Eagle Star Investments

Weekly News

1st December 2008

Global Overview

Equity markets rebound higher

Despite investor and consumer confidence remaining fragile, global equity markets rebounded strongly last week as markets responded positively to the US government's rescue plan for Citigroup, along with the US Federal Reserve's announcement of new measures aimed at pushing short and long-term interest rates lower.

US economic data

There was further grim economic data in the form of weak consumer spending, falling durable goods orders and the collapse in new home sales numbers. However, markets rallied after the US Federal Reserve announced that it is pledging $800bn to bolster markets for loans to homebuyers, small businesses and consumers.

European economic data

Economic confidence in the eurozone fell in November to its lowest point since August 1993 and, combined with consumer price inflation falling in November by 1.1% to 2.1%, adds pressure on the European Central Bank to continue cutting interest rates to battle the economic slump. Markets expect the ECB to cut rates by at least 50 basis points when it meets this week.

Commodities

Oil prices finished the week at over $54 per barrel as traders awaited the outcome of the OPEC meeting scheduled for the weekend. However, after the meeting, OPEC announced its decision to wait until mid-December to make another cut in output to try and defend falling prices. In currency markets, the US dollar came under pressure from the rally in most equity markets and €/$ finished the week at just under 1.27.

Index		Year to Date Return 31.12.07 to 28.11.08		1 Week Return 14.11.08 to 28.11.08	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-39.0	-29.9	12.0	10.6
US	NASDAQ	-42.1	-33.6	10.9	9.5
Europe	FT/S&P Europe Ex. U.K.	-44.2	-44.2	12.1	12.1
Ireland	ISEQ	-63.4	-63.4	9.4	9.4
UK	FTSE 100	-33.6	-40.9	13.4	16.6
Japan	Topix	-43.4	-24.0	4.0	2.4
Hong Kong	Hang Seng	-50.1	-42.3	9.7	8.3
Australia	S&P/ASX 200	-41.0	-49.3	9.5	12.7
Bonds	Merrill Lynch Euro over 5 year Govt.	9.0	9.0	1.0	1.0

Global Equities

United States

Overview

US stocks enjoyed strong gains last week as confidence returned to Wall Street following the government's $306 billion rescue of Citigroup and fresh efforts by policymakers to encourage bank lending and reduce mortgage rates. A series of economic data disappointed markets, with durable goods orders decreasing by 6.2% in October, the largest fall in two years.

Citigroup – Investors continued to embrace the government plan to help the bank survive the mounting losses from the mortgage and credit markets turmoil. Shares in Citigroup rose $1.20 or 17% on Friday after plunging sharply the previous week. Shares had already gained 87% during the first half of last week, before markets closed for Thanksgiving on Thursday.

Europe

Overview

European equity markets rebounded sharply, by over 12%, amid continuing optimism about worldwide interest rate cuts.

Retail sector – In one of the bleakest weeks yet for the industry, two leading UK high street names went into administration. Woolworths Group plc announced that its retail and distribution businesses had both gone into administration, after failing to obtain sufficient backing from banks to deal with crippling levels of debt. The future of its 815 stores still remains unclear with potential for up to 30,000 possible job losses. Elsewhere, MFI, the furniture and kitchen retailer, went into administration after a sharp deterioration in sales forced it to call in a restructuring company.

Commerzbank – The German bank has accelerated its takeover of Dresdner Bank in return for a bigger cash payment to Allianz, the owner. The revised deal reduces the equity stake that Allianz was due to receive in Commerzbank, whose shares have plummeted in value as the financial crisis has worsened. Both companies noted that the turmoil in financial markets had led to the renegotiation of the deal.

Ireland

Overview

The Irish market performed strongly, surging over 14%, with shares across all sectors largely benefiting from the rebound across global markets.

Asia Pacific

Overview

Despite a senior Chinese economic planner warning last week that the downturn in the Chinese economy had accelerated over the past month and could lead to high unemployment levels and social unrest, Asian markets enjoyed one of their best weeks of the year after China aggressively cut interest rates by 108 basis points.

Bonds

Eurozone bonds continued to gain over the week on the expectation that the ECB will cut interest rates as early as next week and will continue cutting though 2009. The Merrill Lynch over 5 year government bond index rose 1% on the week.

Global Outlook

- Policymakers continue to address the most dangerous situation in the global economy for 70 years. US and European growth rates will be severely curtailed in the next year or so and a global recession will continue to be worked through during 2009. Policy action is intended to stabilise the banking system and prevent a prolonged deflationary slump.
- Efforts to revive the money markets and banking system - the lifeblood of the real economy - have been slow to work, and in the meantime, the banking crisis has rapidly spread into the real economy where companies, their suppliers and customers are credit-constrained. A more rapid improvement in the money markets is vital if further deterioration in economic activity is to be forestalled.
- Further sharp falls in official short-term interest rates will be seen in a host of countries over the coming weeks and months. This week the ECB will cut rates by at least 0.5% from their current level of 3.25% and rates will likely fall well below 2% during 2009. UK rates may fall by as much as 1% this week, to 2%, and will be reduced further to new multi-decade lows in coming months. Meanwhile in the US - even with rates now at 1% - investors are toying with rates falling to 0.5% by the middle of this month. 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. Bond prices may suffer periodically as governments step-up their borrowings substantially but the very weak growth and very low inflation backdrop will continue to underpin the market.
- 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 has become in the past two months. The unfreezing of the money markets and the banking system 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 to slightly overweight equities and overweight bonds, versus the manager average. Within equity sectors the funds are overweight healthcare and underweight basic materials and financials. Geographically, the funds have an underweight position in Ireland and Japan, are neutral in the Pacific Basin, and are overweight in the US, the UK and in Europe.

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