Eagle Star Investments

Weekly News

17th November 2008

Global Overview

Markets retreat

Gloomy economic data, corporate earnings and renewed fears for the financial sector led markets lower last week. Markets are now close to the lows reached towards the end of October.

Worrying economic data

US economic data released over the week confirmed to what extent consumer confidence has been affected by the credit crisis. Consumers are fearing the worst, after seeing jobless claims continue to rise, pushing the unemployment rate to levels not seen since the aftermath of September 11th 2001. This resulted in retail sales falling by a massive 2.8% in October, the largest monthly drop since records began.

Recessionary fears

Fears of a worldwide recession were heightened last week after it was confirmed that the eurozone had sunk into a recession in Q3. Two of the biggest economies, Italy and Germany, which make up over half of eurozone GDP, have now joined Ireland in a technical recession, two successive quarters of negative growth.

Commodities

Oil retreated another 4% last week, to finish at $57 per barrel, a level last seen in early 2007. With recessionary fears rife worldwide, the International Energy Agency warned of significantly weaker demand due to the "worrying economic outlook for this year and into 2009".

	Index	Year to Date Return 31.12.07 to 14.11.08		1 Week Return 07.11.08 to 14.11.08	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-40.5	-31.9	-6.2	-5.9
US	NASDAQ	-42.8	-34.5	-7.9	-7.7
Europe	FT/S&P Europe Ex. U.K.	-43.4	-43.4	-5.3	-5.3
Ireland	ISEQ	-61.4	-61.4	-5.4	-5.4
UK	FTSE 100	-34.4	-43.9	-3.0	-8.6
Japan	Topix	-42.6	-24.0	-3.7	-2.0
Hong Kong	Hang Seng	-51.3	-43.9	-4.9	-4.7
Australia	S&P/ASX 200	-40.9	-49.3	-7.5	-9.4
Bonds	Merrill Lynch Euro over 5 year Govt.	5.9	5.9	0.2	0.2

Global Equities

United States

Overview

US equity markets retreated further as low levels of consumer sentiment continue to hit corporate earnings, causing companies to cut full-year forecasts.

Retail sector – As the credit crisis and fears of a recession continue to impact on consumer spending, data released showed a collapse in retail sales last month, forcing department store chains, JC Penny and Nordstrom, to cut earnings forecasts. Both stocks plunged over 20% over the week.

Banking sector – The banking sector was the weakest sector last week, after the US Treasury shelved plans to buy toxic mortgage assets, and amid talk of future government investments having to be matched by private capital raises. This hit banking stocks hard and caused the interbank lending rate to rise slightly, halting a 23-day run of falls towards more normal levels.

Europe

Overview

The outlook for European markets remains bleak as the eurozone confirmed a negative GDP figure for Q3, pushing it into a recession. This cemented investors' expectations of aggressive interest rate cuts over the coming months.

Natixis – The French investment bank, Natixis, announced its securities unit had a loss of roughly €250 million in October because of volatile markets. The bank, which is the worst-performing French banking stock this year, finished the week 22% lower.

Ireland

Overview

Banking stocks were under further pressure as investors fear that they may need some form of recapitalisation over the coming months, resulting in a massive dilution of current shareholders' holdings.

Bank of Ireland – Bank of Ireland had another difficult week after it announced that first-half profits tumbled by 35%, to €706m, and now expects to only break even in the second half. Bad debt provisions were the main reason behind the fall. The stock fell 33% over the week, as the market continues to be concerned about its need to increase its capital ratios.

Asia Pacific

Overview

Most Asian markets finished the week lower as recessionary concerns hang over many countries. One of only a few indices around the world to finish in positive territory was China. This followed its unveiling of a nearly $600bn economic stimulus plan to boost domestic demand.

Bonds

Eurozone bonds traded in a range last week as gains generated by expectations of further rate cuts were pared by the large growth in new bond issuance. The Merrill Lynch over 5 year government bond index rose 0.2% on the week.

Global Outlook

- Policymakers continue to address the incredible risks facing the global economy. It is now a given that US and European growth rates will be severely curtailed in the next year or so and that a global recession will continue to be worked through during 2009. Policy action is intended to stabilise the banking system, put a floor under real economic activity and prevent a prolonged deflationary slump.
- Many measures have been taken in an effort to revive the money markets - the lifeblood of the banking system and the real economy. While there have been some positive developments in that regard, there are abundant signs of how the banking crisis has rapidly spread into the real economy, and a more rapid improvement in the money markets is vital if further deterioration in economic activity is to be forestalled.
- The collapse in economic indicators in the past two months means that further sharp falls in official short-term interest rates will be seen in a host of countries over the coming weeks and months. The ECB has practically pre-announced another cut for December, with investors expecting at least an additional 0.5% cut at that stage; rates are likely to be below 2% during 2009, versus the current rate of 3.25%. Similarly, UK rates will likely be reduced to new multi-decade lows; markets see rates under 2% in coming months. Meanwhile in the US, even with rates now at 1%, investors expect at least an additional 0.25% reduction in December. With rates at these levels, the Fed is likely to be studying more unconventional interest rate policies - such as trying to actively lower longer-term interest rates.
- With some markets priced for the deepest slump since the Great Depression, government bonds have received strong safe haven flows. These may unwind periodically as governments step up their borrowings substantially and if investors' fear of equities and corporate bonds recedes somewhat. Overall, however, bonds should be supported by central bank policies and large drops in inflation rates.
- The shattering loss of confidence in corporate bond markets is also manifest in equity markets, where investors have become almost inured to the huge volatility, the seemingly random price action and large price falls. Co-ordinated policy action is intended to arrest that fear and set the stage for the return of some confidence into the banking system, the real economy and equity markets. History suggests that powerful rallies can occur in the midst of severe bear markets - such as we have experienced this year - especially when sentiment is totally shattered, as it had become in the past few weeks. Over the next couple of months statements by the US President-elect will be closely scrutinised for policy clues. However, it is the unfreezing of the money markets and the banking system that is seen by equity investors as the acid test of whether policy action is working or not. Expect volatility and uncertainty to persist until those markets begin to return to normality.
- Currently, the funds are neutral equities and neutral to overweight bonds, versus the manager average. Within equity sectors, the funds are overweight healthcare and telecoms and underweight basic materials and financials. Geographically, the funds have an underweight position in Ireland and Japan, are neutral in the Pacific Basin, the US and the UK, and are overweight in Europe.

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