Eagle Star Investments

Weekly News

15th September 2008

Global Overview

Most equity markets finish lower

Initially global equity markets responded positively to the US government's bail-out of Fannie Mae and Freddie Mac, but the rally proved short-lived, as concerns surrounding the future of Lehman Brothers and Merrill Lynch dominated market sentiment for the remainder of the week.

US economic data

Retail sales unexpectedly dropped in August as Americans reacted in the face of mounting job losses and record foreclosures. Latest unemployment data reflected a greater-than-expected increase in jobless claims numbers.

UK economic data

Some of Britain's biggest retailers delivered a slew of disappointing trading figures, forecasting even weaker figures over the coming months, as household incomes continue to be squeezed.

Eurozone economic data

The European Commission cut its 2008 eurozone growth forecast to 1.3%, from an earlier prediction of 1.7%, saying that two consecutive quarters of negative growth were likely in Germany, Spain and the UK.

Commodities

The dollar gained more ground against other currencies, with $/€ trading as low as 1.3879, however, some gains were later given back as worries mounted over the future of Lehman Brothers. The oil price dropped briefly below $100 a barrel on Friday for the first time since April 2008, whilst gold sank to an 11-month low of $736 an ounce as the strengthening dollar prompted investors to sell out of metals.

	Index	Year to Date Return 31.12.07 to 12.09.08		1 Week Return 05.09.08 to 12.09.08	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-14.8	-12.4	0.8	1.3
US	NASDAQ	-14.7	-12.4	0.2	0.7
Europe	FT/S&P Europe Ex. U.K.	-23.3	-23.3	2.3	2.3
Ireland	ISEQ	-37.3	-37.3	1.5	1.5
UK	FTSE 100	-16.1	-22.2	3.4	5.4
Japan	Topix	-20.2	-14.7	0.5	0.7
Hong Kong	Hang Seng	-30.4	-28.5	-2.9	-2.3
Australia	S&P/ASX 200	-22.6	-25.9	0.6	1.8
Bonds	Merrill Lynch Euro over 5 year Govt.	1.9	1.9	-1.6	-1.6

Global Equities

United States

Overview

An early rally in financial stocks combined with a reduction in oil prices, was quickly wiped away by uncertainty regarding the future of some major US companies.

Financial Sector – Over the weekend, Lehman Brothers Holdings Inc, the fourth-largest U.S. investment bank, finally succumbed to the sub-prime mortgage crisis, filing for the biggest bankruptcy in history, after it failed to reach a deal to sell the struggling bank. Also, Bank of America agreed to acquire Merrill Lynch & Co., one of America's oldest financial companies for about $50bn, in an all-stock transaction as the credit crisis deepens.

Insurance Sector – American International Group revealed that it is working to stave off rating downgrades and shore up its balance sheet, and is seeking to raise $10bn-$20bn in equity from investors.

Europe

Overview

European markets recovered from the previous week's losses to close the week 2.3% higher. UK airlines and retailers were amongst the worst performers for the week.

XL Leisure Group – The UK's third-largest tour operator declared bankruptcy last week having failed to secure a rescue package amid deep financial difficulties. The group said it had been hit by rising fuel costs and the credit crunch.

Deutsche Bank – Germany's largest bank confirmed that it is buying a 29.75% stake in Germany's biggest retail bank, Postbank, for €2.79bn, enabling it to expand its presence within retail banking.

Ireland

Overview

Despite the volatility within global financial markets, the Irish market pared back some of the previous week's losses, finishing the week 1.5% higher.

Banking stocks – AIB rose 1.1%, Irish Life & Permanent rose 4.4%, whilst Bank of Ireland and Anglo Irish Bank closed down by 5% and 4% respectively.

Asia Pacific

Overview

Renewed uncertainty about the outlook for the global financial sector unsettled Asian markets with the Hang Seng index finishing the week in the red, falling by 2.9%, whilst the Topix index had a flat week, up 0.5%.

Bonds

Initially, bond prices found support from news that the European Commission had cut the growth estimate for the eurozone area this year, but then subsequently weakened as equity markets gained ground. The Merrill Lynch >5 year government bond index fell 1.6% on the week.

Global Outlook

- The global growth rate has moderated from a very high level, with the cumulative effect of previously high oil prices and the credit crisis adding downside risks to this picture. 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 is clearly impacting. Japan's lack of exposure to the credit crunch has been a positive, but its export dependence a clear negative. Oil prices have fallen 30% 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 while investors had anticipated rate hikes by year end up to as recently as five weeks ago, those expectations have flipped around and a modest rate cut is now expected. A rate cut is even possible as early as this week's meeting - Tuesday 16th.
- 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. As further damage from the global financial crisis unfolds, the chances of co-ordinated interest rate reductions has risen substantially.
- Weaker economic data, the sharp fall in oil prices and continued attrition in the credit markets have all helped to support bond prices recently. Bonds also continue to get safe-haven support during more general equity market volatility.
- Equity markets have reacted disappointingly to the Fannie Mae/Freddie Mac bailout, amid concerns about weakness in the global banking system and a general economic slowdown. 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 - and sentiment is clearly weak. A co-ordinated interest rate response from the major central banks may be needed to produce a more positive environment.
- Despite the recent sharp rally in the US dollar versus the euro, the dollar retains valuation support versus European currencies. However 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, the Pacific Basin and Japan, an overweight in the US and are more neutral in the UK and Europe.

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