Eagle Star Investments

Weekly News

25th August 2008

Global Overview

Most equity markets finish lower

Most equity markets retreated last week after banking stocks suffered from renewed concern of further credit-related writedowns, which have now exceeded $500bn, and investors feared that the government may need to intervene to support both Fannie Mae and Freddie Mac.

UK economic data

The UK economy unexpectedly slowed in Q2 as it experienced its weakest second quarter since 1992, when the economy was last in a recession. GDP data released showed no growth in Q2, however inflation is still well above BoE targets. The central bank hopes that the slowing economy will help tame inflation over the coming months.

Bernanke speaks

Federal Reserve Chairman, Ben Bernanke, has indicated that the Fed should be able to keep interest rates low for some time, as the recent drop in commodity prices and the slowdown in the US economy will reduce the inflation threat. He also said that the US economy was "in one of the most challenging economic and policy environments in memory" as turmoil in the financial markets "has not yet subsided".

Commodities

Heightened tensions between the US and Russia caused oil prices to remain volatile last week. After rising more than 6% on Thursday to $122 per barrel, Friday saw the biggest one-day falls in percentage terms since December 2004, after Russia began pulling the bulk of its forces out of Georgia. Oil finished the week at just over $114 per barrel.

	Index	Year to Date Return 31.12.07 to 22.08.08		1 Week Return 15.08.08 to 22.08.08	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-12.0	-13.3	-0.4	-1.3
US	NASDAQ	-9.0	-10.3	-1.5	-2.4
Europe	FT/S&P Europe Ex. U.K.	-22.4	-22.4	-1.5	-1.5
Ireland	ISEQ	-37.1	-37.1	-5.4	-5.4
UK	FTSE 100	-14.7	-21.5	0.9	-0.4
Japan	Topix	-17.6	-17.4	-2.5	-2.8
Hong Kong	Hang Seng	-26.7	-27.9	-3.6	-4.4
Australia	S&P/ASX 200	-22.2	-24.1	-1.0	-1.8
Bonds	Merrill Lynch Euro over 5 year Govt.	2.1	2.1	-0.4	-0.4

Global Equities

United States

Overview

Volatile oil prices and concern over the health of the Government-sponsored mortgage agencies, Freddie Mac and Fannie Mae, led US markets lower last week.

Freddie Mac and Fannie Mae – Both mortgage agencies fell heavily once again as speculation mounted that they would need to be bailed out by the government. Any move of this scale would possibly result in shareholders' investments being wiped out. Fannie Mae fell 37%, while Freddie Mac dropped 52%.

Banking stocks – Stockbrokers, Goldman Sachs cut its Q3 and full-year earnings outlook for five major rivals, due to mounting writedowns on mortgages and a slowdown in overall activity. The banks cut included Citigroup, JPMorgan Chase, Lehman Brothers, Merrill Lynch and Morgan Stanley.

Hewlett Packard – The IT giant continued to weather the economic slowdown after its full-year profit rose on the back of strong sales, resulting in profits beating analysts' forecasts. Its share price rose by 3% over the week.

Europe

Overview

European markets followed the rest of the world lower as concerns persist for the banking sector. Some losses were pared however, following takeover speculation in a few sectors.

TNT – Dutch logistics firm, TNT, gained almost 7% last week on rumours that US rival, UPS was preparing a bid for the company.

Holcim – The world's second-largest cement maker cut growth targets for 2008 as energy prices soared and economies worldwide slowed. It also stated it expects the US construction market to slow further over the coming months. It finished the week almost 2% lower.

Ireland

Overview

A worldwide fall in shares of banking stocks resulted in the ISEQ finishing the week over 5% lower.

Kingspan – Construction materials firm Kingspan made an acquisition of US panel maker Metecno worth €75m. The company stated that the deal "is expected to be mildly earnings enhancing in 2008 and thereafter".

Asia Pacific

Overview

Asian stocks finished the week in the red as fears of a global recession persist. Concern grew after the Bank of Japan cut its assessment for the economy, for the second month in a row.

China – Chinese stocks ended the week in negative territory, despite hopes that the government would introduce a stimulus package to boost the slowing economy and property markets.

Bonds

Eurozone bonds fell slightly last week, giving back some of the gains earned in previous weeks. The recovery in oil and general commodity prices tempered investors belief that inflation in the Eurozone has peaked, leading to reduced expectations of ECB interest rate cuts. The Merrill Lynch >5 year government bond index fell 0.4% 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, but recent data has been worrisome. Oil prices have fallen over 20% from their peak and this has helped lower inflation expectations and taken some of the pressure off interest rates.
- US interest rates are currently 2% and are expected to be 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 rate 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 recently. Bonds also continue to get safe-haven support during equity market volatility.
- Equity markets have rallied 5% from their recent low, helped by lower rate expectations and falling oil prices. While the headwinds for equities 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 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, Japan and the Pacific Basin, an overweight in the US and are more neutral in the UK and Europe.

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