measures will lead to increased demand for crude oil prices causing it to trade within a range, before ending the week at over $81 a barrel. Gold extended its record-breaking run, rising as high as $1,387 per troy ounce.

	Index	Year to Date Return 31.12.09 to 15.10.10		1 Week Return 08.10.10 to 15.10.10	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	5.0	9.9	0.8	0.6
US	S&P 500	5.5	7.9	0.9	0.2
US	NASDAQ	8.8	11.3	2.8	2.1
Europe	FT/S&P Europe Ex. U.K.	3.3	3.3	1.7	1.7
Ireland	ISEQ	-9.8	-9.8	-1.2	-1.2
UK	FTSE 100	5.4	6.9	0.8	0.5
Japan	Topix	-8.9	6.7	-1.6	-1.5
Hong Kong	Hang Seng	8.6	11.0	3.5	2.8
Australia	S&P/ASX 200	-3.7	8.6	0.2	0.0
Bonds	Merrill Lynch Euro over 5 year Govt.	7.5	7.5	-0.3	-0.3

Global Equities

United States

Overview

Despite financial stocks becoming unsettled by concerns about mortgage losses and an investigation into home foreclosure procedures, US markets recorded modest gains on the back of better-than-expected corporate results and speculation that the Federal Reserve will buy more debt to try to stimulate the economy.

Corporate earnings results – Giant chip maker, Intel, revealed that profit climbed 59% and revenue topped $11bn with the company saying it continues to see "healthy worldwide demand for computing products of all types". JP Morgan's third-quarter rose by 23%, helped by lower losses in its retail and credit card units. Google was up over 12% on the week after better-than-expected earnings. Meanwhile, General Electric posted larger-than-expected drop in revenue citing falling demand for heavy equipment.

Europe

Overview

Improving sentiment during the earnings season helped European stocks to end the week almost 2% higher.

Peugeot – The French car maker rose over 10% on expectation of stronger sales due to improving product momentum and stable European car markets.

Ireland

Overview

The Irish market bucked the trend, finishing the week over 1% lower, as markets remain concerned over the strength of Irish banks.

Asia Pacific

Overview

Despite concerns over China's move to curb bank lending, Hong Kong's Hang Seng Index put in a strong performance, rising by 3.5% on the week. In contrast, however, Japanese equities shed almost 2% as the yen rose to a 15-year high against the dollar. In company news, Rio Tinto and BNP Billiton reported that they have abandoned their controversial merger of their Australian iron-ore operations after anti-competition complaints from regulators.

Bonds

Eurozone bonds were initially bolstered by expectations that the US Federal Reserve will soon initiate a further round of quantitative easing measures. However, a lack of detail on QE2 by the Fed Chairman Ben Bernanke, along with increased risk appetite among investors, led to choppy trading on debt markets. The Merrill Lynch over 5 year government bond index fell by 0.3% over the week.

Global Outlook

- Global growth forecasts are still quite healthy enough for this year and next (3.6% and 3.3%). Asian economies are quite strong, driving export demand from some European economies but European domestic demand remains subdued and the global economy is still very lopsided. The underlying strength of private sector demand in Europe and the US is still a key concern. Weak bank lending and financial market volatility add to downside risks to these areas. Inflation pressures globally remain modest, reflecting weaker data in developed economies and stronger readings in emerging economies and Asia. Indeed, further disinflation is probably a greater near-term concern than inflation.
- Central banks continue to set interest rates at emergency levels in Europe and the US, although they have risen somewhat in some of the stronger economies such as Canada, India and China. By extension, 2011 rate expectations are close to or have reached new cycle lows in the US, UK and eurozone, which underlines the risks facing the global economy. Worryingly, ECB rhetoric suggests anxiety about normalising short-term interest rates which seems premature at this stage. Thus, the chances of a policy error have risen, albeit remaining quite low still.
- Low short-term interest rates and disinflation concerns, have been a support to major bond markets such as Germany, the US and Japan; long-term interest rates have recently fallen to record or near record levels in the US and Germany. Irish bond spreads versus Germany had widened by 2.5% since mid-year but narrowed 0.5% after recent banking announcements and the cancelling of debt auctions. However, it remains to be seen whether the latter will have the desired market impact. Ireland has certainly funded well this year and has a large cash buffer. However, the risk remains that investors continue to probe the credibility of the rescue mechanism in place for eurozone countries; if so a rocky road still lies ahead for Irish bonds.
- While global equities are 5% this year, it has been a period of very high volatility with several large gains and falls over the first nine months. Partly because of this, investors' convictions are very low and holding periods quite short. Low interest rates certainly provide some forward support to risk markets. Additionally, investors seem to believe that the Fed will ride to the rescue in November with further quantitative easing policy (QE2), although the Fed's recent comments suggest a division on the scale and timing of additional actions. However, sentiment has already rebounded meaning that the fuel for further gains may be limited, especially if the scale of QE2 disappoints. Currently, we are waiting to see how the balance of these forces will develop in the short-term.
- Currently, the funds are neutral equities and overweight bonds versus the manager average. Within equity sectors, the funds are now reasonably balanced. Geographically, the funds are underweight in Ireland and the UK, overweight in Europe and Pacific Basin and closer to neutral in other markets.

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