

# Eagle Star Investments

## Weekly News

11th August 2008

### Global Overview

#### Equity markets gains

Despite the release of weak economic data, global equity markets finished the week in positive territory. This was primarily due to the decline in oil prices, accompanied by the significant strengthening of the dollar.

#### US economic data

Last Tuesday, the Federal Reserve left its refinancing rate unchanged at 2%, as expected. The Fed reiterated that financial markets remain under "considerable stress" and emphasised that inflationary risks remain a big concern.

#### Eurozone economic data

Last Thursday, the ECB voted to leave interest rates unchanged at 4.25%. However, ECB President, Jean-Claude Trichet, warned that growth in the eurozone would be "particularly weak" in the third quarter, most notably from Germany. These comments were the catalyst for the dollar gaining significantly against the other currencies.

#### UK economic data

The recent slew of data reflecting poor economic activity, along with falling house prices, resulted in the Bank of England voting to hold interest rates steady at 5%, as expected. House prices fell by almost 11% in the year to July – one of the biggest year-on-year falls recorded in the UK.

#### Commodities

Despite tensions escalating between Russia and Georgia over the South Ossetia area, the price of oil fell to a three-month low of \$118.76 a barrel. The dollar rose to a five-month high against major currencies with the €/£ falling to 1.5055 by week end. Elsewhere, gold fell to a three-month low, falling by 5.9% for the week, whilst copper dropped by 6.2%.

Index		Year to Date Return 31.12.07 to 08.08.08		1 Week Return 01.08.08 to 08.08.08	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-11.7	-14.4	2.9	6.4
US	NASDAQ	-9.0	-11.8	4.5	8.1
Europe	FT/S&P Europe Ex. U.K.	-20.8	-20.8	3.2	3.2
Ireland	ISEQ	-34.9	-34.9	10.4	10.4
UK	FTSE 100	-15.0	-20.2	2.5	3.2
Japan	Topix	-14.6	-16.1	-1.0	-0.1
Hong Kong	Hang Seng	-21.3	-23.9	-4.3	-1.1
Australia	S&P/ASX 200	-21.4	-22.7	1.7	0.5
Bonds	Merrill Lynch Euro over 5 year Govt.	1.8	1.8	0.8	0.8

### Global Equities



#### United States

##### Overview

US stocks had their biggest weekly gains since mid-April after oil prices tumbled by nearly \$10 a barrel. Also, on another positive note, the US Institute for Supply Management's non-manufacturing index edged up to 49.5 in July from 48.2 in June – still below the 50 level which indicates contraction, but better than expected.

**Financial sector** – Fannie Mae, the largest US mortgage finance company, reported a larger-than-expected loss of \$2.3bn – its fourth consecutive quarterly loss. Earlier in the week, Freddie Mac announced a loss three times larger than analysts had expected.



## Europe

### Overview

Despite mixed earnings in the financial sector, European markets finished the week 3.2% higher benefiting from appreciation of the dollar and investors expecting no further rate hikes post the ECB meeting.

**Food sector** – Nestle, the world's largest food company, reported the slowest profit growth in four years in its first half, after higher cocoa and coffee prices and a weaker dollar cut into earnings. Net income in the six months through June rose to 5.21 billion Swiss francs (\$US4.92 billion) from 4.92 billion francs a year earlier.

**Financial sector** – Royal Bank of Scotland announced a £691m loss in its half-year results and cut its dividend per share by 41%, in line with forecasts. Profits were wiped out by a £5.9bn of write-downs on assets linked to sub-prime US mortgages. BNP Paribas announced better than expected Q2 profits of €1.5bn, down 34% on the same last year. HSBC also revealed a 28% drop in profits to \$10.2bn for the first half of the year, as bad debts on US home loans and asset write-downs offset strong Asian growth.



## Ireland

### Overview

The Irish market reversed some of its losses from the previous week gaining 10.4%, benefiting largely from rising global equity markets and falling oil prices.

**Equity market gains** – Financial stocks gained across the board and the biggest improvers to note were Anglo Irish Bank and Irish Life & Permanent who both gained 25.2% and 18.6% respectively. Elsewhere, Ryanair benefited from the retreat in oil prices, rising by over 20%.



## Asia Pacific

### Overview

All focus turned on Beijing last week as the Olympic Games got under way. Chinese stocks ended at a 19-month low, with the Topix Index down 1% and the Hang Seng falling by 4.3%.

**India** – Indian stocks registered their fifth consecutive weekly gain despite concerns about current inflation levels. Oil prices retreating pushed the index higher as India is a net importer of oil.

**Automobile sector** – Toyota Motors, the world's biggest car maker, posted a 28% drop in quarterly net profit, as a result of a strong yen and weak US sales.

## Bonds

Bonds prices continued their advance from last week, benefiting from the sell-off in oil prices, easing inflationary pressures. The Merrill Lynch >5 year government bond index rose by just under 1% on the week.

## Global Outlook

- The global growth rate is moderating from a very high level, with the cumulative effect of high oil prices adding downside risks to this picture. Much of the US data has been 'recession-like' while the eurozone economy has slowed abruptly in recent months. Asian (ex-Japan) economies are performing reasonably well, although a slower global economy will impact. Japan's lack of exposure to the credit crunch has been a positive. Oil prices have fallen 18% from their peak and this has helped lower inflation expectations and taken some of the pressure off short rate expectations.
- Current US interest rates of 2% are expected to be the low point for this cycle, although rates are now expected to be only fractionally higher by year-end. The Fed normally doesn't raise rates when the unemployment rate is rising - as it is now. But inflation concerns have been high on the Fed's agenda and this may alter the historic pattern.
- The ECB has been surprised by the recent slowdown in the eurozone economy and this may temper its pre-occupation with inflation. Following its last 0.25% rate increase to 4.25% the ECB says it has no bias on rates - one way or another - from here and investors are no longer anticipating further rates hikes.
- After sharp price falls in the second quarter, following higher than expected inflation, government bonds became more reasonably valued; weaker economic data and the recent fall in oil prices have helped support the market in the past month. Bonds also continue to get safe-haven support during equity market volatility.
- Equity markets have rallied 6% from their recent low, helped by lower rate expectations and falling oil prices. While the headwinds for the markets are strong - the impact of the prior oil price increases, the credit crunch and the cyclical slowing of the global economy - further significant falls in oil price and diminished chances of future rate hikes would be a positive.

- Despite the recent sharp rally in the US dollar versus the euro, the dollar retains much of its valuation support versus European currencies. A volatile period of range trading is the most likely pattern over the next while, as investors assess the willingness of the relevant central banks to alter interest rates over the coming months.
- At the moment the funds are underweight equities and slightly long bonds versus the manager average. Within equity sectors, financials and basic materials are underweight, while other sectors are closer to neutral. Geographically the funds have an underweight position in Ireland and the Pacific Basin, an overweight in the US and are more neutral in the UK, Europe and Japan.

This outlook does not constitute an offer and should not be taken as a recommendation from Eagle Star/Zurich. Advice should always be sought from an appropriately qualified professional.

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