Weekly
# investment news

20th August 2007

EAGLE STAR

## Global Overview

**Falling equity markets**

There were sharp declines on most equity markets last week as credit concerns worldwide continue to dominate sentiment. Some of these losses were recouped after a late rally on Friday following intervention from the Fed.

**Fed intervention**

In a surprise move on Friday, the US Federal Reserve cut one of its bank lending rates and changed its assessment of the economy. The Fed now believes that "downside risks to growth have increased appreciably" and they will continue to monitor the situation and "act as needed to mitigate the adverse effects on the economy arising from the disruptions in financial markets". This sparked an immediate rebound in equity markets which helped markets recover some of their losses. However, many still remained in negative territory over the week.

**US Economic Data**

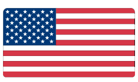
Construction of new homes in the US over the last month fell to its lowest level in 10 years. This data was weaker-than-expected and underlined concerns that were already present in the homebuilding and mortgage sectors.

**Currencies**

The Japanese yen rallied last week as investors unwound carry trades due to increased risk aversion following the sharp falls on equity markets. Carry trades are where low yield currencies are sold to fund purchases of riskier, higher-yielding currencies and assets.

| Market | Index | Year to Date Return 31.12.06 to 17.08.07 | | 1 Week Return 10.08.07 to 17.08.07 | |
|---|---|---|---|---|---|
| | | Local Currency % | Euro % | Local Currency % | Euro % |
| US | S&P 500 | 2.0 | -0.4 | -0.5 | 0.9 |
| US | NASDAQ | 3.7 | 1.4 | -1.6 | -0.2 |
| Europe | FT/S&P Europe Ex. U.K. | 0.1 | 0.1 | -0.8 | -0.8 |
| Ireland | ISEQ | -13.8 | -13.8 | -2.9 | -2.9 |
| UK | FTSE 100 | -2.5 | -3.6 | 0.4 | -0.3 |
| Japan | Topix | -11.9 | -10.4 | -9.4 | -4.9 |
| Hong Kong | Hang Seng | 2.1 | -0.7 | -6.5 | -5.1 |
| Australia | S&P/ASX 200 | 0.0 | -1.6 | -4.5 | -9.0 |
| Bonds | Merrill Lynch Euro over 5 year Govt. | -0.8 | -0.8 | 0.4 | 0.4 |

## Global Equities



### United States

**Overview**

Following the rally sparked by the Fed decision to reduce its discount interest rate by 0.5%, the US markets were relatively unchanged over the week.

**Key Movers**

Retail sector – Housing market difficulties were cited as reasons for both Wal-Mart and Home Depot experiencing lower profits and a poorer financial outlook. Their shares fell by almost 6% and 7% respectively.

Countrywide Financial – The largest US mortgage lender endured further losses of 23% last week after it was forced to draw on an $11.5bn credit line. Merrill Lynch also warned that the bank could face bankruptcy if conditions worsened and this caused the stock to continue performing badly.

## Europe

### Overview

European markets remained fragile last week, finishing the week only slightly lower after a late rally on Friday following the Fed's intervention.

Financials – After rumours that Société Générale's subsidary Lyxor Asset Management had been hit by sub-prime losses, the banking giant's share price fell by 3%. UBS also endured a poor week after issuing an outlook statement with its quarter two numbers that essentially amounted to a profit warning for the second half of the year. Its share price fell by over 3%.

Novartis – Rumours that the pharmaceutical group is lining up a bid for German company Bayer caused Novartis' share price to fall by over 2%. Bayer's share price reacted positively and rose by 3%

France Telecom – The French telecoms company's share price rose by over 5% as the market turned to safer defensive names and on hopes that it would gain the rights to sell Apple's iPhone in France.

## Ireland

### Overview

Irish equities fell last week despite the comfort gained from the Fed's decision and the subsequent rally on Friday.

Financials –The banking sector struggled again last week despite the Fed's surprise decision to reduce its discount interest rate. AIB gained 1.4% and Anglo Irish Bank 3%. However, Bank of Ireland lagged the sector and fell 2.3%.

Grafton Group – Grafton Group brought forward its interim results, which were in line with expectations, in order to give itself the flexibility to buy back shares. The group has authorisation to buy back up to 10% of its issued share capital.

## Asia Pacific

### Overview

Asian markets fell sharply last week and did not get to benefit from the Fed's rate cut, which occurred after Asian markets had closed on Friday.

Australia – Commodity prices fell last week on the back of concern over global growth rates, leading Asian markets lower over the week. Zinc, copper and nickel led the way falling 8.3%, 7.7% and 5.6% respectively.

# Bonds

Eurozone government bonds ended the week higher. However, their gains were pared back after the Fed's decision to cut the discount interest rate and hopes that the ECB may postpone its proposed increase next month. The Merrill Lynch >5 year government bond index ended the week up 0.4%.

# Global Outlook

- Global growth has been strong year to date, although it has moderated from 2006's robust levels. The major central banks had been focused on cyclical inflation pressures, but in the past few days or so they have clearly become concerned about dislocation in parts of the credit markets and how that might impact on real economic activity.
- The Fed kept rates at 5.25% at its last scheduled meeting, but its policy stance was moderated in last week's unscheduled meeting. It will be monitoring liquidity conditions in the credit markets and upcoming economic data in order to judge how policy may have to be changed over the coming weeks and months. At the moment, investors expect rate cuts of 0.50%, to 0.75%, by year end.
- The ECB was the first of the major central banks to add liquidity to help ease the chaos in parts of the credit markets. As a result, markets have lowered interest rate expectations for this year, expecting the ECB to react flexibly to upcoming economic data and financial market developments. To date, it's only shorter-dated bonds that have benefited from the flight to safer assets, while longer-dated bonds have been more volatile.
- Equity markets remain reasonably supported by fundamental factors but it's the impact of credit markets that is dominating investor sentiment at the moment. The Fed and ECB's moves are a positive help in that regard but it will probably require further policy moves before investors regain their poise.
- At the moment, the funds are neutral in bonds and closer to neutral in equities. Sector positions are overweight industrials and technology and underweight financials. In terms of geographical exposures, the funds are underweight Ireland, North America and Japan and overweight Europe and the Pacific Basin.



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